THE REFORM OF INSURANCE SUPERVISORY SYSTEMS FOR ECONOMIES IN TRANSITION WITH PARTICULAR REFERENCE TO POLAND

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THESIS SUBMITTED FOR THE DEGREE OF
DOCTOR OF PHILOSOPHY

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RISK MANAGEMENT AND INSURANCE

THE CITY UNIVERSITY BUSINESS SCHOOL

LONDON

January 2000

FOREWORD

This thesis was prepared under the supervision of Professor G. Dickinson (City University Business School). The analysis presented in this thesis is largely based on the author's experience as adviser to Poland's Minister of Finance (November 95 - May 1998) and as secretariat for the OECD Insurance Committee (August 91 - September 95. Part of the thesis has already presented on several occasions, in particular at the Second East-West conference on insurance systems of economies in transition organised by the Polish Government and the OECD in April 1997. It was later revised on the basis of the conference's discussion and conclusion and published by OECD in December 1997. The author also appreciated the stimulating discussions in the IAIS (International Association of Insurance Supervisors) Emerging Market Issues Committee and G-10 Working Party on financial stability in emerging market economies, which provided some interesting views.

Several of the examples quoted in this thesis refer to the Czech Republic, Hungary and Poland despite the fact that they have joined the OECD. However, it was considered useful to describe the previous situation in these countries in order to illustrate several issues currently facing the economies in transition.

The author would particularly like to thank Professor G. Dickinson, the Polish Ministry of Finance and the State Office for Insurance Supervision, Mr. C. D. Daykin (Government Actuary's Department, UK), Mr. J. L. Bellando (Commission de Contrôle des Assurances, France), Ms. R. Szep (State Insurance Supervisory Authority, Hungary), Mr. E. Stroinski, Mr. Rundo, Ms. Lagoda (PZU, Poland), the OECD Secretariat (Dr R. Pecchioli, Mr. A. Laboul, Mr. H. Ishii, Ms. C. Vignial), KPMG (Warsaw, London, Prague, Budapest), Cameron McKenna (Warsaw), Allen & Overy (Warsaw, London), and participants of the conference and meetings, for their valuable comments and suggestions.

The author had been seconded to the Polish Government by the Government of Japan but the views expressed in this thesis are those of the author alone and do not necessarily reflect the views of the Polish Government nor the Government of Japan.

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THE REFORM OF INSURANCE SUPERVISORY SYSTEMS

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CHAPTER 1: INTRODUCTION - AIMS, STRUCTURE OF THE THESIS AND METHODOLOGY

This chapter constitutes the introductory part to the thesis, covering a short introduction and the aims, structure and methodology of the thesis.

This thesis intends to take stock of the reforms which so far have been implemented and to consider the best policies for the future. In order to achieve this, the thesis provides comprehensive primary information and statistics on insurance markets in economies in transition, identifies and analyses tasks and problems and proposes suitable models for creating secure and robust insurance markets in those countries.

With regard to the methodology of the thesis, since well-developed information, statistics, analysis and policies in this area were not available elsewhere, the author collected the information and statistics provided, analysed the current market situation on the basis of the collected original information and proposed models based on this information and his personal experience in his on-going supervision of the Polish insurance authorities.

1.1 *Introduction*

The progress achieved over the past few years by the Central and Eastern European countries making the transition to a market economy has been striking. New legal and economic frameworks have been established, leading to economic stabilisation and the growth of trade. Privatisation has been making headway. On top of this, most transition countries are now showing high rates of economic growth. With regard to the insurance industry, new legislation and controls have been introduced, making it better adapted to the needs of a free-market economy. New private enterprises are competing with former state monopolies. The transition process is entering a new phase and new challenges will have to be faced in order to achieve further reform. The moment is therefore ripe to take stock of the reforms that have been achieved so far and to consider the best policies for the future. The economies in transition in this thesis in principle mean Central and Eastern European Countries including countries from former Soviet Union.

The starting point for the countries in transition was the command economy based on central planning; the goal is a market economy where demand and supply are decided by market mechanisms. However, all the economies in transition are different. Prior to the Second World War some had developed market economies, while others did not. Their goals may also vary widely depending on the particular features of each country. In other words, the national economic, political and cultural environments which are instrumental in shaping their respective insurance systems are hardly identical.

However, all the insurance markets in the economies in transition are facing similar challenges, the origins of which go back to the core features of both command economies and market economies. This paper focuses on those tasks while giving due weight to the particular characteristics of each country. It then suggests possible ways of reforming insurance in these countries successfully.

Various practical obstacles (such as budgetary constraints, lack of experience and expertise, etc.) have slowed the reform of the insurance markets in these countries. For countries undergoing the early stages of transition, it is crucial to follow proven policies. Indeed, an insurance market which is trusted by policyholders is a precondition for a sound market economy.

1.2 Aims

No comprehensive information, statistics or theoretical basis exists for the reform of insurance markets in economies in transition. This situation often causes confused reform policies and sometimes even has a negative effect on the market conditions. Thus main aims of the thesis are to provide comprehensive information and statistics on insurance markets in those countries, to identify and analyse tasks and problems and to propose a suitable model for creating secure and robust insurance markets in economies in transition with particular focus on supervisory control. In addition to the model applicable to economies in transition in general, the author analyses a specific model for insurance reform in CEECs (Central and Eastern European Countries), which are all pursuing integration into the single European market.

Since co-operation with foreign organisations (foreign governments, international organisations, etc.) is indispensable to the reform of insurance systems, *i.e.* to the proper implementation of models, the author examines appropriate measures for such co-operation. In the final two chapters, the Polish insurance market, the largest insurance market in CEECs is comprehensively reviewed in order to analyse the actual market development and the effectiveness of the proposed model.

1.3 Structure of the thesis

To achieve the objectives mentioned above, the thesis first analyses the existing theories of regulation and confirms the lack of a theory in respect of insurance supervisory systems for emerging markets. Therefore, the thesis points out that a new model is needed. Then, the second part of the thesis describes the particular characteristics of the insurance markets in the various economies in transition, formerly under the communist regime. Under planned economy conditions, the insurance market was a monopoly, free of competition and controlled by the government or self-controlled. Insurance covers were provided semi-automatically and were often compulsory. The accounting system was on a cash basis instead of the accrual basis commonly found in developed countries. Access to information was difficult and investment choices were limited. The economies in transition have all had to commence from a similar starting point.

Thirdly, the current market situation in the economies in transition has been comprehensively examined. Since comprehensive information and statistics in this area were not available, the author drafted questionnaires and collected essential information on insurance statistics, regulation and supervision. Thus the information and statistics provided in this thesis constitute primary information. On the basis of this data and information, the author analysed the insurance market situation in economies in transition.

The analysis shows steady development of insurance legislation and supervision in spite of the failure of the market reforms introduced at the initial stage of the economies in transition. However, some countries have yet to establish basic insurance regulations. Others have still to adopt and develop comprehensive and specific rules and supervisory systems. The economies in transition still have considerable tasks ahead of them with regard to these issues.

The thesis continues by discussing appropriate policy measures for insurance systems in economies in transition. From the results of a thorough analysis of failure of the insurance system in economies in transition including social, economic, legal and insurance aspects, it can be seen that the lack of sound policy measures, aggravated by the unstable market conditions of economies in transition, is the main obstacle to the market reform. In particular, lax control and supervision, shortage of insurance experts, a narrow capital base and the dominance of the former state monopoly prevent the development of sound insurance systems. Economies in transition tend to copy the insurance systems of developed countries without taking their own market reality into account. In view of the above, a concrete model of insurance market reform that takes into account the various levels of market development is proposed.

In developing and implementing this model, several premises are stated:

– an effective model is essential for the market reform;

– a sound insurance system based on a market economy is the goal for the reform;

– sound macroeconomic and structural policies are essential for the stability of an insurance system;

– the reform should be implemented step by step and market situations should be taken into account;

– the system should be sufficiently flexible to be able to correspond to changing market conditions;

– commitment from national authorities is crucial to the market reform.

The model divides markets in transition into three levels of development and proposes the most appropriate policies for each level. The first is that period just after the collapse of the communist regime, where an insurance system based on a market economy has yet to be introduced. The main goal at this level is to establish without delay a basic market-oriented insurance system. The second level is the period during which supervision experience is still limited and the effects of the former communist system remains, although a basic insurance system has been established. At this level insurance authorities should concentrate on ensuring that the insurance system function properly. The third level is where the insurance market is reasonably organised and controlled. At this stage, the objective should be to take measures that, in conjunction with sound prudential regulations, will ensure liberalisation of the market.

The next part of the thesis examines proper implementation of this model in CEECs whose goals include establishment of sound market-oriented insurance systems and simultaneous integration into the EU insurance system when these countries join the European Union in the future. After analysing particular prescriptions for EU integration with regard to insurance and examining the current implementation of these provisions in the CEECs, the thesis proposes concrete measures for those countries still to be integrated into the European single insurance market.

The following aspects are given particular consideration in implementing the measures described:

– a comprehensive programme for European Union integration should be established;

– liberalisation measures should be balanced with prudential regulations;

– a firm foundation for integrating into an EU single market will be close co-operation with insurance supervisors in the European Union;

– the CEECs should keep abreast of the evolution of the European Union.

The market reform measures toward the EU internal market are basically similar to those of the model described above. However, compliance with the EU directives needs particular consideration, and the analysis focuses on this issue. In particular, achieving an EU single licensing system based on the home country control will require one level further than the three-step development model described above. These special measures are described in detail as the fourth level of development.

The thesis also analyses appropriate measures for co-operating with foreign organisations such as foreign governments and international organisations in the belief that effective co-operation is indispensable to successful market reform.

Finally the Polish policy toward the European single insurance market is comprehensively reviewed. As the largest and one of the most developed insurance markets in CEECs, the experience of the Polish insurance market during the initial period of transitional economy in early 1990's provides other CEECs and economies in transition with useful and practical lessons.

1.4 Methodology

1.4.1 Limited existing information and analysis

Past research on the area related to this thesis, *i.e.* insurance supervision for economies in transition, has been limited. Some of the literature available focuses chiefly on the concept of insurance systems under communist regimes and does not necessarily reflect current market realities. Other research is either limited to specific supervisory issues in economies in transition or is weak in analysing actual insurance markets in such economies. In addition, comprehensive information, data and statistics on insurance markets have yet to be established. Indeed, well-developed information, statistics and analysis in this area have not been available anywhere. Thus the existing information and research does not provide a sufficient base for this research. (For further discussion on this issue, please refer to the following chapter).

1.4.2 Questionnaire methodology: purpose, coverage and main contents

1.4.2.1 Purpose

The purpose of the questionnaires used in this thesis is to gather key statistics and information on insurance markets in economies in transition, in particular with regard to regulatory and supervisory issues. Since no comprehensive information or statistics on insurance markets in economies in transition had previously existed, no adequate analysis or policy proposals had ever been conducted or policy proposals made. This lack of statistics and information seriously hindered insurance market reform in those countries. Since the basic facts were not known, there was no possibility of carrying out analysis or proposing appropriate policies for those countries. For this reason, the author decided to collect the necessary key statistics and relevant information by sending out a questionnaire. The author drafted two questionnaires and as preparatory materials for the conference sent by the OECD secretariat after their adding a few additional questions at the first time and by himself at the second time. After collecting information, the author comprehensively analysed the replies to the questionnaires and proposed a model for reform of the insurance supervisory system on the basis of the analysis (see Chapters 5, 6, 7, 8 and 9).

1.4.2.2 Coverage

The first questionnaire was sent to the heads of the insurance supervisory authorities of 19 economies in transition (Albania, Belarus, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Moldova, Mongolia, Poland, Romania, Russia, Slovakia, Slovenia, Uzbekistan and Ukraine) in December 1996, in preparation for the conference on the insurance systems of economies in transition that took place in Warsaw organised by the Polish Government and the OECD in March 1997.

By the end of February 1997, the following 14 countries had replied: Albania, Belarus, Croatia, Estonia, Georgia, Latvia, Lithuania, Moldova, Mongolia, Romania, Slovakia, Slovenia, Uzbekistan and Ukraine. The remaining five countries (Bulgaria, the Czech Republic, Hungary, Poland and Russia) did not respond to the questionnaire chiefly because they did not have a sufficient number of staff at the supervisory authority and consequently could not find time to fill in the questionnaire. For those countries, the author individually interviewed the supervisors both during the conference and by telephone, and collected a minimum of information.

The second questionnaire consists of the updated first questionnaire, several supplementary questions and a questionnaire drafted by the European Commission. This was sent to the heads of the insurance supervisory authorities of 16 Central and Eastern European countries (Albania, Belarus, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Moldova, Poland, Romania, Russia, Slovakia, Slovenia and Ukraine) in October 1997, in preparation for the conference on insurance systems of economies in transition that took place in Warsaw organised by the Polish Government and the IAIS in March 1998.

By March 1998, the following ten countries had sent their replies: Albania, Belarus, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The remaining six countries (Bulgaria, Croatia, the Czech Republic, Moldova, Russia and Ukraine) did not reply to this questionnaire for the same reasons as before and thus the author obtained the minimum information from them by the same method as mentioned above.

1.4.2.3 Main contents

Since the supervisory authorities in the CEECs in general were not fully informed of or prepared for an alternative system in the future, the questionnaire focused more on facts and the existing supervisory system than on opinions or perspectives.

Thus, the aim of the first questionnaire was to collect basic statistics and information on insurance markets in economies in transition, since prior to this no comprehensive information on this area had existed. The questionnaire was comprised of two main parts, i.e. basic information on the insurance markets and basic information on the methods of insurance supervision. The first part of the questionnaire, "basic information on the insurance market", included questions on the number of insurance companies, the number of employees in insurance companies, the volume of direct premiums written and investments by direct insurance companies. The second part of the questionnaire, "basic information on the insurance supervision", included questions on the organisational structure of the insurance supervisory body, licensing, financial soundness, policy conditions and premium rates, distribution, investment, compulsory insurance, reinsurance, winding-up, etc.

The aim of the second questionnaire was to obtain updated statistics and information, to collect information on the preparation for the European internal market and to understand the real challenges faced by supervisory practice in this region (see Appendix).

The author used collected facts and data for comprehensive analysis of the insurance systems in the economies in transition. The analysis is not statistical or numerical but qualitative and is closely related to the insurance supervisory system. These facts, data and analysis provide a basis for establishing a model for insurance supervisory system reform (see Chapters 7, 8 and 9.).

1.4.3 Empirical analysis

The author worked for the OECD Insurance Committee for the four years between 1991 and 1995, being in charge of technical assistance aimed at insurance market reform in economies in transition. The Japanese Government in particular supported this assistance. Since there was no past research in this area, the author collected basic information and conducted several analyses on those markets based on discussions with supervisors from those economies. In addition, the author organised several conferences with supervisors from economies in transition and from OECD member countries in order to find best insurance market reform practices for economies in transition.

After his OECD assignments, the author worked for the Polish Government between 1995 and 1998 as an adviser to the Minister of Finance and to the President of the State Office for Insurance Supervision, assisting both organisations in the reform of the Polish insurance market. Through his assignments in Poland, the author extended his empirical research based on his on-going supervisory experience.

In addition, the author assisted in organising the conference on insurance systems in economies in transition held in Warsaw in April 1997, co-sponsored by the Polish Government and the OECD and a similar conference in March 1998 co-sponsored by the Polish State Office for Insurance Supervision and the IAIS (International Association of Insurance Supervisors) in March 1998. The author also went on a mission to neighbouring countries (the Czech Republic, Hungary and the Slovak Republic) in October and November 1996 and obtained relevant on-the-spot information with regard to the insurance systems of those countries from insurance supervisors, insurers, auditing companies and academics.

In addition, the author has been appointed Deputy Chairman of the Emerging Market Issues Committee at the IAIS since the beginning of 1997. As the IAIS representative he is responsible for improving insurance systems in emerging markets by establishing appropriate supervisory guidelines, organising effective training schemes for those countries and assisting their co-ordination with other financial sectors by for example participating in the G 10 working group on financial stability in emerging markets. These activities on insurance and other financial sectors supervision have broadened the author's perspectives in the area of his research, providing the author with a deeper insight into insurance market reform in economies in transition.

As mentioned above, since there exists no coherent and comprehensive information, statistics or research in this area, the author has had to establish them himself. Thus, the key information and statistics provided in this thesis are original and primary - not secondary information prepared and published by others. The essential information and statistics on insurance markets in economies in transition constitute a major contribution to this thesis.

The research for this thesis has benefited considerably from the above-mentioned discussions, interviews and responses to the questionnaire, as well as, from his work on organising better policy measures for those countries. Indeed, the author is not a mere observer of insurance market reform but constitutes a part of the whole process of market reform in economies in transition. The information, statistics and analysis of the insurance market in economies in transition and the models for creating secure and robust insurance markets in those countries, as proposed in this thesis, are the final products of such activities.

CHAPTER 2: THE THEORIES OF REGULATION: THE NEED FOR A NEW MODEL

In this chapter, the author commences by evaluating existing regulation theories in general and continues with a review of the aims and theories of insurance regulation. Although existing theories provide useful tools for analysing insurance markets in developed economies, the author has found that they do not correspond to insurance markets in economies in transition, where these are dynamically evolving from command economies into market oriented economies. Hence the author points out the necessity of establishing a comprehensive insurance reform theory for economies in transition.

2.1 Why regulation arises?

The International Insurance Solvency Survey (NAIC 1996) proved that almost all countries around the world, i. e. at least 96 countries, regulated the business of insurance. However, regulations do not appear spontaneously. There are always reasons and motivations for regulation. Posner (1974) and Adams and Tower (1994) argue three kinds of regulation theory: the public interest theory; the capture theory and the economic theory of regulation. Main discussions of each theory are as follows:

2.1.1 The public interest theory

According to this theory, a government imposes regulation in order to correct a perceived market failure for the benefits of the public. Wilson (1974) argues that public interest theory sees government regulation as primarily a social welfare device that aims to correct the misallocation of resources due to market failure or political crisis. Peltzman (1976) explains that public interest theory views regulators as independent and neutral arbitrators responding to the demands of the public to correct inefficient and inequitable market practices.

This theory applies in many cases where the market mechanism has failed to prevent failures of insurance companies, causing considerable damages to policyholders and as a result the government reinforces regulation in order to avoid similar failures in the future. Amendments to existing insurance laws in the economies in transition, correspond, in many cases, to this example.

Pubic interest theory also justifies government regulatory intervention as a general desire to improve the market situation. As Adams and Tower (1994) point out, public interest theory may explain the situation where a regulatory process helps to promote price competition by, for example, removing the restrictive trade practices commonly associated with the abuse of monopoly power.

In Addition, Kipling (1997) argues that public interest theory can be stretched to accommodate situations where a broader public benefit is the objective. An example would be local regulation introduced that harmonises practices with those of other countries of the European Union.

Meier (1991) offered the following three possible reasons for the failure to protect and to promote the public interest:

- bureaucratic ineptitude - having no skill;
- lack of skills and resources in the regulating agency;

- the complexity of technical issues.

2.1.2 The capture theory

Capture theory argues that regulation is mainly created by the desire of an interested party either political or industrial, to achieve a position of power and influence. Reagan (1987) points out that capture theory views regulation as a political process conferring benefit on politically effective groups that dominate the regulatory process. Feroz (1987) considers that industry groups tend to be particularly successful in capturing the regulatory process since they have expertise, economic resources, an interest in the beneficial outcome and sound organisational skills. On the other hand, Meier (1991) argues that insurance companies are an ineffectual lobby group because they fail to mobilise their economic resources towards developing political skills and expertise.

Gormley (1986) believes that the influence of industry groups increases where the issue discussed is complex and technical. Kipling (1997) argues that the statutory involvement of certain professions (e.g. doctors, accountants, barristers, etc. in health, finance, legal matters, etc.) is another example of regulatory capture. Kipling (1997) explains that the professions concerned would argue in return that it is in the public interest that only those whom they approve and who adhere to their code of conduct provide that particular service, in spite of the fact that many professions prove to be sufficiently proficient despite the lack of statutory responsibilities.

2.1.3 The economic theory of regulation

Stigler (1971) modifies capture theory by considering regulation an economic good whose allocation is governed by the laws of demand and supply. Stigler (1971) argues that economic regulation theory, unlike public interest theory, contends that state intervention does not seek to correct market inefficiencies and inequities, but like capture theory, it accommodates the notion that regulation exists to promote the economic interests of politically effective groups.

Kipling (1997) explains:

"A government will legislate in an area if the demand, measured in the indirect currency of the potential increase in public esteem, netted against any adverse consequences of increased regulation, is perceived as sufficiently high to command a place in the legislation. A regulatory agency will supply regulation in response to demands either from government or from consumers."

In addition, Munch and Smallwood (1980) note that insurance companies might lobby for tighter regulation to discourage new entrants into the market in order to protect their economic position.

Comparing these three theories, Posner (1974) considers that economic regulation theory might have greater explanatory power. However, as Kipling (1997) argues, the currency of demand for regulation is that of political self-preservation, hence capture theory also has a strong argument. Political self-preservation, at least in a democracy, requires the continuous support of the voters. Hence it will often appear that public interest theory also corresponds to the reality of the regulation process.

2.2 Aims of insurance regulation

The insurance market, according to its unique character, has its own specific regulation aims. In this section, the author focuses on the particular purposes and rationale for insurance regulation.

Ellis (1998) points out that the essential aim of government control of insurance business must be to protect policyholders against the consequences of the insolvency of insurance companies. Ellis (1998) argues the importance of policyholder protection, in particular for compulsory third party automobile insurance, due to its huge impact on society. Batten (1981) points out that solvency control of insurance companies, particularly with regard to life insurance, is a primary objective of the regulatory authority, because life insurance offices, like banks, deal with the future security of a large proportion of the population with a high degree of public trust.

The importance of policyholder protection is justified, in particular with regard to two characteristics of the insurance business: information asymmetry and premium payments for a potential benefit in the future. Meier (1991) argues that the regulatory objective of fair trading seeks to prevent information asymmetry from distorting the market to the disadvantage of the consumer. Government intervention is necessary since policyholders cannot readily evaluate the information available and the costs of mistakes are high. Skipper (1993) argues that the other main reason why policyholder protection regulations are justified is that insurance prices are paid today for a potential benefit to be derived in the future. Unscrupulous suppliers could take unfair advantage of this and conclude insurance contracts without having executed the obligations stipulated in the contract.

Adams and Tower (1994) note that another reason supporting the case for regulation with regard to insurance is that regulators can improve access to the insurance market by monitoring monopoly practices on price and encouraging competition through the removal of barriers to entry.

Adams and Tower (1994) likewise note that regulators might also seek social as well as economic objectives, an example of which is government direction of investment. However as Ellis (1998) points out, government direction of investment must lead to a lower rate of return, in the long term, to policyholder. In this respect, regulation in a certain environment could be justified even if it is against policyholders interest.

2.3 Prudential regulations: the core of insurance regulation

The financial soundness of insurance companies constitutes the foundation for market stability and protection of policyholders. Thus, prudential regulation to ensure that financial soundness is the key to an insurance regulatory and supervisory system. In the European Union, Ellis (1994) pointed out that the collective body of insurance law that underpins the Single Market can be classified into three constituent parts: insurance company law, the law relating to insurance intermediaries and insurance contract law. He considers that, for all practical purposes, EU insurance law can be taken to mean EU insurance company law. Insurance company law is briefly described as the body of substantive law relating to the licensing, management and winding up of insurance undertakings.

The insurance supervisory principles of the IAIS (International Association of Insurance Supervisors), that were adopted by the insurance supervisory authorities from more than 100 jurisdictions, identify key issues for insurance regulators and supervisors, covering:

- Licensing and changes in control
- Corporate governance and internal controls
- Prudential rules (assets, liabilities, capital adequacy and solvency, derivatives and "off-balance sheet" items and reinsurance)
- Monitoring and on-site inspection (financial reporting and access to information)

- Sanctions
- Co-ordination and co-operation

All those areas, described by Ellis (1994) as insurance company law and covered by IAIS supervisory principles, relate to prudential regulations for insurance companies.

2.4 Regulatory failure and the lack of a theory governing insurance supervisory systems for emerging markets

Regulatory theories and practice have generally developed in tandem. However, the theories mentioned above are based primarily on developed insurance markets. This section reviews regulatory failures in economies in transition and evaluates the literature on insurance regulation theories for economies in transition that by nature, differ considerably from developed markets.

2.4.1 Regulatory failure in economies in transition

A considerable number of insurance companies have faced financial problems, in particular during the initial stage of transitional economies. As a result, a huge number of policyholders have suffered from the financial troubles of these insurance companies. For example, several hundred companies in Russia and Ukraine found themselves in financial trouble between 1994 and 1996, under a system where no specific policyholder protection measures had been created. Between 1992 and 1997, five insurance companies in Poland went bankrupt and two of these were the largest insurance companies in the market after the state related companies. In Lithuania, out of less than fifty insurance companies in total, thirteen companies had their licenses revoked in the period between 1994 and 1996. (Please refer to Chapter 6 of this thesis for further analysis.)

Where insurance regulation fails to achieve its major goal, i.e. the protection of policyholders through jurisdiction, such a situation is recognised as regulatory failure. For example, if a considerable number of insurance companies or several major ones fail and in consequence, a significant number of people suffer losses and lose confidence in the insurance market, this should be described as regulatory failure. The above-mentioned examples occurring in economies in transition correspond to this category.

On the other hand, any market irregularities that can be addressed by modification of the existing regulatory or supervisory framework may be defined as regulatory problems. The life insurance mis-selling in the United Kingdom is an example of those problems.

2.4.2 Existing literature for prudential regulation for emerging markets

In the area of the emerging insurance market, there has yet to be established a regulatory and supervisory theory on the basis of comprehensive research to address regulatory failure. Some major international organisations have conducted research in this area in connection with their technical co-operation activities. However, the level of research has not reached the point at which it would be identified as a theory for insurance regulation for emerging markets.

IAIS (International Association of Insurance Supervisors), UNCTAD (United Nations Conference on Trade and Development) and OECD (Organisation of Economic Co-operation and Development) have published some documents on the regulatory reform of insurance systems for emerging markets.

The Emerging Markets Committee of the IAIS has conducted technical co-operation s for insurance supervisory authorities in emerging markets and since 1997 has organised several seminars and conferences. IAIS is a unique international organisation with a statute that prescribes the establishment of insurance supervisory standards for more than hundred jurisdictions. IAIS has published "Guidance on Insurance Regulation and Supervision for Emerging Market Economies" (drafted by Kawai, 1997), that covers the main area of insurance system reform for emerging markets. However, this does not include a comprehensive analysis of the insurance markets in emerging economies.

The insurance section of the UNCTAD has undertaken studies on insurance matters relevant to developing countries and countries in transition to market economies through its technical co-operation activities.

UNCTAD (1993a) analyses the development of insurance markets in developing markets between 1989 and 1993. UNCTAD (1994) reviews the reasons for regulation and supervision of insurance and explains why many developing countries would benefit from transforming their regulatory and supervisory regimes. In addition, UNCTAD has prepared other documents, such as UNCTAD (1995a), (1995b), and (1995c).

Although the analysis in the documents provides an overview of insurance markets in developing countries and a review of general principles of insurance supervision, it does not propose any specific reform theory or system, that would take into account the specific market conditions in those countries.

Chiefly since 1991 the Insurance Committee of the OECD has also undertaken technical co-operation activities with economies in transition and published several documents on insurance markets and supervisory issues in those countries. The first two publications, namely, Policy Issues in Insurance (1993) (Angerer, Skipper, Simonet, Dickinson, Fontaine) and Policy Issues in Insurance: investment, taxation, insolvency (1996) (Skipper, Player, Dickinson and Dinenis) provide precise analyses of insurance supervisory systems. However, proposals for economies in transition are limited to only some areas of regulation, such as investment and taxation and do not fully cover the question of insurance regulatory systems for those countries. Since 1991, the OECD Insurance Committee has organised several informal meetings between experts from OECD countries and economies in transition. OECD secretariat prepared some analytical documents such as Issues for Discussion for the First East-West Conference of insurance supervisors and regulators (1994) but these do not pay due attention to the particular nature of those economies.

The third OECD publication in this area, *i.e.* "Insurance Regulation and Supervision in Economies in Transition" (1997) (Fontaine and de Rode, Falush, Kawai and several speeches during the conference) provides interesting insights into insurance reforms in economies in transition. However, the analysis does not wholly correspond to the dynamically evolving insurance systems in economies in transition.

Some researchers in this area, such as Booth and K. Stroinski (1994a, 1994b), E. Stroinski (1998) provide a precise analysis of the specific nature of insurance markets in transitional economies. However these again do not include a comprehensive supervisory reform theory for economies in transition.

In view of the reality facing insurance markets in economies in transition mentioned in 2.4.1 "Regulatory failure in economies in transition", the lack of any comprehensive theory based on empirical analysis of insurance supervisory systems in those markets has caused serious deficiencies in the whole market in this region. Since there has been no theoretical base for insurance market reform, the governments in those countries have either followed the models of developed insurance markets regulation or have trusted in market mechanisms and have failed to adopt essential measures for insurance regulation. The consequence of this is overall failure of the insurance regulatory system in this region.

2.4.3 The need for a new model

A theory which supports a sound supervisory reform for economies in transition on the basis of a comprehensive analysis of those markets should be urgently established for the security and welfare of the pubic in those countries. In other words, the lack of theory in this area should be addressed as soon as possible.

The weakness of the existing theory on insurance regulation originates from the fact that it fails to take into account the reality of economies in transition. The unique nature of transitional economies is their constant state of flux, flux from command economies towards market-oriented economies. Any theory corresponding to these circumstances should include a dynamically evolving rather than a static model.

Therefore, having collected key information and statistics by the means of questionnaires and having carried out an analysis on the basis of the collected data, the author classifies the development of the insurance market in economies in transition at three levels.

The author then proposes a dynamic model for the insurance supervisory reform of economies in transition. In those countries, the original insurance system was based on a command economy. The insurance market was wholly controlled by the central government. There existed only a state monopoly controlled by or identical to the government. The entire insurance system was managed by the government, free of competition. The goal of insurance supervisory systems is to ensure competition on an international level on the basis of policyholders' self responsibility and information disclosure, accompanied by sound prudential regulations. In order to reach this goal, insurance systems in economies in transition should develop step by step in accordance with the general economic, legal and social conditions.

The model proposed in Chapter 7 and 8 of this thesis is based on information and statistics that the author established and an empirical analysis of economies in transition in Central and Eastern European Countries. However, it would also be applicable to other emerging insurance markets such as that in China, Vietnam or India which are in the transformation stage from a state controlled insurance system without free competition to that of a market oriented insurance system.

CHAPTER 3: CHARACTERISTICS OF THE INSURANCE SYSTEMS IN COMMAND ECONOMIES AND CURRENT INSURANCE MARKET SITUATIONS

The previous chapter advances the view that new paradigm for regulation is necessary in the circumstances of economies in transition. For this purpose, the current insurance system should first be properly analysed. Therefore in this chapter the author examines thoroughly the major features of insurance systems in command economies and the current insurance market situation in economies in transitions. This chapter highlights the burdens inherited from the past and clarifies the characteristics of insurance markets in economies in transition. Since no comprehensive information, data or statistics exist elsewhere, the author established data and information through questionnaires and interviewed more than hundred and twenty experts on insurance in economies in transition such as insurance supervisors, insurers, auditors, lawyers, actuaries and professors.

3.1 Characteristics of the insurance systems in command economies

3.1.1. Centralised state monopoly

The main characteristic of insurance systems in command economies was that they were monopolies *i.e.* there was no competition. Insurance was controlled and managed by an insurance monopoly or by the government. It thus had a comparable role to the banking system in command economy, where the national "monobank" had the function of both central and commercial bank.

In some command economies (such as Czechoslovakia, Poland and the USSR), two insurance companies existed side by side, but their markets were clearly separated by types of business or by geographical region, *i.e.* one dealt with all foreign currency-related businesses and the other with domestic insurance (Poland and the USSR). In Czechoslovakia, the two companies covered different territorial regions. Competition did not exist.

Although the state monopoly was an independent entity, it was owned by the state and thus in practice controlled by it. For example, in Hungary, Rogers (1988) pointed out that the insurance department of the Ministry of Finance was abolished in 1954 and all its functions were transferred to the Allami Biztosito, a state monopoly. The company was directly controlled by the state through its management. In Poland, the 1952 law transformed public insurance companies into separate governmental entities. In 1958, these were all transformed into a state-owned company. However, the government retained control over the management of the company. The situation in the USSR was similar to that in Poland. The company' s profits were often transferred to the state, not in the form of corporate tax and dividends but rather as direct contributions to the state budget.

During the 1980s the situation began to change. The concept of competition was introduced to a limited extent in some countries. However, as the basic principles had not changed, reform was superficial. Real change began only with the collapse of the communist regimes.

3.1.2 Limited product choice and semi-automatic insurance cover

In the command economies, compulsory insurance dominated the market. Even though some forms of insurance were not legally compulsory, in practice people were obliged either by administrative persuasion or out of practical necessity to take out insurance. Furthermore, the type of insurance that could be purchased by individuals or entities was also narrowly circumscribed by the state. For example, in some of the command economies, state-owned companies (*i.e.* the majority of companies at that time) were not allowed to write property insurance. Insurance products covering loss of benefits were also often not allowed. Since the state covered the bulk of social security costs in many command economies, demand for life insurance was marginal. In any case, the socialist framework allowed very limited room for individual freedom of choice.

In addition, compulsory insurance in the command economies had a unique character. In Poland, for example, Polish Insurance Act (POLAND(1984)) prescribed that it had a statutory, non-contractual basis. It was the insurance company's obligation to provide compulsory insurance. In practice, the insurance company sent a "bill" to potential "policyholders" and people paid the prescribed amount. It was similar to taxation or social insurance rather than private insurance. Since people were not really aware of whether they were covered or not, they did not form the habit of taking out insurance on their own initiative. There was a case in Poland 2-3 years after the collapse of the communist insurance system where farmers complained that the former state monopoly did not compensate them for flood damage. They had not personally taken out insurance, as they had assumed it was the responsibility of the former state monopoly to compensate them for such losses.

3.1.3 Accounting systems in command economies

The main purpose of the accounting and reporting systems in the command economies was to provide information for central planners to enable them steer the economy, allocate resources and monitor performance.

The main difference between accounting in command economies and that in market economies was the treatment of business transactions. OECD (1993) states that in the command economies, transactions were reported on a cash basis, *i.e.* revenues were recognised at the time of cash-in and expenses were recognised at the time of cash-out. In contrast, the accounting system in free market economies is based on the accrual concept, *i.e.* business transactions are recognised when they occur. This difference has a tremendous impact, particularly in the insurance business where accrual-basis accounting is essential for evaluation purposes.

Moreover, no distinction was made between the classes of business, *i.e.* life and non-life insurance business was written by the same monopoly and in some cases there was no breakdown of reserves or profit and loss account by class. In other words, the reserves of all the different types of businesses were pooled together. A loss on one product was often compensated for by the profit on another; this was done even between life insurance and non-life insurance products.

In addition, there was no need to disclosure information to the public since accounting records were prepared for the central planners only.

3.1.4 Investment choice and credit evaluation expertise shortages

The former communist financial system was unique in many respects. As mentioned above, the "monobank" had a passive function, playing both commercial and central banking roles. Credit was not rated by risk and return but was simply allocated according to the decisions of the central authority. Security markets were virtually non-existent. Most of the assets of insurance companies were allocated to the state budget or deposited in the central bank. In Poland, according to the 1960 regulation, the reserve fund and technical reserves had to be secured by investments in the state budget, bank accounts and securities issued by the State.

3.2 Current insurance markets situations

Insurance regulations have been steadily developing and enforcement bodies (supervisory authorities) have been established in economies in transition. The insurance markets in this region have also been developing dynamically over the last few years. Since the existing statistics in this area have yet to be developed, most information provided in this section is primary information established by the author.

3.2.1 The general economic situation

The insurance industry's sound development depends on a stable macroeconomic environment. Growth in the insurance business depends largely on the growth of GDP. In general, high rates of inflation are obstacles to the development of insurance businesses in particular to life insurance business. Capital market development is essential to the planning of stable and sound investment strategies by insurance companies. Progress in privatisation is another precondition for a market oriented insurance sector.

Following a severe recession at the beginning of the 90's, *i.e.* at the initial stage of transition, most CEECs have returned to economic growth since 1993 or 1994 as is shown in table 3-1. Table 3-2 shows that rates of inflation have remarkably decreased in most of the CEECs. Capital markets have developed steadily and privatisation is in progress.

Table 3-1
Growth in real GDP (percentage change) and private sector share of GDP

Country	1994	1995	1996 (estimate)	1997 (projection)	Private sector share of GDP in %, mid-1997 (estimate)
Albania	9.4	8.9	8.2	-15.0	75
Belarus	-12.6	-10.4	2.6	3.0	20
Bulgaria	1.8	2.1	-10.9	-7.0	50
Croatia	0.6	1.7	4.2	5.0	55
Czech Republic	2.7	5.9	4.1	1.0	75
Estonia	-1.8	4.3	4.0	7.0	70
Hungary	2.9	1.5	1.0	3.0	75
Latvia	0.6	-0.8	2.8	3.4	60
Lithuania	1.0	3.0	3.6	4.5	70
Moldova	-31.2	-3.2	-8.0	-2.0	45
Mongolia	NA	NA	NA	NA	NA
Poland	5.2	7.0	6.0	5.5	65
Romania	3.9	7.1	4.1	-1.5	60
Russia	-12.6	-4.0	-5.0	1.0	70
Slovakia	4.9	6.8	6.9	4.5	75
Slovenia	5.3	4.1	3.1	4.0	50
Ukraine	-23.0	-11.8	-10.1	-3.0	50

Table 3-2
Inflation (change in the year-end retail/consumer price level, in per cent) and market capitalisation of GDP

Country	1994	1995	1996 (estimate)	1997 (projection)	Market capitalisation/GDP
Albania	16	6	17	42	NA
Belarus	1 900	243	40	99	NA
Bulgaria	122	33	311	592	NA
Croatia	-3	4	3	4	0.22
Czech Republic	10	8	9	9	0.27
Estonia	42	29	15	12	0.23
Hungary	21	28	20	17	0.39
Latvia	26	23	13	8	0.14
Lithuania	45	36	13	10	0.09
Moldova	116	24	15	11	NA
Mongolia	NA	NA	NA	NA	NA
Poland	29	22	19	15	0.12
Romania	62	28	57	116	0.05
Russia	217	132	22	14	0.17
Slovakia	12	7	5	7	0.06
Slovenia	18	9	9	9	NA
Ukraine	401	182	40	15	NA

NA - data not available

Source of data: Transition Report 1997 (EBRD), Emerging Europe April 1998 (ING Barings), Baltic Securities Market (TALINVEST SUPREMA SECURITIES, April 1998)

Table 3-1 shows that some countries have achieved a more than 70% private sector share of GDP. Thus the general macro-economic circumstances fundamental for insurance market development are in general positive in the CEECs.

3.2.2 Premium volume

Table 3-3 shows that total premium volume in this region amounted to USD 12,061 million in 1996, constituting approximately 0.6% of the world insurance market. This market is relatively small compared to the region's GDP and population.

Table 3-3 and figures 3-1 show that total premium volume in this region has been increasing at the rate of more than 10% annually since 1993 (47.3% in 1994, 30.3% in 1995, 10.0% in 1996), a much faster growth than the average for OECD countries, whose premium growth amounted to 6.6% in 1994 and 9.5% in 1995.

Table 3-3 also shows that life insurance grew rapidly until 1995 (93.8% in 1994, 30.4% in 1995). In 1996, the life insurance premium volume in Russia, the largest market in the region had declined by 18.9% for such reasons as the abolition of tax incentives for certain types of life insurance products. Thus the development of life insurance premiums in this region is now much weaker than in previous years (1.4% in 1996). However, if one excludes the exceptional data for Russia, life premium in the region increased by 16.3% in 1996.

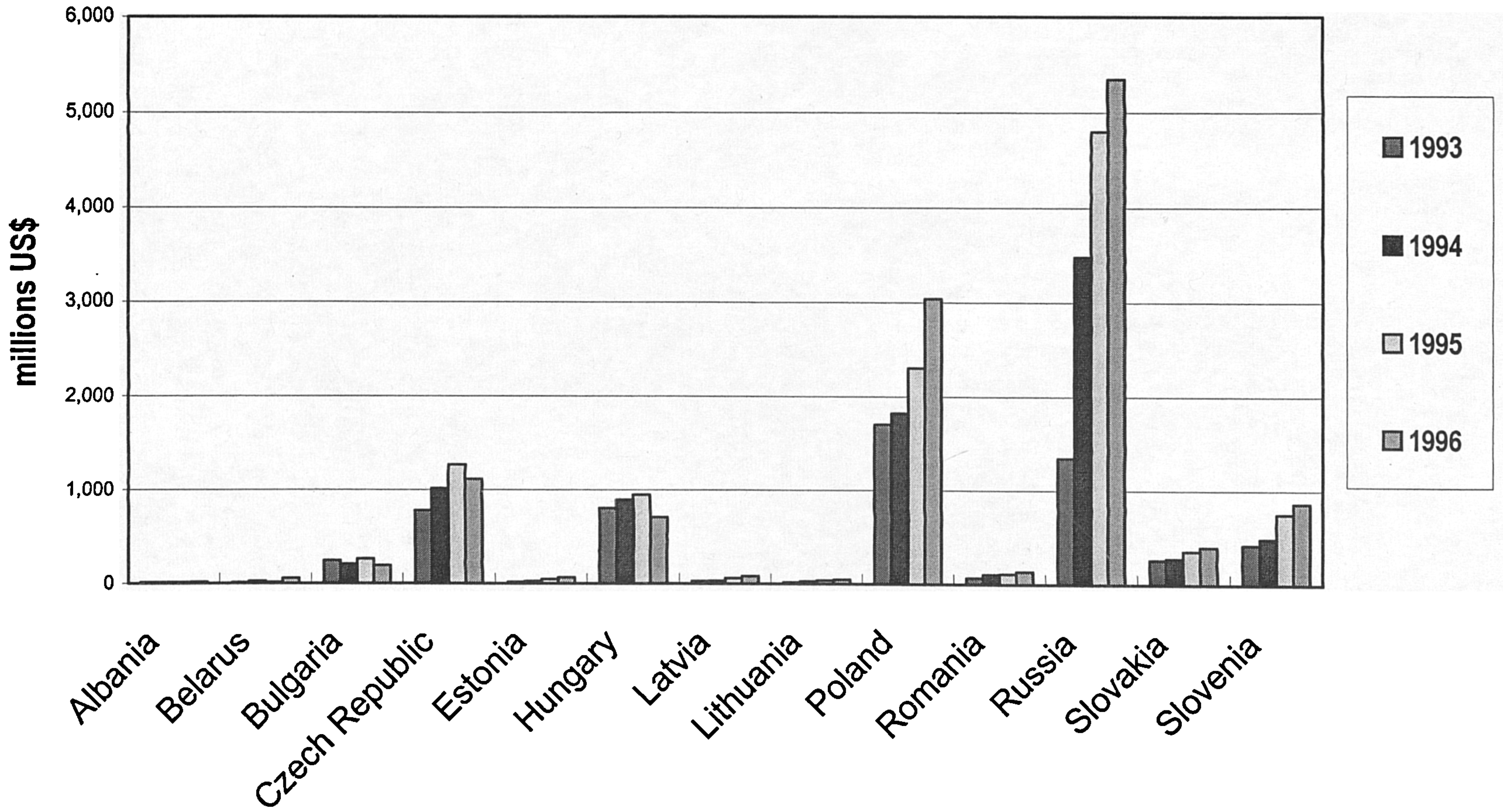
Table 3-3 Insurance premiums in Central and Eastern Europe (1993 - 1996)

(in millions US$)

Country	*Total*				*Non-life*				*Life*			
	1993	1994	1995	1996	1993	1994	1995	1996	1993	1994	1995	1996
Albania	12	12	13	14	12	12	13	14	0	0	0	0
Belarus	10	25	11	56	9	21	11	54	1	3	0	2
Bulgaria	246	206	263	191	181	139	173	150	65	67	90	41
Czech Republic	781	1 015	1 268	1 114	581	756	923	708	200	259	345	406
Estonia	14	26	46	66	12	24	42	61	2	3	4	5
Hungary	804	894	947	710	614	665	664	494	190	229	283	216
Latvia	27	32	59	79	18	22	43	65	8	10	16	14
Lithuania	14	27	38	46	7	14	25	33	8	13	13	14
Poland	1 706	1 824	2 302	3 041	1 217	1 259	1 539	2 007	489	565	764	1 033
Romania	67	104	112	136	61	94	100	123	6	10	12	13
Russia	1 348	3 483	4 802	5 347	912	1 844	2 702	3 376	436	1 639	2 100	1 871
Slovakia	262	280	356	398	198	214	269	279	64	66	87	119
Slovenia	425	489	752	863	380	419	641	720	45	70	111	143
Total	5 716	8 417	10 969	12 061	4 202	5 483	7 145	8 084	1 514	2 934	3 825	3 877
Growth rate		47.3%	30.3%	10%		30.5%	30.3%	13.1%		93.8%	30.4%	1.4%

Source of data: OECD Questionnaire (1997, 1998) drafted by the author
Sigma (Swiss RE) data in 1993, 1994
EEIR in 1996

Figure 3-1: Total Premium Volume 1993-1996
(country by country)
(in millions US$)



Source of data: OECD Questionnaire (1997,1998) drafted by the author
Sigma (Swiss RE) data in 1993, 1994
EEIR in 1996

The volume of non-life insurance premiums has been constantly increasing since 1993 (30.5% in 1994, 30.3% in 1995, 13.1% in 1996).

Figure 3-2 shows that the largest market in this region is Russia, whose market share rose by 0.7% to 44.3% in 1996, followed by Poland up 4.2% to 25.2%, the Czech Republic, down 2.4% to 9.2%, Slovenia up 0.3% to 7.2% and Hungary down 2.7% to 5.9%.

3.2.3 Premium share of life and non-life insurance

One of the main characteristics of this region is that the non-life insurance market is much larger than the life insurance market. In OECD countries, the proportion between the two is about equal. But in this area, non-life accounts for about 70% of the total market (see figures 3-3 and 3-4). This phenomenon is due to the following:

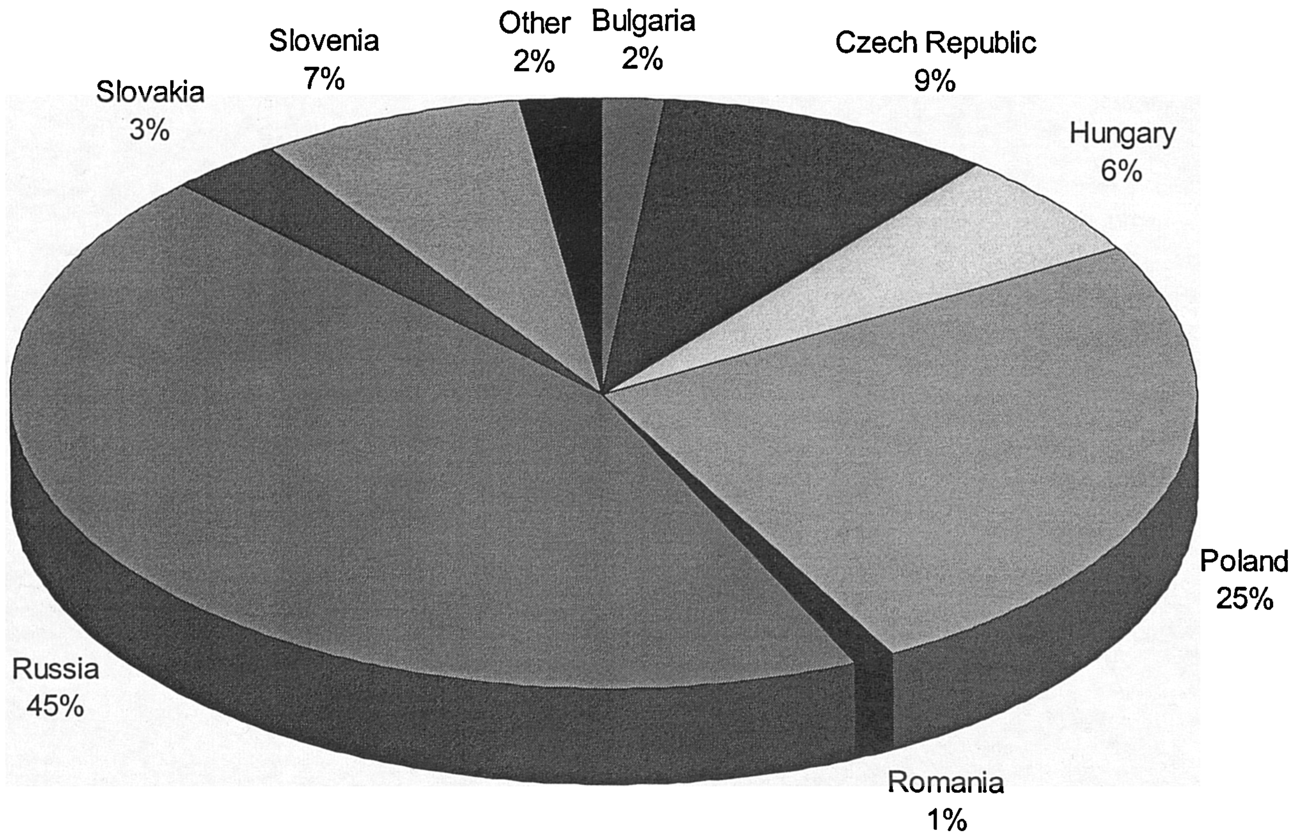
- The social security system is still of significant importance to the majority CEECs, providing a wide range of coverage;

- Rates of inflation are relatively high, which discourages people from purchasing life insurance;

- Compared with OECD countries, GDPs are lower, tending to constrain spending on life insurance. (Normally, demand for life insurance manifests itself only after certain basic needs have been satisfied);

- The capital markets are less developed than those in OECD countries.

Figure 3-2: Total premium volume in 1996 (country by country)

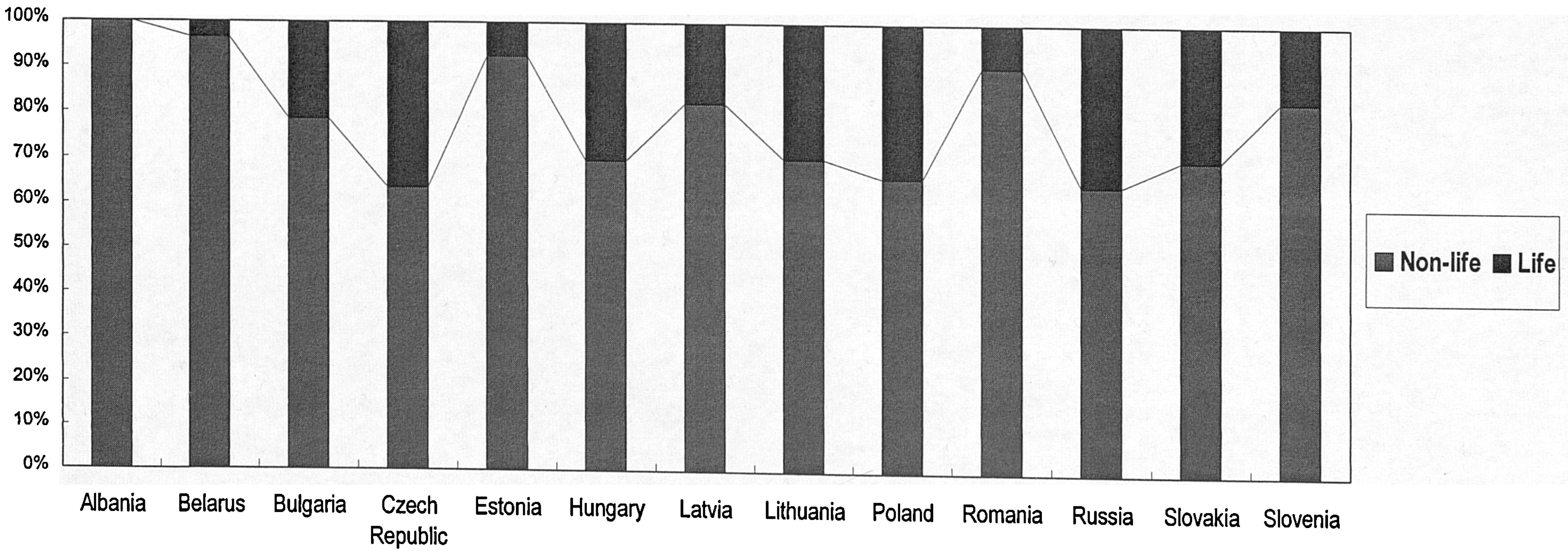


Source of data: OECD Questionnaire (1998) drafted by the author

Countries with less than 1% (Other):

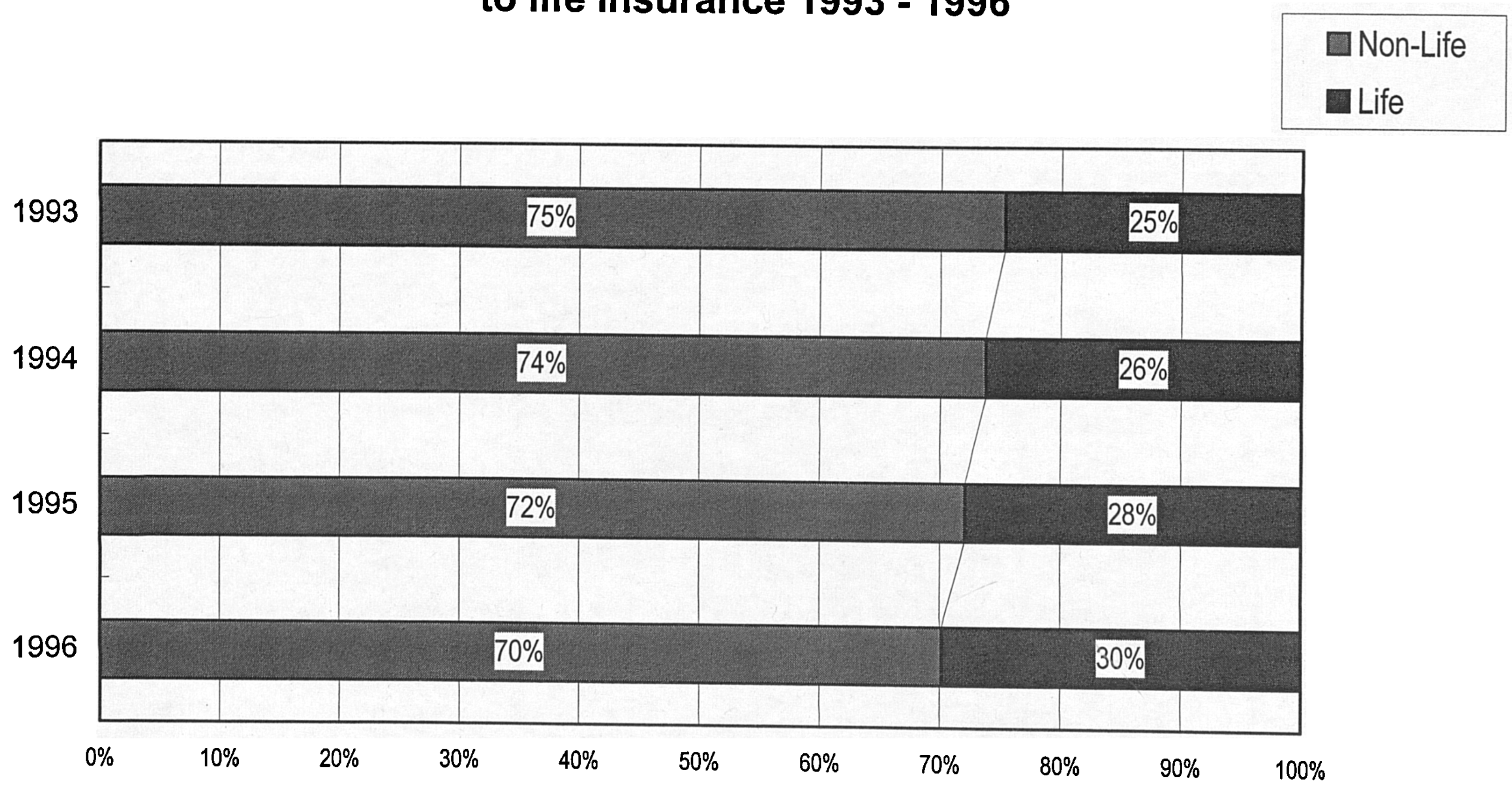
Albania	0.12%
Belarus	0.46%
Estonia	0.55%
Latvia	0.66%
Lithuania	0.38%

Figure 3-3: Premium proportion of non-life insurance to life insurance in 1996 (country by country)



Source of data: OECD Questionnaire (1998) drafted by the author

Figure 3-4: Premium proportion of non-life insurance to life insurance 1993 - 1996



Source of data: OECD Questionnaire (1997,1998) drafted by the author
Sigma (Swiss RE) data in 1993, 1994
EEIR in 1996

* Data of Russia is not included in this table

Nevertheless, future prospects for life insurance business are very positive in this region since:

- The general economic situation has stabilised. In particular, rates of inflation have been decreasing rapidly;
- Most CEECs have shown positive growth in GDP;
- Societies in this region are aging more rapidly than those in more developed economies;
- In several countries private pension systems have been recently introduced;
- Capital markets have been developing rapidly.

As figure 3-4 shows, the proportion of life insurance to non-life insurance has been increasing steadily since 1993 and it will continue to increase in the near future.

3.2.4 The market share of former monopolies and the emergence of foreign insurance companies

As table 3-4 shows, even though former monopolies still have a dominant market share in the majority of these countries, this share has been constantly decreasing. The biggest factor for this change is foreign insurance company business.

Table 3-4
Premium market share of former monopoly (1993 - 1996)

Country	Non-life				Life			
	1993	1994	1995	1996	1993	1994	1995	1996
Albania	100.0%	100.0%	100.0%	100.0%				
Belarus		26.8%	35.0%	43.2%				40.1%
Bulgaria	40.0%				71.0%			
Croatia		82.0%	77.1%					
Czech Republic	83.5%	76.1%	69.1%		93.5%	78.7%	71.2%	
Estonia	30.5%	26.5%	24.1%		91.3%	78.6%	68.6%	
Hungary	74.7%	71.4%	65.6%		44.4%	41.0%	36.3%	
Latvia		65.0%	58.0%			90.9%	92.0%	
Lithuania		33.0%	25.0%			33.5%	30.0%	
Poland	65.7%	60.6%	60.2%	66.4%	99.2%	95.1%	87.3%	77.2%
Romania		58.3%	52.1%					
Russia	31.0%	28.0%	24.0%		90.5%	78.0%	68.0%	
Slovakia	84.2%	81.4%	78.2%		98.7%	92.6%	82.4%	
Slovenia	61.0%	58.3%	46.0%		51.8%	41.1%		

Table 3-5
Premium market share of foreign insurance companies (1993 - 1996)

Country	Non-life				Life			
	1996	1995	1994	1993	1996	1995	1994	1993
Albania	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Belarus	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Czech Republic		4.8%	1.2%	2.0%		20.5%	12.8%	6.5%
Estonia	31.7%	30.5%	31.7%	23.0%	22.3%	15.9%	8.8%	2.0%
Hungary	94.1%	94.6%	95.5%	96.7%	99.6%	99.6%	99.4%	100.0%
Poland		4.1%	2.9%	1.0%		12.0%	5.2%	1.0%
Romania	14.0%	9.6%			24.8%	20.0%		
Russia	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Slovakia	28.1%	21.8%	18.8%	19.2%	15.0%	9.9%	4.0%	1.2%
Ukraine	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source of data: OECD Questionnaire (1997, 1998) drafted by the author
Sigma (Swiss Re) data in 1993, 1994, EEIR in 1996

Although these still have only a minor market share in all the CEECs except Hungary, their market growth has been remarkable in several countries (see table 3-5).

For example, in Poland, the market share of foreign insurance companies has over the last few years been increasing annually by nearly 10%. In Hungary, a foreign insurer which started life insurance business in the early 90's, had by 1997 become the country's biggest life insurance company.

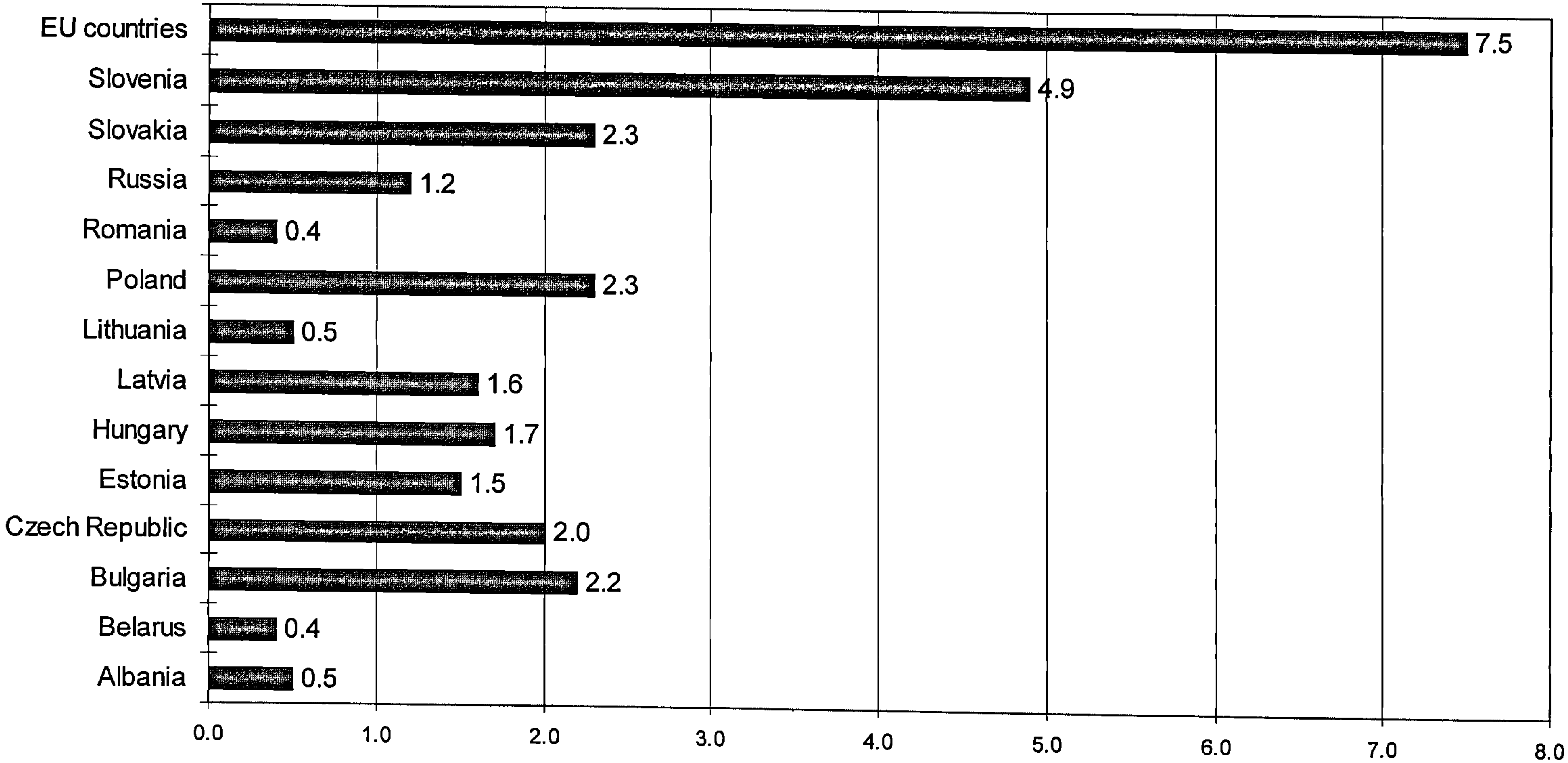
3.2.5 Premium spending per capita (density) and premium/GDP (penetration)

Compared with EU countries, per capita income in CEECs is lower, resulting in a correspondingly low expenditure on insurance per capita (see figure 3-6). Figure 3-5 shows that the share of the insurance industry (total premiums) in GDP, although the ratio has been on the increase, is still far lower than the EU average. This is due to the fact that insurance expenditure tends to develop once the more basic needs of life have been satisfied.

3.2.6 Future prospects

In most of the CEECs, the relatively stable macroeconomic situation and the high growth in GDP ensure a good insurance business environment. The steady establishment of insurance regulations and their enforcement bodies, *i.e.* supervisory authorities, ensure the sound development of insurance markets. (For comprehensive analysis on supervision and regulation, see chapter 4 and 5.) In addition, a structural change in insurance markets with privatisation of the former state monopolies and new insurance companies gaining ground is in progress. Thus, future perspectives for this region's insurance markets are positive. As mentioned earlier, life insurance

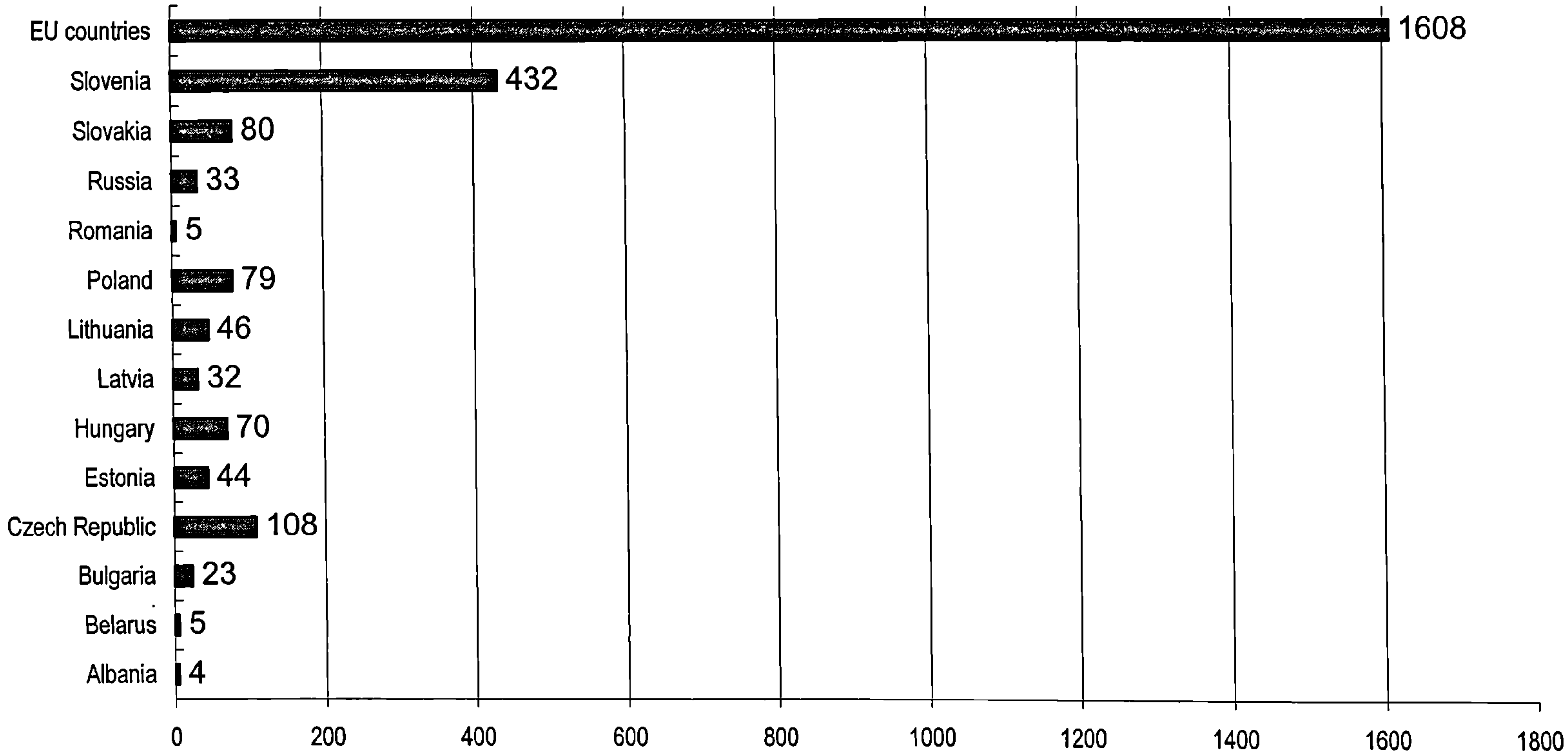
Figure 3-5: Insurance penetration (total premium/GDP in %) 1996



Data on EU countries are of 1995

Source of data: OECD Questionnaire (1998) drafted by the author
European insurance in figures (CEA)

Figure 3-6: Insurance density
(total premium/population in US$) 1996



Data on EU countries are of 1995

Source of data: OECD Questionnaire (1998) drafted by the author
European insurance in Figures (CEA)

markets in particular have significant potential.

Of course, a description of the situation of the CEECs should not be too generalised. For several countries such as Romania and Bulgaria, the stability of their general economic situations is still the first priority if they are to achieve a sound insurance system. A few countries should urgently establish basic insurance regulations and supervisory systems in order to ensure sound insurance market development. Some countries have not yet achieved privatisation of the former state monopolies which continue to dominate their markets.

CHAPTER 4: KEY FEATURES OF INSURANCE MARKETS AND REGULATORY SYSTEMS

This chapter provides information and analysis of the current insurance system of each economy in transition so that a comprehensive view of the insurance markets in all economies in transition may be obtained. The insurance markets of the six major countries in terms of premium volume (Czech republic, Hungary, Poland, Russia, Slovakia and Slovenia) are analysed below. These six countries cover 95% of the insurance market premium volume in CEECs. The analyses of the insurance market in the other CEECs (Albania, Belarus, Bulgaria, Croatia, Estonia, Latvia, Lithuania, Romania and Ukraine) are found in the appendix 2. The main characteristics of each country are reviewed from three aspects, *i.e.* historical background, current situation and prospects. The information and analysis in this chapter provide an essential base for establishing policy measures for insurance regulations and supervision in economies in transition as described in Chapter 7 and 8. The key information in this chapter is primary and original, established by the author through interviews and questionnaires.

4.1 The Czech Republic

4.1.1 A brief history of the insurance market

The insurance market in Bohemia and Moravia can be traced back to the Habsburg monarchy. The first Czech insurance company, First Bohemian Mutual, was founded in 1827 in Prague. Later, many Austro-Hungarian and Bohemian companies were created.

After World War II, all insurance companies were nationalised. *Ceskoslovenska statni poijstovna* operated as a monopoly in the Czechoslovak Socialist Republic until 1969, at which time it was divided into two operating segments which supplied services to the two parts of the Republic. The Czech company retained responsibility for international and reinsurance activities. The company operated as a monopoly until the early nineties.

Enactment of a new Insurance Law by the Czech National Council in 1991 laid the grounds for operating conditions in insurance business and state supervision. In 1992 the *Ceska poijstovna* (CP) was converted into a joint-stock company, becoming one of the county's largest enterprises.

4.1.2 The current situation

As of January 1st 1996, there were 35 insurance companies operating in the Czech Republic. Of these, 27 are joint-stock companies, 14 of which have exclusive Czech participation, 7 are 100% foreign-owned and 6 are joint ventures. The remaining entities are branches of foreign insurance companies.

A monopoly still exists in the compulsory TPL motor insurance class. The premiums for this class of insurance are laid down by the Ministry of Finance and are extremely low when compared with other European countries. At present, legislation is being developed to abolish the monopoly. Demonopolisation is eagerly awaited by the other insurance companies that, despite low rates would like to enter this market segment. Currently, no formal insurance policies are issued (so-called "non-contractual insurance") and all covers run for 12 months from January 1st. Premiums may be paid at Post Offices and transferred to the insurance company. No supplementary fee is charged for Green Cards.

In the case of compulsory employer's liability insurance, these premiums are also set by the Ministry of Finance, but the product is offered by three insurers. In the case of this insurance, any surplus of premiums over claims paid is passed to the state budget which also covers any deficit. This frees the companies from carrying technical reserves in respect of this line of business.

4.1.3 Legislative development

Insurance activities in the Czech Republic are regulated by the Act on Insurance 185/1991 of April 26th 1991, subsequently amended and supplemented. This Act governs inter alia: requirements for insurance activity, licensing procedures, technical reserves, solvency, accounting and audit, state supervision and regulation, penalties for infringement, mergers and dissolution of insurance companies, confidentiality and compulsory insurance.

Further legislation, intended to complement the Act, is derived from its broad requirements. Such regulations cover certain classes of insurance business and the solvency, financial reporting and accountancy of insurance companies.

The principal supplementary laws and regulations as of 1996 are as follows:

I. The Ministry of Finance's Decree no. 492/1991 Col., determines the extent and conditions of compulsory motor liability insurance, in the wording of decree No. 582/1992 Col., decree No. 327/1993 Col., decree No. 246/1994 Col. and decree No. 307/1995 Col.

II. The Ministry of Finance's Decree no. 492/1991 Col., determines the conditions and rate of compulsory employer's liability insurance, in the wording of decree No. 43/1995 Col.

At present, no specific Insurance Contract Law exists and this area is governed by Chapter XV of the Czech Civil Code (40/1964 with later amendments). A draft law is being prepared.

Accounting legislation is based on the EU's Directive on annual accounts and consolidated accounts of insurance enterprises (91/674/EEC). Accounting procedures for insurance companies are derived from the Czech Accounting Act (563/1991) and the Insurance Act. Provisions are incorporated in regulation 430/1992. These regulations have been substantially amended, with the changes taking effect in 1996. A further regulation, 380/1992, governs the contents of financial statements, including notes to accounts. Balance sheets and profit and loss accounts are prepared on pre-printed official forms that do not provide for an alternative presentation.

The creation, use and financial placement of technical provisions are determined by a separate regulation (52/1992). These requirements are broadly in line with the EU Directive and accounting procedures. This decree imposes certain limits on types of investment relating to all technical provisions. At least 30% must be held in domestic banks and unless approval is granted, all investment must be domestic.

Under the Accounting Act, all insurance companies and branches are subject to compulsory audit and thus required to publish annual reports. At present, there are no formal requirements for insurance companies with regard to the contents of such annual reports, beyond the broad guidelines laid down in the Accounting Act. This oversight will be corrected in the near future. Also, no deadline has been established for the preparation of annual reports.

Insurance groups are required to prepare consolidated financial statements in accordance with the decree of the Ministry of Finance (200/1994). An insurance company that is included in the consolidated financial statements of a group outside the Czech Republic and which prepares such statements in accordance with the Seventh Council Directive of June 13th 1983, based on Article 54 (3) (g) of the treaty on consolidated accounts (83/349/EEC), is exempt from the requirement to prepare consolidated financial statements in the Czech Republic.

4.1.4 Prospects

The prospects for insurance growth look promising. Despite demonopolisation and open market access, the premium share of the former state monopolies remains high, though with a declining trend from year to year. This development is advancing far more rapidly in non-life insurance than in life insurance.

There has been some development in the area of bancassurance, with three of the four biggest banks opening insurance subsidiaries. The market share of these subsidiaries is as yet quite small (the highest being 3% of market share).

With regard to the legislative changes being considered, the major growth is predicted in the motor segment of the market. This is due to the fact that motor insurance business accounts for a smaller percentage of total non-life premium volume than in any other European country. Demonopolisation of TPL motor insurance is also expected and will result in other entities in the market underwriting comprehensive motor insurance.

Draft amendments to the Insurance Act (185/1991) are being prepared by the Ministry of Finance. The amendments are aimed at introducing stricter and more efficient financial control by the Ministry, not least because of the planned abolition of CP's monopoly over motor TPL. The rather limited 1991 legislation will be strengthened by incorporation of additional provisions that are expected to include:

- establishment of a figure for minimum paid up (equity) capital and other solvency criteria;
- regulations for the transfer of portfolios between insurers;
- powers for insurers to be placed under Ministry administration, possibly followed by a decrease in a company's paid up capital and changes in company management;
- abolition of the requirement that general policy conditions and insurance terms be approved by the Ministry;
- abolition of the requirement that a CZK 10m (US $ 345,000) guarantee deposit accompany licence application.

Introduction of tax benefits for life insurance purchasers are also being reconsidered. Insurers would also like to see legislation implemented to combat insurance fraud either as part of the amendments or by separate legislation.

4.2 Hungary

4.2.1 A brief history of the insurance market

Asztalos (1995) notes that the development of Hungarian insurance business could not be defined as organic or successive. From the very beginning, an important role was played by foreign capital investors. Up to the 1920's Hungarian insurance development was closely related to other European insurance companies.

The stabilisation of the Hungarian Forint (HUF) after World War II permitted renewed insurance operations. A decisive event occurred when, by a decision of the Council of Ministers on April 29th 1949, the State Insurance Company was founded, which until 1986 constituted a monopoly. In July 1986, the State Insurance Company was divided into two associations: the Hungarian Insurance Co. Ltd. and the "remainder" State Insurance Company, performing in principle all types of insurance activity, but in practice during a "transition period", each specialising in only one branch of insurance. This changed the monopolistic situation into what is known as a 'duopolistic' one. Later, both these companies began to create affiliate insurance companies. Following this, privatisation and decentralisation of the companies took place, with the Dutch AEGON company originally having a minority share in the State Insurance Company and the German Allianz group majority ownership in the Hungarian Insurance Co.

4.2.2 The current situation

By 1990, there were 7 insurance companies operating and in 1991 and 1993, there were 10 and 14 companies operating respectively. A fifteenth company was founded at the end of 1995. The two largest companies had 94.2% of the total premium income in 1990. This market share decreased to 84.9% in 1991, falling to 70.5% in 1992 and in 1995 to 58.9%. In practice this means that year by year, the duopoly of the two companies is gradually being reduced. However, their present position is not likely to change significantly in the near future.

4.2.3 Legislative development

The system of regulations governing insurance activity that existed in different forms for more than a hundred years, changed significantly on January 1st 1996 as Act XCVI of 1995 on Insurance Activity introduced new measures to the sector.

Under the new law, insurers may operate as companies limited by shares, co-operatives or mutual associations. Life and non-life activities are separated.

Reinsurance abroad is permitted. The compulsory capital requirement of HUF 1bn for establishing an insurance company has been abolished. There are two minimum capital requirements: companies limited by shares have a minimum "foundation" requirement of HUF 100m and a minimum "security" requirement of HUF 150m.

Foreign participation is permitted in the form of joint-stock companies or co-operatives, with no limits on foreign shareholding. Cross-border services are not permitted, although companies operating in foreign trade can take insurance abroad. Insurance premiums and other deductibles are tax deductible up to HUF 50,000.

The law contains detailed provisions regarding investment of assets. Insurers are obliged to keep at least 30% of their liquid assets in state bonds and domestic securities issued by the central bank. They may also keep up to 25% of their liquid assets in bank deposits, 10% in corporate bonds, 20% in real estate and 10% in listed and 5% in non-listed shares.

The State Insurance Supervisory Authority (SISA) employs a staff of 35. It is an independent body reporting to the Ministry of Finance. The SISA issues insurance licences after approving a regulated business plan. It can impose fines, restrict activities, revoke licences and institute liquidation proceedings.

Every insurer must employ a senior actuary, a legal adviser, a chief accountant and an internal auditor with high levels of professional experience. The law specifies the method for calculation of minimum solvency capital. The government regulates the content of annual reports. Special rules apply to the disclosure of professional secrets in cases of suspected drug trafficking, money laundering, terrorism and illegal arms trade.

There are no official actuarial rules for premium calculations as set by the SISA, but these must be approved by both the insurers and the SISA through the compulsory licensing system for new products.

The state-run social security funds are in deficit and have been borrowers rather than investors in domestic capital markets. A law passed in 1993 enabled the first non-state pension funds to be established. A large number of investment funds are now active in the country.

The following main subject groups are regulated by the Act:

- fundamental insurance system institutions (insurance joint stock companies, co-operatives, associations, representation of foreign insurers in Hungary, insurance intermediaries, insurance consultants),
- conditions for instituting insurance activity (a business plan, personal and material conditions, other conditions on authorisation, etc.),
- the financial condition of the insurer (insurance technical reserves, solvency margin guarantee fund, etc.)
- the legal status, tasks and operations of the State Supervisory Authority.

The Act is already supplemented by several issued decrees e.g. on the regulation of insurance accounts and the obligation of insurers to prepare annual reports on the content of insurance technical reserves, the order of their creation and utilisation, the internal data supply system of insurers and the separation of life and non-life insurance activities. Compulsory motor TPL insurance is also regulated by a separate decree. In addition to these rules, there are also other regulations controlling the activity of insurers, among others the Civil Code, the rules of law on taxation and the provisions of the law on competition.

The regulations on the operation of the insurance market and its supervision are broad, considering the specialities of insurance activity. In the course of preparing the Act on Insurance, legislators focused on the Directives of the European Union, almost fully adopting the regulations in the first generation of Directives, but in some cases including third generation rules as well. In accordance with this approach, a supervisory system concentrating on solvency began to replace the former material supervisory system, avoiding possible over-regulation.

4.2.4 Prospects

In Hungary's efforts to harmonise legislation, Government Decision No. 2174/1995 (VI.15) plays a significant role, envisaging the following tasks in the field of insurance:

EU Compulsory MTPL Insurance Directives

The current rules of law with regard to harmonising those related to compulsory motor third party insurance with Directives 72/166/EEC, 90/233/EEC and 84/5/EEC are:

- Government Decree 58/1991 (IV.13) on compulsory motor third party insurance of motor car operators,
- Decree of the Minister of Finance No. 171/1992 (VI.10) on the system of premium calculation and profit accounting in compulsory motor third party insurance.

Experts are presently working out the rules of law on the system of profit accounting and data supply for compulsory motor third party insurance, and at the same time some amendments to Government Decree 58/1991 are underway.

EU First Life and Non-Life Directives

In respect of insurance, both the above mentioned Government Decree and the European Commission in its White Paper recommend first measures that will implement legal harmonisation in accordance with the First Non-life Directive of the Council, No. 73/239/EEC and the First Life Directive of the Council, No. 79/267/EEC. The aims specified in the First Directive in respect of instituting and pursuing insurance activities are implemented by the Act on Insurance. The rules aimed at creating the conditions specified in the Third Directive, for freedom of establishment, the liberalisation of services and a single domestic market can not as yet be adopted.

EU Insurance Accounting Directives

The Act on Accounting was made in consideration of the EU Directives. The formal differences in the form of balance sheet and the profit and loss account reports were only in the sequences applied. Profit and loss accounts were not yet divided into lines of business.

This changed with the Act on Insurance coming into force and from 1997, no insurance company can conduct both life and non-life business. This means that after the transition period (to December 31st 1996) insurance companies which had previously operated in both life and non-life segments were obliged to establish separate organisational and accounting structures. Amendments to the Act on

Accounting or else preparation of a new law are being considered. This will effect Government Decree 182/1991 (XII.30).

The Act on Insurance repealed Decree of the Minister of Finance No. 14/1987 (IV. 13) and gave the Minister the authority to issue a decree determining the content, creation and utilisation of insurance technical reserves. Decree of the Minister of Finance No. 12/1996 (IV.24) on the creation and utilisation of insurance technical reserves was drawn up on the basis of this authorisation.

A draft of the rules related to the so-called internal accounting system of insurers as well as other rules which relate to the Act on Insurance are presently being prepared by the relevant experts.

4.3 Poland

The comprehensive analysis of the Polish insurance market can be found in Chapter 11 and Chapter 12.

4.3.1 A brief history of the insurance market

Up to the mid 80's, the Polish insurance market was for all practical purposes monopolised by two big insurers, namely PZU and Warta. The real breakthrough came when a new act on insurance activity was introduced on September 20th 1984, permitting the establishment of new insurance companies in the form of state-owned companies, co-operatives and joint stock companies with major shares held by the State Treasury. But full reform of the insurance system in Poland was initiated with the introduction on July 28th 1990 of the Act on Insurance Activity.

4.3.2 The current situation

In January 1998, there existed 54 insurance companies in Poland, including 26 companies controlled by Polish capital, 26 companies controlled by foreign capital and 2 state-owned companies.

4.3.3 Legislative development

The principal act that regulates performance of the insurance market is the Act on Insurance Activity of July 28th 1990, amended in 1995. This law determines the conditions for commencing insurance activity in Poland. It forms the basis for demonopolisation of the insurance market, by permitting the entrance into the insurance market of private as well as foreign entities. Other important issues regulated by this act concern the introduction of a compulsory insurance system (replacing the insurance provided for by the previous act) and the establishment of a basis for prudential insurance regulations.

Licensing

As stipulated in the Act, both direct and indirect (reinsurance) insurance activities may only be carried out after obtaining a licence from the Ministry of Finance. The insurer may only carry out activity as a joint stock company or as a mutual society. It is not permitted to simultaneously carry out life and non-life insurance business. Insurers may not be directly involved in any business other than insurance and insurance related activities.

Supervisory authority

The insurance supervision authority in Poland is the State Insurance Supervision Office (PUNU), with a President at its head. The Office's organisation is determined by its charter, as conferred by the Council of Ministers on a motion by the Minister of Finance. The State Insurance Supervision Office has been in operation since

February 1st 1996.

Financial control

The financial condition of insurance companies is also regulated by the Accounting Law, published on September 29th 1994 (the form of financial reports is based on EC directive 91/674/EEC of December 19th 1991 concerning annual accounts and consolidated accounts of insurance enterprises). This act establishes the principles of accounting, providing standard forms for balance sheets, profit and loss accounts and cash flow reports. Principles for calculating technical provisions are regulated by the Minister of Finance's decree of December 29th 1994. This decree specifies additional requirements concerning information that should be included in the insurer's balance sheet as well as profit and loss account statements. Other important legislation was passed on October 17th 1995, in the form of a decree from the Minister of Finance on calculation of the solvency margin and minimum guarantee capital.

Technical provisions

Insurance companies are required to establish technical insurance provisions, designed to cover current and future liabilities that may result from insurance contracts concluded.

Technical insurance provisions contain:

- provisions for prime risks
- provisions for non expired risks
- provisions for unpaid indemnities and benefits, including provisions for the capitalised value of pensions

- provisions for equalising damage (risk)
- life insurance class provisions
- life insurance class provisions, where the investment risk is borne by the insured
- provisions for bonuses and rebates for the insured
- other technical insurance provisions specified in the charter.

Technical insurance provisions are created according to three possible methods:

- individual provisions, consisting in assessment and evaluation of a single damage or accident, as reported to the insurance company and registered by it, or determined separately for each insurance contract
- global, consisting in determining joint provisions for the whole insurance portfolio or for any part, expressed as a certain percentage of premium collections or the value of paid indemnities and benefits, if the results obtained are similar to those obtained through the individual method
- actuarial, consisting in determining provisions by means of insurance mathematics and statistics.

Compulsory insurance

Compulsory insurance includes:

a) civil liability of motor vehicle owners for damage resulting from collision of these vehicles,

b) insurance of farm buildings against fire and other accidents,

c) civil liability of farmers,

d) other insurance, as provided for by relevant acts or international agreements ratified by the Republic of Poland.

The terms of the general conditions for compulsory insurances are determined by regulations of the Minister of Finance. Above all, they determine the scope of an insurance company's liability and the minimum guarantee rate for compulsory insurances.

An insurance company that conducts the kinds of compulsory insurances in question, does not have the right to refuse conclusion of such compulsory insurance contracts.

Other issues

The amended Act on Insurance Activity has also defined the institution of insurance intermediary and likewise, the requirements governing insurance agents and brokers have also been specified. The Act has established an Insurance Guarantee Fund, whose functions cover the scope of the previous Insurance Guarantee Fund and the Insurance Protection Fund. Apart from these amendments, the Act has established the post of Ombudsman and introduced a Polish Green Card Office.

4.3.4 Prospects

Proposed legislation development is divided into two stages. The first stage of legislative measures, relating to the activity of EU insurance companies through their branches (Stage I, as stated in the EU White Paper), will be implemented by December 31st 1998. The second stage, relating to conduct of cross-border insurance activities (Stage II, as stated in the EU White Paper), is scheduled for January 31st 2004.

Comprehensive amendments to the current insurance law are being drawn up and will be ready by the end of 1998. The current laws relating to insurance activities will be restructured into four laws, *i.e.* the law on insurance activities, the law on insurance supervision, the law on compulsory insurance and the law on insurance intermediaries. The new Insurance Laws will comply with the major requirements for the EU's internal market.

4.4 Russia

4.4.1 A brief history of the insurance market

The first Russian insurance institutions were established as early as 1765, in Moscow and St. Petersburg. Rapid growth in the number of insurance companies occurred between 1882 when there were 40 companies and 1919 with some 140 companies. This market growth slowed and finally stopped due to World War I and the Russian revolution. Insurance companies were nationalised on November 28th 1918.

In July 1922, the state insurance company Gosstrah was founded, an enterprise that made substantial contributions to the state budget by imposing an additional compulsory tax on soviet citizens.

With the disintegration of the Soviet Union, the insurance sector was bound to change. A private insurance sector began to emerge in Russia, together with the development of private enterprise and banking, along with increased demand for various forms of insurance and competition.

4.4.2 The current situation

At the beginning of 1996, there were approximately 2,700 registered insurance companies, of which 800 were based in Moscow. Since 1993, the number has remained substantially the same.

4.4.3 Legislative development

The Russian insurance market is regulated by a number of laws:

- the Insurance Act of the Russian Federation of November 27th 1992, which covers the basic aspects of registering private and state insurance organisations and the forms and methods of insurance. The Act supplies definitions of insurers, insured parties, reinsurers, brokers, agents, risks, insurance premiums and payments, insurance policies or agreements and liability insurance. It also sets guarantees, norms for insurance fund reserves and accounts publication requirements, provides for state supervision and control, licensing and registration, and regulates the personal insurance of foreigners;
- the Insurance Association Registration Act of April 26th 1993;
- the Medical Insurance Registration Act of March 29th 1994;
- the Broker Registration Act of February 9th 1995, covering procedures, licensing, regulation, rules and obligations;
- the Insurance Financial Act on Insurance Reserve Investments of March 14th 1995;
- the Insurance Common Pool Registration Act of May 18th 1995, including procedures for the incorporation and registration of an insurance pool, defines the rules, liabilities and activities of a pool, sets the requirements for a regulatory body of a pool, outlines its responsibilities, and defines the rules for the liquidation of a pool;

- the Insurance Companies Registration Act of May 19th 1994 (Revised), which replaced the Licensing Act of October 12th 1992, introduces new conditions for registration and licensing of new insurance companies in the Russian Federation. This Act governs licensing for different forms and methods of insurance and has also introduced structured procedures for issuing of licences;

- the Insurance Companies Liquidation Act of June 19th 1995 introduced provisions enabling an insurer to be prohibited from conducting business in Russia. This act provides the legal framework for closing down insurance companies.

- the Citizens Act of the Russian Federation (Part II, Chapter 48: Insurance) of December 22nd 1995, covers compulsory insurance and non-compulsory insurance, uninsurable interests, non-life insurance, accident and health insurance, permissible forms of insurance, agreements, conditions and legal procedures in the case of default and reinsurance.

The current Insurance Act permits no insurance contracts between Russian citizens and foreign insurers abroad. This restriction extends to brokers and agents acting on behalf of foreign insurers. However, a foreign insurer can participate as a founder or as a 49% (or less) shareholder in a joint venture with a Russian insurance company. At present there are over 70 such joint ventures.

The supervision of insurance business in the Russian Federation was formerly the responsibility of RosStrahNadsor, which acted through territorial bodies to oversee the insurance market. This supervisory body was responsible to the central government until it was dissolved by President Yeltsin in 1996 and its tasks were transferred to the Ministry of Finance.

4.4.4 *Prospects*

Further amendments to the Insurance Act are being considered by the Russian parliament as a solution to the problems currently facing the insurance market. Proposed changes are as follows:

- by January 1st 1999, Russian insurance companies must increase their fund capital: to Rbs 2.1bn for those companies carrying on any non-life insurance business; to Rbs 2.9bn for life companies and to Rbs 4.2bn for reinsurance companies. This means that the requirements for the registration of an insurance company will change and new fund capital requirements will increase by a factor of nearly 1,000. Currently only 300 insurers out of the 2,700 registered have fund capital over Rbs 1bn;

- insurance of Russian citizens and resident legal entities may only be carried out by insurance organisations that are registered on the territory of the Russian Federation. This will curb the flow of large sums of money out of Russia and will eliminate unfair competition;

- permit requirements for Russian companies to sell Green Card policies;

- substitution of corporate profit tax by a 2% tax on premiums, for easier tax collection and greater clarity and control, in order to reduce fraud and increase budget income.

4.5 *Slovak Republic*

4.5.1 *A brief history of the insurance market*

Since the socio-economic turnaround in 1989, the process of transforming the Slovak

Republic into a market economy has continued rapidly. As the Slovak economy continues to grow, particularly in the services sector, the insurance sector becomes an increasingly important element of further economic and social development.

In early 1991, the Slovak Republic was one of the first economies in transition to enact a new insurance law when the Slovak authorities began work on establishing an efficient insurance system, insurance regulations and insurance supervision. Slovakia's insurance market has enjoyed steady development, thanks to relatively modest inflation levels.

4.5.2 The current situation

There are 24 insurance companies operating in the Slovak Republic. The only state-owned insurance company is the Export Credit Insurance Company (*Spoloenost pre poistenie exportnych uverov, a.s.*). Its market share is marginal, amounting to only 0.069% in 1996. The former state monopoly, the Slovak Insurance Company (*Slovenska pojistovna a.s.*) is no longer a 100 per cent state-owned company and its domination over the market is decreasing from year to year (1993 - 87.1%; 1994 - 83.1%; 1995 - 77.9%; 1996 - 67.0%).

Following the removal of a 25% limit on foreign participation, there has been growing interest by foreign investors, and currently there exist 11 foreign controlled insurance companies.

4.5.3 Legislative development

Important changes were introduced by Act No. 306/1995 Coll. of Laws on December 13th 1995 which amended and supplemented Insurance Act No. 24/1991 Coll. of Laws. The main principles incorporated into the law were following:

- the transformation of the insurance funds system into a technical provisions system;
- establishment of provisions for solvency control of insurance companies;
- in order to avoid liquidity problems in insurance companies, introduction of a measure requiring a minimum level of paid-up capital.

The amendments to the Insurance Act and the Decrees on technical provisions and solvency have created conditions for the implementation of standard methods and procedures not only in commercial insurance but in the supervision of the insurance industry according to the criteria applied in developed countries.

Licensing

When applying for a licence to operate, general insurance conditions must be presented for approval by the supervisory body. The general insurance conditions must conform with the provisions of the Civil Code (Law No. 509/1991 Coll. of Laws), of which articles 788-828 relate to insurance contracts - including the definition of an insurance contract, types of insurance, the rights and duties derived from insurance, and the circumstances and ways in which insurance may expire. Moreover, there are specific provisions for property, life and liability insurance. In the case of life insurance, premium calculations and mortality tables must be also submitted for approval by the supervisory body.

In accordance with Act No. 306/1995 Coll. Laws, the establishment of a domestic or a foreign controlled insurance company is treated equally, whereby in relation to a foreign entity, neither quantitative requirements nor specific conditions are required either by the law or in practice. The legal form of an insurance company is a joint stock company.

Financial supervision

According to the provisions of amendment No. 306/1995 Coll. of Laws of the Insurance Act, solvency control of insurance companies is to commence in 1997. The method for calculation of the solvency margin is defined in the Decree of the Ministry of Finance of January 1997, which accords with the methods for calculation set by EC directives No. 73/239/EEC and No. 79/267/EEC.

Insurance Act Amendment No. 306/1995 Coll. of Laws of April 15th 1996 adopted new technical provisions that brought the Insurance Act in line with the accounting system already in force for insurance companies.

The newly adopted Decree of the Ministry of Finance No. 136/1996 Coll. of Laws, on generating, using and allocating the technical provisions of insurance companies, contains provisions concerning investments by insurance companies: the principles governing investments, a list of permitted investments and the maximum limit for each category of investment.

Insurance Accounting

The insurance accounting principles currently applied in Slovakia have been adopted step by step. In 1991 the Act on Accounting No. 563/1991 Coll. of Laws was the basic law and this was accompanied by a specific accounting system for insurance companies and accounting methodology that was implemented in 1992. These regulations are in line with EU standards. In 1994, rules on preparation of consolidated accounts were adopted.

Compulsory Insurance

Motor TPL insurance is regulated on the basis of Insurance Act No. 24/1991, as amended by Act No. 25/1992 and Decree of the Ministry of Finance No. 423/1991, as amended by subsequent regulations. The liability insurance against employee accidents at work or occupational illness is regulated by the Labour Code, as amended by Act No. 275/1993 Coll. of Laws and Decree of the Ministry of Finance No. 280/1993 Coll. of Laws, as amended by subsequent regulations.

Taxation

According to the Law on Income Tax No. 286/1992 Coll. of Laws, as amended by subsequent regulations, insurance benefits are free of taxation except for (pure) endowment life insurance, where the difference between the insurance benefit and the sum of premiums paid is subject to taxation at a rate of 15%. The earnings from insurance companies' deposits in banks, securities and bonds are subject to taxation at a special rate of 15%.

4.5.4 Prospects

The main legislative tasks that will support the liberalisation policy in the near future are as follows:

- introduction of a new amendment to the Insurance Act that will reflect EU White Paper measures is scheduled for 1998;

- in order to abolish the monopoly of the company *Slovenska pojistovna a.s.* with regard to motor TPL insurance and enable insurance contracts for this type of insurance to be concluded with various insurance companies, a new regulation on motor TPL insurance is envisaged. The draft law should be ready by 1998, though its preparation depends on an amendment of the Civil Code, in particular the provisions related to insurance contracts and indemnity;

- preparation of the law on insurance intermediaries, scheduled for 1997-1998;
- with regard to employee accidents or occupational illness, a further task involves transformation of liability insurance into a social security system by the year 2000.

4.6 Slovenia

4.6.1 A brief history of the insurance market

Slovenia achieved independence in 1990. Between 1918 and 1990, Slovenia was part of Yugoslavia. In the period 1945-1990, no private capital was permitted in insurance business. The Slovene insurance market was dominated by one State regulated insurance company. Most business was conducted in the field of property, fire, cargo and motor liability insurance. The volume of life insurance was relatively small, due to the high rate of inflation and the high level of social and health security guaranteed by the State and for this reason, life insurance was seldom purchased.

In 1991, three regional branch offices of the Triglav insurance company, the only Slovene insurance company before independence, became independent and were transformed into the following joint stock companies: the Adriatic, Tilia and Maribor Insurance Companies. The Croatian-owned insurance company Croatia was renamed Slovenica and the Serbian-owned insurance company Dunav was renamed the Ljubljanska Insurance Company. Many new and relatively small insurance companies were also established, such as the Mercator, Merkur and Prima insurance companies. Prima and Merkur were established through foreign capital investment and thus became the first companies to have a foreign capital share.

4.6.2 The current situation

The Slovene insurance market is divided in a distinctive asymmetric way, with three major insurance companies accounting for four-fifths of the market.

There were 16 insurance companies in 1996 (11 insurance companies, two reinsurance companies, one export credit company, one pension insurance company and one health insurance institution). Four companies have foreign equity participation. The share of life insurance was 16.5% of total gross premium and this is increasing rapidly.

4.6.3 Legislative development

A key date for the Slovene insurance industry is November 11th 1994, when the first Slovene Insurance Companies Act (ICA) was adopted. This act brought to an end the application of the former Yugoslav Law on the basic principles of the life and non-life insurance system, applied in Slovenia even after attaining its independence. The ICA governs basic questions with regard to foundation, operation, transformation, supervision and winding up of insurance companies and companies performing other insurance activities (agents, brokers - intermediaries), as well as the possibility of performing other insurance activities by individual entrepreneurs.

According to ICA provisions governing the legal forms of insurance companies, such companies may be founded as joint-stock companies in conformity with the Commercial Companies Act (CCA) or as special legal organisational forms, permitted only to perform insurance activities - *i.e.* insurance mutual companies, fully governed by this Law.

The internal supervision of operations within insurance companies shall be organised by the companies themselves, while external supervision shall be covered by the state through a competent supervisory body called the Insurance Supervisory Authority (ISA), established as an independent authority within the Ministry of Finance of the Republic of Slovenia.

The Law is modelled on Austrian and German lines and the first and second generation of EU directives. It determines the statistical insurance standards for technical provisions, solvency levels and guarantee funds (which vary for individual insurance groups). In general, ISA advises a higher level of requirements than the EU because of the vulnerability and uncertainty of the share market and real estate market and other inherent commercial risks. The standards and uniform methodological basis and instructions for calculating technical provisions have been prescribed in these regulations. Insurance accounting standards have been adopted, based upon the EU directive.

Joint ventures between foreign shareholders and domestic shareholders are permitted. Joint stock insurance companies may not be founded exclusively by foreign private individuals or legal entities. A joint stock company in which foreign capital has a majority or controlling share may not handle reinsurance business nor establish a separate insurance company to deal with reinsurance business. Foreign insurance companies are not allowed to operate in Slovenia as branches.

Premiums are taxed at 5%. Pension fund reform envisages the removal of this tax on life and pension premiums. Returns on investment are not taxed, but there is 25% tax on profit.

4.6.4 Prospects

The Insurance Supervisory Authority (ISA) was established in 1995, after the Law on Insurance Companies was passed.

During 1997, ISA prepared amendments to the current insurance law, especially elaborating and emphasising the following areas:

- The elaboration of articles on troubled insurance companies, particularly the stricter supervision phase, rehabilitation / receivership and insurance company termination phase;
- Policyholder protection procedures and funds;
- The 100% increase in minimum required guarantee capital;
- The licensing of other insurance business (intermediaries);
- Fit and proper management;
- Shortening the deadlines for presenting annual financial statements and audit reports;
- The possibility of investing a certain share of insurance funds in other domestic and foreign securities, etc.;
- Relaxing the rules for the entry of foreign insurance companies to the Slovenian market.

CHAPTER 5: COMPARATIVE ANALYSIS OF THE REGULATORY AND SUPERVISORY SYSTEMS

This chapter constitutes a comparative analysis of the main features of the regulatory and supervisory systems that exist in the 19 countries. The author classifies the characteristics of regulatory and supervisory systems into 13 categories, analysing each in turn.

5.1 Framework for analysis

Analyses in this section are based chiefly on the information collected through questionnaires and interviews by the author (see 1.4.2). From the collected information, the author selected the data essential to understanding insurance supervisory systems in economies in transition, divided them into 13 categories and conducted comparative analysis by each item. These analyses are the basis for a model for insurance supervisory system reform proposed in Chapters 7 and 8.

The 13 categories can be classified under the following four main headings:

(1) Supervisory authority

The insurance supervisory system functions only if an enforcement body, i.e. a supervisory body, is established and operated effectively. In particular, organisational structure, financial resources and size are key factors in understanding the organisation.

(2) Licensing

Controlling the entry of an insurance company onto the market is essential to maintaining a sound insurance system. Amongst the licensing requirements, minimum capital requirements and requirements for foreign insurers are particularly important in economies in transition.

(3) Ongoing supervision

Once an insurance company enters the market, the task for the insurance supervisor is to foster and maintain its sound operation. Essential supervisory issues in this regard are financial reporting, technical provisions, investment, products and premiums, solvency margin, reinsurance, distribution, compulsory insurance and winding-up. The supervisory authority should also ensure that it has an effective monitoring system.

(4) Privatisation

In many economies in transition, a market structure reform - in particular, an effective privatisation of the former state insurance monopoly - is a key factor for establishing a sound market economy.

5.2 Comparative analysis of regulations and supervision

5.2.1 Insurance supervisory authority

An effective supervisory system is the foundation of a sound insurance market.

Table 5-1 shows that all the countries in the region with the exception of Poland have only one supervisory authority. Poland is the only country that has two authorities, *i.e.* the Ministry of Finance, which is mainly in charge of legislation and licensing, (authorisation, withdrawal) and an independent supervisory authority in charge of on-going supervision.

In the case of Estonia, a licensing commission exists within the Ministry of Finance. Headed by the Minister, this Commission issues and revokes licenses. The Director and Deputy Director of the Estonian Insurance Supervisory Authority are members of the Commission and the opinion of the supervisory authority is crucial to final decisions.

The supervisory authority is either part of the Ministry of Finance (in several countries) or an independent body under the control of the Minister of Finance (as in the case of the three Baltic countries and Hungary). In Albania, the supervisory authority (Insurance Supervisory Commission) is an independent government body but its members are from the Ministry of Finance.

A few countries (Albania, Croatia, Georgia, Poland (the State Office for Insurance Supervision) and Ukraine) have an independent state supervisory body. In Croatia, the supervisory authority (Supervisory Directorate for Insurance Companies) is managed by a board of five members appointed by the Croatian Government.

The supervisory body is financed either by the state budget (Belarus, Czech Republic, Georgia, Moldova, Mongolia, Romania, Russia, Slovak Republic, Ukraine), by insurers (Albania, the three Baltic countries, Hungary) or by a combination of both (Croatia, Poland, Slovenia).

Challenges common to many of the supervisory authorities include:

- hiring, training and maintaining sufficiently qualified personnel;
- obtaining a sufficient budget for implementing effective control;

- maintaining independence.

Table 5-1 Insurance supervisory bodies as of 1997/1998

Country	Name of supervisory body (and role, if more than one body)	Financed by:	Number of employees
Albania* (1)	(Insurance Supervisory Commission)	(Insurers' fees)	(7)
Belarus*	State Insurance Activity Supervision Committee at the Ministry of Finance	State budget	72
Bulgaria*(2)	Insurance Supervisory Office	State budget	—
Croatia*	Directorate for the Supervision of Insurance Companies	90% insurers' fees 10% Ministry of Finance	7
Czech Republic*	Department of Financial Markets Insurance Sector and Pension Funds (Supervisory Authority)	Ministry of Finance	20
Estonia*	The Estonian Insurance Supervisory Authority	Insurers' fees(3)	12
Georgia	Georgian State Service for Supervision over Insurance Activity	State budget	50
Hungary*	State Supervisory Authority of Insurance	Insurers' fees	40
Kazakstan	State Insurance Authority	—	20
Latvia*	State Insurance Supervisory Inspectorate	Insurers' fees	22
Lithuania*	State Insurance Supervisory Authority	Insurers' fees	22
Moldova	Supervisory office within Ministry of Finance	Ministry of Finance	10
Mongolia	Finance Ministry Department of Financial Policy(4)	Ministry of Finance	3
Poland*	1. State Office for Insurance Supervision - responsible for supervision. 2. Department of Insurance - responsible for licensing and legislation matters.	1. Insurers' fees(5) 2. Ministry of Finance	1. 64 2. 22
Romania*	Supervisory Office of Insurance and Reinsurance(6)	State budget	13
Russia	Insurance Surveillance Department	Ministry of Finance	200
Slovak Republic*	Two departments in the Ministry of Finance: 1. Department of Insurance - responsible for licensing, approving policy conditions and legislation matters. 2. Department of Insurance Supervision - responsible for on-going supervision	State budget	1. 4 2. 7
Slovenia*	Insurance Supervisory Authority in the Ministry of Finance	70% insurers' fees 30% State budget	7
Ukraine	Committee for Supervision of Insurance Activity	State budget	50

Note: (-) .. data not available
*: data for 1998, no mark: data for 1997

Sources: OECD Questionnaire (1997, 1998) drafted by the author, Hearings of the supervisory bodies (1998) by the author
Transitional report 1996, EBRD (Bulgaria, Croatia)
Bulgarian Law on Insurance
Report of the State Insurance Supervisory Office for 1995, Poland

Notes:

(1) Albania: Created under Law no. 8081, of 07.03.1996. The legal framework will be soon completed.

(2) Bulgaria: Main body - National Council on Insurance (subordinate to the Council of Ministers), the Insurance Supervisory Office is subordinate to NCI. The own income of the supervising body consists of: licence fees, annual fees for renewal of licences, charges for amendments to licences, fines levied under Art. 94 of the Law on Insurance.

(3) Estonia: Minister of Finance decides on the percentage of gross premiums written to be paid by insurers.

(4) Mongolia: With the introduction of a comprehensive law on commercial insurance, state supervision of insurance will be transferred to the Insurance Surveillance Body under the Ministry of Finance.

(5) Poland: 0,3% of the gross premiums written to be paid by insurers.

(6) Romania: This is a general Directorate in the Ministry of Finance.

5.2.2 Licensing

Table 5-2 shows that in all the countries in the region, insurance companies must be licensed before they can start up business. The main requirements for licensing are very similar in most of the countries, *i.e.* statutory capital, general insurance policy conditions, professional requirements for management, and a business plan. In addition, several countries require information on shareholders (the three Baltic countries, Croatia, Georgia, Hungary, Poland, Slovenia and Ukraine). Some countries (Croatia, Poland and Slovenia) may take into consideration the economic needs of the market. Several countries in the region allow insurance companies to write both life and non-life insurance business.

Table 5-2 shows that joint ventures with foreign companies are allowed in all of the countries. However, some countries do not allow a majority share holding by foreign investors (Albania limits it to 40 %, Belarus, Russia and Ukraine 49 per cent). Some countries (Romania, Slovenia) do not allow 100 per cent foreign-owned subsidiaries. In Slovenia, joint stock insurance companies may not be established by foreign private individuals or legal entities alone. A joint stock insurance company in which foreign capital has a majority or controlling share may not handle reinsurance business or establish a separate insurance company to handle reinsurance business. Only four countries (Czech Republic, Georgia, Hungary and Romania) allow foreign insurers to set up branches. Poland will authorise branches of foreign insurers from 1999. In the case of Romania, branches of foreign companies may conclude insurance contracts only with foreigners or for their properties, and reinsurance contracts with Romanian companies.

In Georgia, a favourable investment regime has been created to attract foreign investors (for example, tax exemptions for a certain period of time). Mongolia has similar provisions in its law on foreign investment.

In the early period of the transitional process, countries such as Russia and Ukraine set low capital requirements and encouraged companies with only a small amount of capital to enter the market. After some years' experience, these countries increased, or are planning to increase, capital requirements to prevent financially weak companies from entering the market. However, minimum capital requirements are still very low in countries such as Belarus, Moldova and Romania (see table 5-3).

In some countries, a lack of detailed licensing requirements stated in legal statutes has often led to imperfect documents being submitted to the authority and thus delays in the licensing procedure.

Table 5-2 Licensing control as of 1997/1998

Country	Main requirements	Life /non-life activity Separated	Foreign establishment (allowed or not)		
			Subsidiaries[1]	Joint ventures[2]	Branches
Albania*	Business plan; classes of risks covered; rates; components of the minimum guarantee fund; minimum capital; *technical and financial resources of the company; qualification of the staff*; composition of company capital.	Yes	—	X	—
Belarus*	Under the *Insurance Law it is necessary to have statutory capital* and to provide: a business development plan; rules or conditions of insurance or reinsurance; samples of documents which will be used; business plan, including estimates of profits and losses, a reinsurance programme and other guarantees to ensure liabilities are met; copy of document showing licence issuance fee has been paid.	No	—	X(3)	—
Bulgaria	Statutes; list of shareholders; business plan for 3 years; reinsurance programme for the first 3 years; programme of investment for the first 3 years; *insurance conditions; tariffs; minimum (statutory) capital; shareholders* and origins of capital; details of founders and staff; qualified actuary.	Yes	X	X	—
Croatia	Deed of foundation; minimum (statutory) capital; conditions of insurance ; premium rates; technical basis; tables of maximum coverage; operating plan for 3 years; financial status of the founders; share of individual shareholders; proposed chairman of the company's Board of Management; number of employees and personnel qualification structure; actuary *(for life insurance company)*.	Yes	X	X	—
Czech Republic	Minimum (statutory) capital; general insurance conditions; professional qualifications of management; business plan, reinsurance plan; "guarantee" (deposited in a bank).	No	X	X	X
Estonia	Application; status; general insurance conditions; business plan; certificate attesting capital has been entirely paid-up; guarantees for required share capital during the following six months; particulars of founders and staff; qualified actuary.	Yes	X	X	—
Georgia	Certificates of incorporation; copy of the document certifying insurer is registered as a legal person; certificates attesting authorised capital; qualifications of managers; terms and conditions of insurance by insurance type with contracts (insurance certificate, policy and insurance rates) attached. A very favourable regime has been created for foreign investors.	Na	X	X	X
Hungary*	Deed of foundation; certification attesting availability of capital required to commence writing insurance; business plan; certification of personal and material conditions.	Yes	X	X	X(5)

Notes:
1 Foreign insurer's wholly-owned subsidiaries.
2 Joint venture between foreign shareholders and national shareholders.
3 Foreign capital not exceeding 49%.
4 Limited scope of activities: insurance contracts with foreign natural or legal persons or for their properties or reinsurance contracts with Romanian insurance/reinsurance companies.
5 Foreign capital limited to 40%. *: data for 1998, no mark: data for 1997 na - data not available X allowed (—) not allowed

Sources: OECD Questionnaire (1997, 1998) drafted by the author
Transitional Report 1996, EBRD
Hearings of Supervisory Bodies (1998) by the author

Table 5-2 Licensing control as of 1997/1998 (continued)

Country	Main requirements	Life /non-life activity separated	Foreign establishment (allowed or not)		
			Subsidiaries[1]	Joint ventures[2]	Branches
Latvia*	Company registration certificate and company foundation documents; statutory capital (equity); general insurance conditions; a list of share-holders; licence fee; business plan; staff's professional skills.	Yes	X	X	—
Lithuania*	Statutory capital; draft articles of association; general insurance conditions; tariff; business plans; samples of insurance certificates; information about management and owners; other legal documents.	Yes	X	X	—
Moldova	Business plan and balance sheet; minimum capital; general insurance conditions; rates; method of calculation; copies of insurance policies; information on company managers.	No	X	X	na
Mongolia	Registration certificate of the entity or firm; initial capital; information about employees. The foreign investment law provides a favourable regime for foreign investment.	Na	Na	Na	na
Poland*	Application including: name, head office and scope of activities, amount of share or company capital, founders, organisational form, experience and qualifications of management, actuary - for a life insurance company; business plan for 3 years; evidence of own resources equal to planned share capital and organisational fund; charter of the insurance company; general insurance terms.	Yes	X	X	—
Romania*	Application form; draft of articles of association and company by-laws; feasibility study (first three years); minimum capital; general policy conditions; information about management; for life insurance, the mathematical calculations of premium tariffs on actuarial basis.	No	—	X	X(4)
Russia	Minimum (statutory) capital; business plan; calculation of rates; general insurance conditions; investment of insurance reserves.	No	—	X(3)	—
Slovak Republic*	Minimum (statutory) capital; general insurance conditions; professional qualifications of management; business plan, reinsurance plan; "guarantee" (deposited in the bank of one million SKK).	Yes	X	X	—
Slovenia*	Business plan; company articles; data on provision of guarantee capital; list of shareholders; information on direct and indirect capital; information about management; minimum capital.	Yes	—	X	—
Ukraine	Application; statute; registration certificate; various information from banks (amount of paid-up statutory capital, etc.), business plan; reserves placement plan; calculation of solvency; insurance conditions; rates; reinsurance plan; information about owners and management.	No	—	X(3)	—

Notes:
1 Foreign insurer's wholly-owned subsidiaries.
2 Joint venture between foreign shareholders and national shareholders.
3 Foreign capital not exceeding 49%.
4 Limited scope of activities: insurance contracts with foreign natural or legal persons or for their properties or reinsurance contracts with Romanian insurance/reinsurance companies.
5 Foreign capital limited to 40%. *: data for 1998, no mark: data for 1997 na - data not available X allowed (—) not allowed

Sources: OECD Questionnaire (1997, 1998) drafted by the author
Transitional Report 1996, EBRD
Hearings of Supervisory Bodies (1998) by the author

Table 5-3 Minimum capital requirements as of 1997/1998

Country	Non-Life		Life		Life and non-life	
	Local currency	US$	Local currency	US$	Local currency	US$
Albania*	ALL 30m	190,476	ALL 30m	190,476	-	-
Belarus*	-	-	-	-	BYR 444m	9,610
Bulgaria[1]	BGL 3,000m	1.67m	BGL 2,000m	1.11m	-	-
Croatia	HRK 4-12m	0.63-1.88m	HRK 8m	1.25m	-	-
Czech Republic	CZK 22-156m	0.65-4.61m	CZK 70m	2.1m	-	-
Estonia*[2]	EEK 5-10m	0.35-0.69m	EEK 12m	0.83m	-	-
Hungary*[3]	HUF 250-450m	1.2-2.2m	HUF 350m	1.7m	HUF1bn	4.8m
Kazakstan	-	-	40 times the minimum wage irrespective of organisational form	-	-	-
Latvia*	LVL 0,5m	0.85m	LVL 1m	1.7m	-	-
Lithuania[4]*	LTL 2m (credit ins. LTL 7m)	0.5m (1.75m)	LTL 4m	1m	-	-
Moldova[5]	-	-	-	-	MOL 0,3m MOL 0,9m	64 170 192 500
Mongolia	TUG 50m	61,781	-	-	-	-
Poland*	ECU 0.2-1.4m	0.22-1.52m	ECU 0,8m	0.87m	-	-
Romania*[6]	-	-	-	-	ROL 25m	3,078
Russia	RUB2m	0.33m	RUB150m	24.8m	ECU 0.5m	0.54m
Slovakia*	SKK 25-40 m (credit ins. SKK 150m)	0.72-1.15m (4.3m)	SKK 50m	1.43m	-	-
Slovenia*	ECU 0.2-0.4m	0.22-0.44m	ECU 0,8m	0.87m	-	-
Ukraine	ECU 0.1m ECU 0.5m with foreign participation	0.11m 0.54m	ECU 0,1m ECU 0,5m with foreign participation	0.11m 0.54m	-	-

Notes: Exchange rate as of 28 February, 1998 (LC/US$)

(-) .. data not available

*: data for 1998, no mark: data for 1997

[1] Bulgaria: Established insurers are to re-register by 31 December 1997 and pay the minimum capital required by 31 March 1998.

[2] Estonia: Minimum paid-up capital has applied to all companies since 1.1.1997 as follows: Motor TPL, general liability, credit, guarantee, financial risks EEK 10m (US$0,85m), other no-life EEK 5m (US$0,4m), life EEK 12m (US$1,3m), reinsurance EEK 20m (US$ 1,7m).

[3] Hungary: Including HUF 100m guarantee capital, for companies authorised after 1.1.1996. For companies authorised before that date minimum capital is HUF 1bn.

[4] Lithuania: Organisation fund 1m Lt (0,25m US$) is required in addition.

[5] Moldova: 0,2m US$ for company engaged in compulsory insurance.

[6] Romania: Minimum subscribed capital is ROL 25 million for each of 10 classes of insurance provided by the Law 47/1991.

Sources:
OECD Questionnaire (1997 & 1998) drafted by the author {all the countries except those mentioned below}.
Transition Report, EBRD {Estonia, Kazakstan}.
The development of reinsurance markets in economies in transition (OECD), Mr. Falush {Czech Republic, Hungary, Latvia, Russia}

5.2.3 Ongoing supervision

5.2.3.1 Control of technical provisions

Table 5-4 shows that all the countries in the region except Albania, Georgia, Mongolia and Uzbekistan have regulations on technical provisions.

However, in most cases the regulations only specify the items which should be included in technical provisions and do not give guidance or set standards regarding the application of the regulations. Often, control of technical provisions is inadequate.

For example, the Romanian regulations regarding technical provisions are contained in Law 47/1991. This law states that insurers must constitute premium reserves for life insurance and premium and loss reserves for general insurance:

- premium reserves for life insurance shall be constituted separately on the basis of actuarial calculations.

- premium reserves for general insurance shall be constituted on the basis of estimates, statistical data or actuarial calculations concerning outstanding payments. They may not be less than 40 per cent of the difference between the premium income collected and claims paid out in respect of insurance cover during a given year. There are no other rules for calculating technical provisions.

In Belarus, the law obliges insurers to maintain an adequate ratio between their assets and technical provisions. The method of calculating the ratio is specified by the supervisory authority. In Moldova, the adequacy of technical provisions is measured by calculating the ratio of a company' s assets to the sum of its insurance cover. In Croatia, the control of technical provisions is under consideration. Bulgaria and Slovak Republic introduced the control of technical provisions at the beginning of 1997.

The situation in which detailed and specific standards on insurance accounting have yet to be established in some countries has led to difficulties in controlling insurance companies, particularly with regard to technical provisions. Technical provisions are recorded in the same accounts as other legal provisions. Insurance companies differ in their methods for calculating technical provisions and use different statistics and data. This makes it difficult for the insurance supervisor to discover the real level of the technical provisions established and to judge whether these are sufficient.

Estonia has exceptionally detailed guidelines for the formation of technical provisions, which were enforced in 1994. This instruction has been the basis for all insurers to draft their own rules, which have since been submitted to the supervisory authority for approval. In 1997 the supervisory authority amended this instruction. The Estonian authority pointed out that once the data on technical provisions had been accumulated, appropriate computer s would be required in order to monitor the adequacy of technical provisions.

5.2.3.2 Monitoring methods

As table 5-4 shows, in most countries in the region, financial statements have to be examined by auditors. At least in some countries (Czech Republic, Estonia, Hungary, Latvia, Poland, Slovak Republic and Slovenia), actuaries play a role in checking the adequacy of the technical provisions of life insurance companies. The authorities of several countries conduct on-site inspection where necessary.

Table 5-4 Control of technical provisions as of 1997/1998

Country	**Provisions** (YES/NO)	**Control measures for technical provisions** (including roles of actuaries and auditors)
Albania*	NO	Na
Belarus*	YES	Technical provisions are determined by insurance companies in co-operation with the supervisory body. Their calculation and use are controlled by the supervisory body annually and during on-sight inspections. Technical provisions are checked by chartered auditors as well.
Bulgaria	YES	Technical provisions are determined in accordance with regulations and controlled by supervisory body annually. Annual reports are examined by the chartered auditors.
Croatia	YES	A general principle exists. Each insurer determines its technical provisions in co-operation with the Supervisory Directorate. Their validity is controlled by the Directorate in the course of direct inspections. Regulations are currently under consideration. External audits are conducted annually.
Czech Republic	YES	EU compatible standards were introduced in 1994. Annual reports audited.
Estonia*	YES	Control under special procedures based on EU Directives. The actuary is responsible for calculating an insurance company's technical provisions. External audits are conducted annually. The supervisory body conducts regularly and planned on-site inspections as well as spot checks.
Georgia	NO	Na
Hungary*	YES	EU compatible standards. The chief actuary and auditor are responsible; the supervisory authority monitors submissions to the data reporting system and in some cases makes on-site checks.
Latvia*	YES	A general principle exists. There are no special regulations on the calculation or evaluation of technical provisions. At present, technical provisions are controlled on the basis of information provided by insurance companies. Actuaries assess the financial position of life insurance companies. Annual report s are examined by chartered auditors. On-site inspections are conducted no less than once every three years.
Lithuania*	YES	Technical provisions must be calculated accordingly to the regulations on calculations of technical provisions. Requirements for technical provisions conform to the requirements of EU directives. Audits are carried out annually. The supervisory authority conducts on-site inspections.
Moldova	YES	Financial reports have to be audited. Technical provisions are determined by insurance companies in co-operation with the supervisory body. Methodological guidelines on technical provisions are currently being drafted.
Mongolia	NO	Na
Poland*	YES	There are comprehensive regulations and supervision of technical reserves. Auditing; annual reports; quarterly reports; inspections. The actuary's role is stipulated in the Insurance Act.
Romania*	YES	For life insurance, technical reserves must be calculated on actuarial bases. For non-life insurance, loss reserves and premium reserves must be calculated as stipulated by law. The financial soundness of companies is audited by external auditors annually. On-site inspections are made by the supervisory body.
Russia	YES	The supervisory authority approves procedures for generating technical provisions. Auditors examine technical provisions and annual reports. On-site inspections are conducted as required.
Slovakia*	YES	Administrative financial control, from annual reports, performed by actuaries. Adequacy of technical reserves to be controlled from 1997. The financial soundness of companies is audited by external auditors annually.
Slovenia*	YES	EU compatible standards. Technical provisions and life insurance reserves must be confirmed by an authorised actuary, who is required to submit confirmation to the insurance company and the supervisory authority. Annual financial statements are audited by both auditors and actuaries. On-site inspections are conducted as required and visits to the Supervisor's office by company representatives.
Ukraine	YES	The amount of unearned reserves is determined by aggregate premiums received. Reserves and assets are audited (Art. 30 of the Act).
Uzbekistan	NO	Na

Note: na - data not available
*: data for 1998, no mark: data for 1997

Sources: OECD Questionnaire (1997 &1998) drafted by the author
Hearings of Supervisory Bodies by the author (1998)

5.2.3.3 Solvency margin requirements

Table 5-5 shows that most countries in the region have introduced solvency margin requirements based on EU directives. Belarus and Romania have their own measures of solvency margins. In Belarus, insurance companies must observe a given ratio between assets and technical provisions. The Romanian regulations state that the premium income of an insurer net of reinsurance may not exceed five times its paid-up capital plus capital reserves. In Lithuania, the only requirements relate to the amount of authorised capital. Regulations on solvency margin requirements are under preparation. Albania and Georgia do not have such requirements.

Table 5-5 Solvency margin requirements as of 1997/1998

Country	Solvency margin requirements (exist or not)	Main requirements
Albania*	No	Na
Belarus*	Yes	To ensure solvency, insurance companies must maintain a certain ratio of assets to liabilities. Requirements and calculation methods are established by the state supervision body.
Bulgaria	Yes	As prescribed by the Insurance Act.
Croatia	Yes	Based on EU Directives.
Czech Republic	Yes	Based on EU Directives.
Estonia*	Yes	Based on EU Directives.
Georgia	No	Na
Hungary*	Yes	Based on EU Directives.
Latvia*	Yes	In accordance with EU Directives.
Lithuania*	Yes	Rules for calculating solvency margins are under preparation. Minimum capital requirements are in force.
Moldova	Yes	As prescribed by the Act of 15 June 1993.
Mongolia*	Yes	Based on EU Directives.
Poland*	Yes	Based on EU Directives.
Romania	Yes	Under Act 47/1991, the insurer's premium income, net of reinsurance, may not exceed five times its paid-up capital plus capital reserves.
Russia	Yes	Based on EU Directives (premium method), with some modifications.
Slovak Republic*	Yes	In accordance with EU directives.
Slovenia*	Yes	In accordance with EU directives.
Ukraine	Yes	In accordance with EU directives, with some modifications.

Note: *: data for 1998, no mark: data for 1997

Sources: OECD Questionnaire (1997 and 1998) drafted by the author.

Hearing of supervisory authorities by the author (1998).
Transitional Report , EBRD.

5.2.3.4 Financial reporting

Table 5-6 shows that all countries require companies to file financial reports at least annually. Most countries require quarterly or semi-annual reports. Several countries have introduced EU accounting principles or have developed insurance accounting systems. Others (Albania, Belarus, Croatia, Georgia, Lithuania, Moldova and Romania) have not yet developed accounting systems specifically for insurance, although some countries (Albania, Georgia, Lithuania, and Moldova) are now preparing to introduce them.

In Estonia, the new insurance law in 1998 requires insurers to publish their annual accounts and the supervisory authority to control the quality and accuracy of the data submitted.

Table 5-6 Financial reports as of 1997/1998

Country	Financial Reports		Main Accounting Principles
	Nature	Frequency	
Albania*	na	na	Accounting and financial issues to be regulated by the relevant Act of the Minister of Finance, not yet published.
Belarus*	1. Appendix to the balance sheets, attached to the annual financial report. 2. Balance sheet; profit and loss account; report on the main indicators of financial and economic activity.	1. Annual 2. Quarterly	Accounting principles are the same for all sectors of the national economy. There are no accounting principles specifically for insurance.
Bulgaria	Balance sheet; profit and loss account.	Annual	na
Croatia	1. Balance sheet; profit and loss account. 2. Structure and amount of financial resources as well as premium and losses.	1. Three times a year 2. Quarterly	Special accounting principles for insurance were not yet adopted but regulations prepared according to the EU Directive on accounting.
Czech Republic	Financial reports.	Annual	Prepared according to the EU Directive on accounting.
Estonia*	Accounting reports[1]; investments by companies; insurers' borrowed funds and assumed liabilities.	Semi-annual; annual	An accounting system complying with the EU Directive has been introduced.
Georgia	Balance sheet.	Annual	Insurance accounting laws are being drafted.
Hungary*	Annual report with auditor's clause; reports on reinsurance contracts.	Quarterly, annual	Act XCVI of 1995 on Insurance Institutes and Insurance Activities; other laws on accounting.
Latvia*	1. Annual balance sheet; profit and loss account; cash flow statement; notes. 2. Changes in number of insurance contracts and amount of coverage, premiums, claims, expenses, investments.	1. Annual 2. Quarterly 3. Monthly	Prepared according to the EU Directive on accounting.
Lithuania*	1. Annual balance sheet, profit and loss account and notes on the accounts. 2. Balance sheet; statistical accounts.	1. Annual 2. Quarterly	Accounting methods and charts accounts to be adopted by insurance companies are currently under preparation, with annual accounts to be co-ordinated with accounting documents.
Moldova	Balance sheet; profit and loss account and two statistical reports on main indicators of insurance operations.	Annual and quarterly.	New accounting instructions and a new accounting plan just introduced but accounting methods not fully harmonised with insurance legislation.
Mongolia	Reports on activity.	Semi-annual; annual	na
Poland*	1. Financial statements.[2] 2. Supervisory reports.	1. Annual 2. Quarterly and annual	Based on EU Directive. The Minister of Finance issues rules for drawing up quarterly and annual financial statements presented to the supervisory body.
Romania*	Annual balance sheet; profit and loss account; report to shareholders and auditors' report.	Annual, before 15 April	There are no specific insurance principles, and the accounting methods and the content of accounting documents are not harmonised.
Russia	Annual account; report on solvency; report on placement of insurance reserves; report on insurance reserves in insurance sectors other than life; report on reinsurance transactions.	Annual	Insurance company balance sheets and reports on financial results have been approved by the supervisory authorities. Format and terminology have been aligned as much as possible on the EU Directive on the annual accounts and consolidated accounts of insurance undertakings.
Slovak Republic*	Final account; balance sheet; profit and loss report; list of investments of technical reserves and solvency report.	Annual	Regulations harmonised with EU Directive 91/674/EEC.
Slovenia*	1. Financial statements and supporting statistical analysis. 2. Detailed statements on investments by life and non-life insurers. 3. Statistical activity reports by class, listing levels of premiums and claims.	1. Annual 2. Semi-annual 3. Quarterly	There are a number of accounting standards for the insurance industry, all of which are in accordance with EU Directive.
Ukraine	1. Balance sheet; income statement; inventory report, special additional information containing some details on insurance activity. 2. Balance sheet; profit and loss account; supervisory reports.	1. Annual 2. Quarterly	Articles 33 and 34 of the Insurance Act.

*: data for 1998, no mark: data for 1997 (na)- data not available

Notes:

[1] Balance sheet; profit and loss accounts; non-technical statements; technical provisions; investments; cash flow statements; statements of overheads; solvency report.

[2] Financial statements have to be signed by the managing board, and in the case of life insurance also by the actuary.

Sources: OECD Questionnaire (1997 & 1998) drafted by the author.
Hearings of insurance supervisory authorities by the author (1998).

5.2.3.5 Policy conditions and premium rates

The supervision of policy conditions and premium rates is considered to be an important part of the role of the supervisor, who generally is empowered by law to monitor products and rates. However, the claims databases and other systems needed to underpin such supervision have not yet been established in the majority of the countries (see tables 5-7 and 5-8). Even in those countries that have set up databases, there is much room for improvement.

As the Estonian authority mentioned, quite often insurers do not use statistics to calculate premiums. In addition, by and large, insurers still do not exchange the information they have in databases. In Estonia, principles and the basis on which insurance premiums, provisions and refunds are calculated, are already submitted to the supervisory authority when an insurance company applies for the license. However, the supervisory authority does not have power to request any increase in the tariff. As the Russian authority pointed out, due to the lack of understanding and embryonic state of the insurance market and insurance culture, the need for insurers to exchange data is still not perceived as being necessary.

Table 5-7 Supervision of policy conditions and premium rates as of 1997/1998

Country	Supervised or not				Comments
	Licensing(1)		Operating(2)		
	Policy conditions	Premium rates	Policy conditions	Premium rates	
Albania*	Y(3)	Y(3)	—	—	Supervisory functions are being carried out by the Ministry of Finance until the Supervisory Commission begins its activity.
Belarus*	Y	Y	Y	Y	
Bulgaria	Y	Y	—	—	
Croatia	Y	Y	Y	Y	
Czech Republic	Y	—	—	—	
Estonia*	Y	Y	N	N	The supervisory authority receives the relevant documentation from insurers but it cannot supervise them on site.
Georgia	(Y)	(Y)	(Y)	(Y)	Supervision is not in force, as the Insurance Act is being drafted.
Hungary*	Y	Y	Y(4)	Y(4)	
Latvia*	Y	Y	Y	Y	
Lithuania*	Y	Y	Y	Y	Statistical documents submitted quarterly by insurers.
Moldova	Y	Y	Y	Y	—
Mongolia	Y	Y	Y	Y	
Poland*	Y	Y	N	N	
Romania*	Y	Y(5)	Y	Y(5)	
Russia	Y	Y	Y	Y	—
Slovak Republic*	Y	Y(6)	Y	Y(6)	
Slovenia*	Y	Y(7)	Y(7)	Y(7)	
Ukraine	Y	Y	—	—	

Notes: Y - Yes N - No (—) - data not available
*: data for 1998, no mark: data for 1997

(1) During the licensing procedure.
(2) When new products are introduced.
(3) Only for compulsory classes.
(4) Motor Third Party Liability (MTPL) insurance, life insurance and accident and diseases insurance.
(5) All the actuarial calculations have to be provided in respect of life insurance products.
(6) MTPL, workman's compensation and life insurance.
(7) MTPL is subject to the approval of the Ministry of Finance.

Sources: OECD Questionnaire (1997 &1998) drafted by the author.
Hearings of the supervisory bodies by the author (1998)

Table 5-8 Claims data collection as of 1997/1998

Country	Shared data[1] (exist or not)	Collecting body	Data collection
Albania*	No		
Belarus*	Yes	Issuance Activity Supervision Committee and Insurance Association	—
Croatia	Yes	Supervisory Directorate	—
Czech Republic	Yes	Czech Insurance Association	
Estonia*[2]	Yes	Supervisory Authority	—
Georgia	No		
Hungary*	Yes	An independent organisation	Only for compulsory motor insurance
Latvia*	No	No	No
Lithuania*	No	Supervisory Authority	—
Mongolia	No	—	—
Poland*	No		
Romania*	No		
Russia	Yes	Regional insurance associations	Insurers collect information themselves for their own purposes and mutual co-operation.
Slovak Republic*	Yes	Slovak Insurance Association	—
Slovenia*	Yes	Supervisory Authority	
Ukraine	No		

Notes: (—) data not available
*: data for 1998, no mark: data for 1997

(1) Claims data such as loss frequency and loss severity are shared among insurance companies so that adequate premium rates can be calculated on a broader statistical basis.

(2) Insurers report premiums and losses by class of business. Definitions of the data are not required.

Sources: OECD Questionnaire (1997 & 1998) drafted by the author.

Hearings of the supervisory authorities by the author (1998).

5.2.3.6 Distribution

Table 5-9 shows that most counties have three types of distribution channel *i.e.* insurance company employees, agents and brokers. Regulations controlling intermediaries have been established in several countries (Belarus, Bulgaria Czech Republic, Hungary, Lithuania, Moldova, Poland, Romania, Slovak Republic, Slovenia and Ukraine). However, some countries (Albania, Croatia, Estonia, Georgia, Lithuania and Mongolia) have not yet established a legal framework for insurance intermediaries, although some of them are preparing legislation. There is no clear difference between brokers and agents in some countries. Most countries that do have legislation on intermediaries require brokers to be licensed. The Slovak Republic is the only country that requires only registration and not a licence. In Bulgaria, brokers are required to obtain a licence and agents must be registered through their insurance company. In those counties that do regulate intermediaries, they are supervised by a government supervisory authority, not by a self-regulatory body. In countries such as Lithuania and Poland, brokers are required to have qualified managers and minimum professional liability insurance coverage.

Table 5-9 Supervision of distribution as of 1997/1998

Country	Kind of intermediaries	Legislation on distribution
Albania*	1,2	Legislation to regulate relations between intermediaries is under preparation.
Belarus*	3	Brokers must be licensed by the supervisory body. The state insurance agency has drawn up the Statute of Insurance Brokers, defining the functions, objectives, areas of operations, rights, obligations and liability of brokers, along with procedures for licensing and supervising them.
Bulgaria	1,2,3	Insurance Act (Art. 43). Brokers must licensed and agents registered
Croatia	1,2	New insurance legislation is being planned.
Czech Republic	1,2,3	na
Estonia*	1,2,3	New insurance legislation is being prepared.
Georgia	1,2,3	New insurance legislation is being prepared (brokers must be licensed).
Hungary*	1,2,3	Regulated by insurance law.
Latvia*	1,2,3	Insurance intermediaries must be licensed. There are no special regulations on distribution.
Lithuania*	1,2,3	The Insurance Act and a resolution adopted by the state Insurance Supervisory Authority (Nov. 1996) regulating the activity of brokers. (1)
Moldova	1,2,3	Act of 15 June 1993.
Mongolia	1,2	Insurance legislation is being prepared.
Poland*	1,2,3	Agents and brokers must be licensed by the State Office for Insurance Supervision.
Romania*	1,2,3	Authorisation required from the Insurance and Reinsurance Supervisory Office.
Slovak Republic*	1,2,3	The supervisory body judges brokers' qualifications and requires their registration.
Slovenia*	1,2,3	Insurance intermediaries must be licensed.
Ukraine	1,2,3	Decree of the Cabinet of Ministers.

Kinds of intermediaries:
1 - Employees of insurance companies
2 - Agents
3 - Brokers

Note: *: data for 1998, no mark: data for 1997
na - data not available

(1) Requirements for brokerage activities: ① licence,
② qualification of the manager,
③ minimum professional liability insurance LTL 100,000 (US$ 25,000).

Source: OECD Questionnaire (1997 & 1998) drafted by the author
Hearings of the supervisory authorities by the author (1998).

5.2.3.7 Compulsory insurance

MTPL (Motor Third Party Liability) is compulsory in the majority of the countries in the region as shown in the table 5-10. Most of the countries in which it is not compulsory are in the process of making it so (Belarus, Lithuania and Russia).

In the case of the Czech and Slovak Republics, MTPL is written by only one insurance company, *i.e.* the former state monopoly. Premium rates and conditions are established by government decree.

In Romania, insurance companies other than the former state monopoly have been permitted to carry on MTPL since 1996. The requirements for conducting such business are that:

- the minimum capital requirement be 10 billion lei (2.5 m US$) - there exist at least two subsidiaries or branches in every district;
- trained staff be deployed for claims assessment and payment at each subsidiary or branch.

MTPL premium rates and policy conditions are fixed by the government in the majority of the countries that have such insurance. Some countries (Belarus, Georgia, Lithuania) do not have any compulsory classes of insurance.

Table 5-10 Supervision of compulsory insurance as of 1997/1998

Country	Kind of compulsory insurance	Market share(1)	Comments
Albania*	Motor Third Party Liability	60	Act no. 7641, of December 1st, 1992 „Compulsory Motor Vehicle Third Party Liability Insurance" (in force as of 1 January 1993).
Belarus*	None, except for mandatory state insurance of certain categories of employees, which is financed from the state budget.	—	The state-owned insurer Belgosstrach holds the monopoly on compulsory insurance. The new law will introduce compulsory motor liability insurance.
Bulgaria	Motor Third Party Liability, public transport passenger accident.	—	Insurance Act.
Croatia	Motor Third Party Liability, public transport passenger accident, occupational accident insurance.	44	MTPL conditions and premiums are set by law.
Czech Republic	Motor Third Party Liability, occupational accident insurance.	11,5	Ceska has a monopoly on compulsory insurance; premiums are set by law.
Estonia*	Motor Third Party Liability and other minor insurance classes, e.g. notaries' liability insurance.	51.6(2)	A special Traffic Insurance Foundation (TIF) regulates compulsory MTPL and compiles the necessary reserves for it. TIF is to maintain the central MTPL database. There is a separate act governing MTPL.
Georgia	None.	—	Regulations on compulsory insurance are under preparation.
Hungary*	Motor Third Party Liability, liability for some professional groups.	40	Motor liability insurance is governed by separate legal provisions of 1991. Premium rates are fixed by the Ministry of Finance. There are no limits on the loss amounts.
Latvia*	Motor Third Party Liability, liability for some professional groups.	28.6	The law "On Compulsory Third Party Liability Insurance for Inland Motor Vehicle Owners is in force since September 1st, 1997. Conditions and premiums are set by law.
Lithuania*	None.		The Compulsory Motor Third Party Liability insurance is under preparation.
Moldova	Insurance of railway, air, river and motor transport passengers. Insurance of employees of the Internal Affairs Ministry, National Security, Defence and judicial agencies. Motor Third Party Liability.	20	—
Mongolia	Medical insurance, passenger insurance, automobile insurance and certain kinds of liability insurance.	19.3	—
Poland*	Motor Third Party Liability, civil liability of farmers and insurance of farm buildings, liability insurance for some professional groups and other insurance under consideration under acts in force or international agreements ratified by Poland	—	Insurance conditions are set by law.
Romania*	Motor Third Party Liability.	12	Law 136/1995(3); the level of insurance premium, payment terms, maximum limit on indemnities, sanctions and other elements are established by the Government, on the proposal of the Ministry of Finance.
Russia	Insurance of personal property, health insurance, passenger accident, some types of insurance for certain civil servants.	—	The introduction of compulsory Motor Third Party Liability insurance is planned.
Slovak Republic*	1.Motor Third Party Liability. 2.Liability insurance in case of work-related accidents or occupational disease. 3.Professional liability insurance (of auditors, commercial lawyers, hunters, dentists, etc.) 4.Liability insurance for civil aviation	1. 12.6 2. 4.5 3. 1.8	Motor Third Party Liability and occupational accident insurance is written by only one insurance company (Slovenská pojistov a a.s.); premium rates and conditions are set by decree. In the case of professional liability the supervisory body can designate an insurer to cover the risk, if none is willing to do so voluntarily.
Slovenia*	1. Motor Third Party Liability. 2. Personal accident for passengers on public transport. 3. Aviation.	1. 16.2 2. 0.03 3. 0.1	Auto liability rates are subject to supervision. There is currently a single national tariff.
Ukraine	Motor Third Party Liability	—	Classes of compulsory insurance are defined in Article 6 of the Insurance Act. Introduction of compulsory Motor Third Party Liability was introduced in 1997. Compulsory insurance of state property has been abolished.

Notes:

(1) % of the overall volume of insurance premiums.
(2) Estonia: Motor Third Party Liability 48,5% and other insurance 3,1%.
(3) Romania: Act no.136 on insurance and reinsurance activities in Romania was issued in 1995.
PA - personal accident insurance.
MTPL - Motor Third Party Liability Insurance
(—) data not available *: data for 1998, no mark: data for 1997

Sources: OECD Questionnaire (1997 & 1998) drafted by the author
Hearings of the supervisory authorities (1998) by the author
Sigma No.8/1996 Swiss Re

5.2.3.8 Regulation of investments

Table 5-11 shows that most countries regulate insurers' investments. In general, the regulations permit certain classes of investment up to certain limits. Exceptionally, in Croatia, a minimum amount of investment in state bonds is required by law. Insurance companies are obliged to invest at least 30 per cent of life insurance mathematical reserves in securities issued by the Republic of Croatia.

In Romania, the insurance companies have to keep their liquidities in at least two different banks, with not more than 50% of them in any one bank. They may invest in investment funds but not more than 20% of this kind of investments may be made in any one investment fund.

All the countries except for Hungary and Slovenia allow portfolio investment abroad. In Estonia, insurers may invest in foreign shares and deposits but not in foreign loans or bonds. In Belarus, Poland and Russia, there are upper limits on the proportion of reserves that can be invested abroad. In the Slovak Republic, the foreign exchange law limits the amount of foreign investments. In Lithuania, the maximum limits for investment of assets corresponding to technical provisions are the same as local investments but prior approval by the supervisory authority is required.

Most countries monitor the investment activities of insurance companies by on-site inspection and/or by checking financial reports. Currency matching requirements are not common in the region.

Table 5-11 Supervision of investment activities as of 1997/1998

Country	Evaluation method	Regulation of portfolio investment abroad		Legislation and monitoring
		(allowed or not)	(how regulated if allowed)	
Belarus*	Present value.	Yes	Up to 20% of the total amount of reserves is allowed to invest abroad.	Permissible classes of investment and maximum investment per class stipulated by law. Monitoring by on-sight inspections and reporting.
Bulgaria	-	Yes	Funds may be invested abroad with permission from the Ministry of Finance.	Permissible classes of investment and maximum investment per class stipulated by law. Free assets (assets not covered by technical provisions) also regulated.
Croatia	Historical or market value.	Yes	In accordance with regulations governing foreign exchange transactions (prior approval required).	Permissible classes of investment and maximum investment per class stipulated by law. Monitoring by Department of Insurance Supervision through financial reports submitted quarterly. At least 30% of mathematical reserves have to be invested in state securities.
Czech Republic	-	-		Regulated by Ministry of Finance decree.
Estonia*	Acquisition costs. Long term financial investments to be evaluated by the equity method.	Yes	Companies may invest in foreign shares or deposits, but not in foreign loans or bonds. An insurance company with foreign shareholders must keep its reserves in Estonia.	Permissible classes of investment and maximum investment per class stipulated by law.
Georgia	-	Yes	No specific limitation on investment abroad.	Permissible classes of investment and maximum investment per class stipulated by law.
Hungary*	-	No	Except for the acquisition of the ownership share, amounting to at least 10%, of an insurer based abroad or an economic association based abroad carrying out insurance broker's activities, if the equity of the insurer and the ownership shares of the owners of the insurer reach jointly the same level.	Permissible classes of investment and maximum investment per class stipulated by law. Reporting on a quarterly basis.
Latvia*	Mainly purchase value or market value.	Yes	No restrictions.	Permissible classes of investment and maximum investment per class stipulated by law. Reporting on a quarterly basis.

Note: (-) data not available
*: data for 1998, no mark: data for 1997

Source: OECD Questionnaire (1997 & 1998) drafted by the author
Hearings of the supervisory authorities by the author (1998)

Table 5-11 Supervision of investment activities as of 1997/1998 (continued)

Country	Evaluation method	Regulation of portfolio investment abroad (allowed or not)	(how regulated if allowed)	Legislation and monitoring
Lithuania*	Purchase value.	Yes	Maximum limits for technical provisions the same as for local investments, but prior approval by the insurance authority is required.	Permitted classes of investment and maximum investment in these classes is laid down by law. Free assets also regulated.
Moldova	-	-		Permissible classes of investment and maximum investment per class stipulated by law. Compliance with the rules is checked through quarterly reports.
Poland*	-	Yes	Up to 5% of technical reserves may be invested abroad.	Insurance Act specifies exact investment guidelines, a list of permissible investments and the maximum limit for each. Supervisory body monitors whether provisions are being maintained.
Romania*	None.	Yes	No limit on foreign investment.	Insurers have to maintain their deposits in at least 2 commercial banks, but not more than 50% in one bank. Investment in a given investment fund may not exceed 20% of aggregate investments in such funds. Supervisory authority may request information whenever it appears necessary.
Russia	-	Yes	Not more than 20% of insurance reserves may be invested abroad.	Control of diversification and return on investment.
Slovakia*	Historical value.	Yes	There are limitations under the Foreign Exchange Act, but these should be abolished for investment in OECD Member countries in the near future.	Ministry of Finance decrees, provisions concerning investments by insurance companies, investment guidelines, list of permissible investments and maximum limit for each category of investment. Supervisory authority to monitor provisions for the first time in 1997.
Slovenia*	Depreciated historical cost adjusted for inflation or market value, whichever is less.	No		Permissible classes of investment and maximum investment per class stipulated by law. Monitoring is done on a half-yearly basis and through random on-site inspections.

Note: (-) data not available
*: data for 1998, no mark: data for 1997

Source: OECD Questionnaire (1997 & 1998) drafted by the author
Hearings of the supervisory authorities by the author (1998)

5.2.3.9 Supervision of reinsurance

Reinsurance regulations vary from country to country. Some countries like the Slovak Republic do not control or supervise reinsurance activities. Others, like Slovenia, Croatia and Romania, regulate and supervise reinsurance activities just like insurance (see table 5-12).

The Estonian insurance authority has introduced reinsurance supervision, the objectives of which are to

- control reinsurance arrangements and specific reinsurance treaties;
- ensure adherence to basic treaty provisions and technical requirements as well as to control accounts related to reinsurance arrangements.

Methods for comparing the volume of ceded reinsurance with the market average and also for examining indicators that influence this volume have yet to be completely developed. The supervisory authority examines technical calculations of reinsurance business and controls the results submitted.

In Lithuania, licensed insurance companies may transfer a portion of the risk assumed to insurance and reinsurance companies abroad which enjoy financial credibility on the international market. A list of financially credible insurance and reinsurance companies abroad shall be established by the supervisory authority.

In Latvia, insurance companies must inform the insurance authority of any new reinsurance contract within 10 days following its conclusion.

Several countries apply domestic retention requirements. Typically, domestic capacity must be given first option on reinsurance (Moldova and Slovenia). In Croatia, an insurance company may only be reinsured abroad if the conditions offered by a foreign reinsurer are more favourable than those of a domestic reinsurance company. Even then, however, the insurance company is obliged to offer domestic reinsurer participation in the surplus of risks up to the amount of his capacity, under the conditions provided by the foreign reinsurer.

Table 5 -12 Supervision of reinsurance as of 1997/1998

Country	Domestic retention requirements (its content if applicable)	Cross-border transaction of reinsurance(1) (allowed or not)
Albania*(2)	NO	YES
Belarus*	–	YES(3)
Croatia	YES(4)	YES
Czech Republic	–	YES
Estonia*	YES	YES
Georgia	–	YES
Hungary*	YES(5)	YES
Latvia*	NO	YES(6)
Lithuania*(7)	NO	YES
Moldova(8)	YES	YES
Mongolia	NO	–
Poland	NO	YES
Romania*(9)	NO	YES
Slovak Republic*	NO(10)	YES
Slovenia*(11)	YES	YES
Ukraine	NO	YES

*: data for 1998, no mark: data for 1997 (–) data not available

Notes:

(1) Reinsurance cover by reinsurance companies outside the country.

(2) Albania: Domestic retention requirements are not clearly stipulated in the Insurance Act.

(3) Belarus: Cross-border reinsurance transactions are continuously monitored by the State Insurance Supervisory Committee. According to the law "On the Corporate Income Tax", premiums transferred by foreign insurance and reinsurance companies are booked as the original cost of insurance service, i.e. are not subject to tax income.

(4) Croatia: An insurance company may be reinsured abroad if the conditions of a foreign reinsurer are more favourable than those of domestic reinsurance companies, but in such cases the insurance company in question is required to offer to a domestic reinsurer a share in the surplus risk up to the amount of its capacity to bear them for its own account, on the terms offered by the foreign reinsurer.

(5) Hungary: Only one indirect requirement in the case of life insurance, pursuant to Article 75 of the Act: "In the case of life insurance, with the exception of the net life insurance risk and the risk portion of insurance that also covers death risk, insurance reserves shall also be formed in respect of risks ceded to reinsurance."

(6) Latvia: Within ten days of concluding a reinsurance contract, the ceding insurer shall notify the supervisory authority of the content thereof.

(7) Lithuania: Regulated by the Insurance Act (Article 20).

(8) Moldova: No domestic reinsurance companies are registered in Moldova, and for this reason the reinsurance business is underdeveloped and depends on foreign reinsurers (from Germany and Russia) or larger insurance companies in Moldova, Ukraine, Russia and Belarus. The reinsurance of risks with foreign reinsurers unlicensed by the State Insurance Supervisory Office is permissible if risks cannot be covered on the domestic market.

(9) Romania: Reinsurance may be obtained in the international market only if the risks cannot be ceded domestically.

(10) Slovak Republic: No regulation on reinsurance.

(11) Slovenia: Domestic capacity must have first offer of reinsurance. Reinsurance is regulated and supervised just like direct insurance.

Sources: OECD Questionnaire (1997 & 1998) drafted by the author
Hearings of the supervisory authorities by the author (1998)

5.2.3.10 Winding-up measures

Table 5-13 shows that most of the countries in the region have put in place measures to protect policyholders in the event of bankruptcy or liquidation. In Estonia, for example, there is a separate section in the law governing the merger, de-merger and winding-up of insurance companies. It includes specific provisions for mandatory liquidation, voluntary liquidation and bankruptcy. These provisions are designed to protect the interests of policyholders in the event of bankruptcy and to permit the transfer of insurance portfolios from bankrupt company to another insurance company. This measure has been used twice in Estonia. On both occasions, the insurance portfolios of the companies being wound up were transferred to other insurers under the guidance of the Supervisory Authority. The interests of policyholders and the insured were thereby protected.

However, this example is rather exceptional. In many cases, the interests of policyholders were not sufficiently protected because of the troubled state of the insurer was not detected early enough and/or because the regulations on policyholder protection were inadequate. It is often the case that supervision does not function properly or is not organised in such as way as to allow preventive action to be taken.

Several countries have policyholder protection schemes such as a motor insurance guarantee fund in the event that an insurer goes bankrupt.

Table 5-13 Supervision of winding-up as of 1997/1998

Country	**Motor Insurance Guarantee Fund** (exist or not)	**Policyholder protection measures prior to bankruptcy**	**Policyholder protection measures included in liquidation procedures**
Albania*	–	–	Y(1)
Belarus*(2)	N	–	N
Bulgaria	Y	Y	Y
Croatia	Y	Y	Y
Estonia*	Y(3)	Y	Y
Hungary*	N	Y	N
Latvia*	Y(4)	Y	Y
Lithuania*	N(5)	Y	Y(6)
Moldova	N	–	–
Mongolia	N	N	N
Poland*	Y	Y	Y
Romania*	Y	N	Y
Russia	N	Y	N
Slovak Republic*	N	Y	–
Slovenia*	Y	Y	Y
Ukraine(7)	Y	–	Y

Notes:
Motor Insurance Guarantee Fund – fund for protecting policyholders from losses in the event a company goes bankrupt.
Y - exist
N - not exist
(–) - data not available   *: data for 1998,   no mark: data for 1997

(1) Albania: the Albanian Bankruptcy Act has a special section on insurance undertakings.
(2) Belarus: There are currently no regulatory provisions protecting the interests of policyholders in the event an insurance company goes bankrupt or is liquidated.
(3) Estonia: Traffic Insurance Foundation in case of bankruptcy.
(4) Latvia: To be introduced in June 1997.
(5) Lithuania: Under consideration.
(6) Lithuania: In the event a bankrupt company is liquidated, policyholders are protected under Article 37, Section 11 of the Insurance Act.

Sources: OECD Questionnaire (1997 & 1998) drafted by the author
Hearings of the supervisory authorities by the author (1998)

5.2.4 Privatisation

Table 5-14 shows that privatisation of former monopolies has been completed or there is a plan to be carried out in the near future in the majority of the countries in the region. The shareholders of the privatised companies are mostly employees or domestic investors. The state usually retains a stake in the companies after privatisation. Only in exceptional cases -- Hungary -- do foreign shareholders have majority holdings. Belarus and Russia do not have any plans to privatise their state insurance companies.

Table 5-14 Privatisation schedule as of 1997/1998

Country	Privatisation completed (YES/NO)	Privatisation schedule
Albania*	Yes	The new law for states the privatisation of the former monopoly
Belarus*	NO	There are no plans to privatise state-owned insurance companies.
Croatia	NO	Special legislation will be enacted will be enacted with regard to the privatisation of state-owned insurance companies.
Czech Republic	YES	The former state-owned monopoly has been privatised.
Estonia*	YES	The only state-owned company (a holdover from Soviet times, which wrote both life and non-life insurance) was privatised in 1996.
Georgia[1]	NO	The state-owned insurer will become a joint stock company in the future.
Hungary*	YES	The former state-owned monopoly has been privatised.
Latvia*	NO	*The privatisation process completed in 1997.*
Lithuania*	YES	The (state-owned) State Insurance Company was privatised and its shares were distributed between the state and employees of the company. It now operates as a joint stock company, but the main shareholder (with voting rights and equity in excess of 50%) is still the state.
Moldova	YES	
Mongolia	NO	Privatisation of the state-owned company Mongol Daatgal is expected in 1997-1998.
Poland*	NO	It is expected that the state-owned company, Powszechny Zaklad Ubezpieczeñ will be privatised in 1997 and 1998.
Romania*	NO	Law concerning the privatisation of the state owned companies ASIROM and ASTRA is prepared. According to the provisions of this draft, the privatisation of these two companies will be finished after one year, beginning with the date when this law will be in force.
Russia	NO	There is no Russian legislation laying down any particular pattern of privatisation of the state organisation.
Slovakia*	YES	The former state-owned monopoly, Slovak Insurance Company, has been privatised (the state's share being 49%).The only state-owned insurance company in the Slovak Republic is the Export Credit Insurance Company which is to be converted to an export-import bank in the near future.
Slovenia*	NO	Privatisation of four insurance companies and one reinsurance company is in progress.
Ukraine	NO	Preparations for privatisation are underway.

Note: *: data for 1998, no mark: data for 1997

[1] Georgia: specific date of privatisation not available.

Source: OECD Questionnaire (1997 & 1998) drafted by the author

Hearings of the supervisory authorities by the author (1998)

5.3 Conclusions

Insurance legislation and supervision have been steadily developing in the region. However, some countries have not yet established basic insurance regulations governing technical provisions, insurance accounting, investments, solvency margin requirements etc.

Although the majority of the countries in the region have already prepared basic insurance rules which in many cases are compatible with EU directives (accounting, solvency margins, technical provisions, etc.), more specific insurance rules need to be adopted in most of the countries. For example, regulations on intermediaries or regulations on technical provisions which state the methods of calculating them have not yet been introduced in many countries. In addition, the supervisory authorities need to build up expertise and experience in order to ensure that these rules are applied properly and to enforce effective supervision.

CHAPTER 6: REASONS FOR THE FAILURE OF THE INSURANCE SYSTEM IN ECONOMIES IN TRANSITION

Although the insurance sector should play a key role in the transitional economies and has been developing remarkably, it still faces in vulnerable situations surrounded by unstable and high risk environment. The insurance market is yet to operate as those in developed economies. A considerable number of financial problems have been faced by insurance companies in economies in transition, in particular during their initial stages. For example, between 1994 and 1996, several hundred companies in Russia and Ukraine found themselves in financial trouble. Between 1992 and 1997, five insurance companies in Poland had gone bankrupt, and all of them were among the largest insurance companies in the market except state-owned or state-related insurance companies at the time of their bankruptcy. In Lithuania, out of less than fifty insurance companies, thirteen had their licenses revoked in the period 1994-96.

However, there may have been positive effects of these problems. Consumers recognised that insurance companies should be selected not on the basis of the lowest premiums but according to their sound financial conditions, service quality and reasonable price corresponding to their service. Insurance companies also started to comprehend that the insurance business involves not only collecting premiums, but also paying claims.

However, taking into account their negative effects on the whole market, such problems should nevertheless be by all means avoided. An insurance company bankruptcy is an intolerable event for an emerging market, causing significant damage to policyholders. While it is true that in some cases liabilities were taken over by policyholder protection funds, the majority of insured incurred parties losses: they either did not receive any benefits, claim payments or reimbursement, received them incompletely or received them with such delays so that their value had depreciated. Even where they received payments from the funds, the costs had to be covered by existing insurance companies and consequently, by existing policyholders, thus weakening the insurance market as a whole.

As the result of these bankruptcies, the trust of policyholders in the insurance system has fallen considerably. Many consumers have returned to former state monopolies which are often still controlled by the state, or else have withdrawn from insurance altogether, acknowledging that it does not protect against risk anyway. These situations have a very detrimental effect on insurance market reform.

Though the scope and frequency of financial difficulties or irregularities are diverse, such problems usually stem from common causes. This chapter analyses those common causes and sources of failure of the insurance system, quoting actual examples. (The Polish insurance market is often used an actual example in this chapter. The troubles faced by the Polish market and mentioned here existed until the amendments to the insurance law came into force and a new insurance supervisory authority commenced its operations in 1996. Since then, there have been no major problems in this market.)

6.1 Social, economic and legal aspects and corporate governance

6.1.1 Social characteristics

6.1.1.1 Rapidly-changing social conditions

Because of the uncertainties arising from rapidly-changing social and economic conditions, crime such as theft is ever more frequent, which in turn affects the prices of certain types of insurance. For example, in one country, the average price of car insurance in the communist period was about 2 per cent of the value of the car but currently it is 10 per cent. An increase in litigation has also pushed insurance prices up. The current levels of compensation in transition economies are lower than those in developed market economies. However, if levels of compensation rise in the future, this will have a significant impact on the loss ratio of liability insurance, although this is difficult to estimate at this stage.

6.1.1.2 Demographic trends

Changes in the mortality rate are crucial for calculating life insurance premiums. Since 1989 the mortality rate has risen considerably in the CIS, Bulgaria and Romania, making it difficult to calculate appropriate life insurance premiums.

6.1.2 Economic and legal issues

6.1.2.1 High inflation rates

In general, the inflation rate is high and unstable in the initial stage of transition. This complicates risk assessment for insurers and can cause a mismatch between assets and liabilities. Booth and Stroinski (1994a) point out that in the early stages of the transitional period, it is difficult to invest with a reasonable degree of certainty of attaining a positive real rate of return. Risk mismatching is, of course, a serious problem for long-term products such as certain types of life insurance and third party liability. However, it also applies to short-term products when the situation is highly unstable (inflationary). There is a potential mismatching risk involved in using any kind of fixed-interest investment to match even the shortest-term liabilities.

6.1.2.2 Underdeveloped financial markets and limited choice of investments

Financial markets based on market economy principles were established or revived only several years ago. In the initial stage of transition, stock markets are underdeveloped. Since credit risk evaluation began only after the fall of communism, the skills it requires still have to be developed. Moreover, even though private ownership of land is now widespread, in some countries permission is still required from the government to sell residential and agricultural land. The new property laws in some countries are not yet well established. Reliable land registration systems are still far from being the norm. As Booth and Stroinski (1994a) argue, it is therefore difficult to make property-related investments in the initial stage of transition, although investment in real estate often provides institutional investors with long term protection against inflation.

Diversification of the investment portfolio is very much limited due to the narrow choice of investment location. The situation is often exacerbates by the prohibition of insurance companies' investment abroad.

Safe investment measures are also limited in some countries. For example, in Lithuania, eight insurance companies went bankrupt during 1995 and 1996. At this period Lithuanian banks experienced a serious crisis which resulted in considerable losses for many insurance companies. The insurance companies assumed that deposits in reputable banks constituted safe investment measures, but in reality these led to serious losses.

6.1.2.3 Court systems and penal proceedings

All the countries in transition have revised their contract laws to bring them into line with the legislative principles found in market economies. The civil codes and commercial codes are also being revised. EBRD (1994) reports that the main legislative problem in the early stages of transition is rather the inadequacy of remedies. Indeed, since courts have limited experience of commercial disputes, the remedies available for breach of contract generally do not provide adequate compensation. This is a serious drawback for consumer protection.

Penal proceedings are usually long-term and their results are demobilising for the supervisory authority and demoralising for the insurance environment. Unfortunately, public prosecutors still often regard commercial cases (including insurance cases) as less important thereby causing them to be entrusted to the hands of inexperienced and poorly prepared district public prosecutors.

In Poland, the supervisory authority is not permitted to participate in court proceedings because, in the opinion of most public prosecutors, it does not constitute an injured party. This makes it difficult to appeal decisions and halt proceedings. The supervisory authority informed relevant authorities about discovered infringements related to troubled insurance companies long before their bankruptcies. In the case of Westa and Westa-Life, proceedings have continued for several years and their end is still not in sight. In the case of Gryf, after a year and a half of investigation, the Regional Public Prosecutor's Office has submitted charges to the court. In the case of Hestja, the District Public Prosecutor's Office first closed its investigation, but later, as a result of a complaint made by the supervisory authority, and on the order of the Regional Public Prosecutor's Office, re-opened proceedings. In several other cases, the supervisory authority's complaints have been ignored and efforts are still being made to ensure that investigations are supervised by the National Public Prosecutor's Office. In the case of Fenix, legal proceedings have yet to be started with regard to charges placed one and half year ago and in two other cases, investigations have lasted even longer.

6.1.3 Corporate governance

The instability of the insurance sector in the early stages of transition can be mainly attributed to institutional failures. Problems are often caused by lax management within insurance companies. Poor internal controls, collusive lending, insider dealing and fraud are often at the root of the failures of insurance companies. Moral hazard worsens when owners or managers do not have proper incentives to act prudently. In many cases, management boards are not able to, or do not attempt to oppose those shareholder demands which are unfavourable for insurance companies. A typical case is the demand to invest company assets in the risky and unprofitable securities of shareholder related companies. Two types of fraud are also often observed. One is caused by conspiracy between a claim agent or an employee in the claim department of an insurance company and a customer. An agent or an employee intentionally over-pays claims or pays out claims which are not covered by insurance policies and receives returns from customers. The other type is fraudulent claim declarations by customers. In both cases, a lack of internal control in insurance companies facilitates such behaviour. BOOTH AND STROINSKI (1994b) state:

"False claims on motor insurance policies were particularly frequent. Cars were insured often far above the real value of the vehicle. They were then reported stolen and the insurance money was cashed and the car would reappear and be insured in a different part of the country".

Since motor insurance constitutes the majority of personal insurance premiums, this has a considerably negative financial impact on companies.

Working Party on Financial Stability in Emerging Market Economies (1997) points out that the problems may be exacerbated in the case of government-owned companies if their managers are guided by objectives that are not compatible with sound financial practices and they are shielded from external disciplines. Weaknesses in the legal framework and supervisions compound the problems of lax management and weak corporate governance. For example, the insurance authority often does not in reality have any influence over the selection of company board members and shareholders during the licensing procedure and on-going supervision, thus allowing unfit and unsuitable managers, directors and shareholders to enter the market.

6.2 Insurance aspects

6.2.1 Lack of established policy measures

The fundamental problem facing the reform of insurance markets in economies in transition is the lack of established guidelines which take into account the social, economic and legislative environment of the market and describe a clear policy priority and concrete measures for reform. In many cases reform measures fail to correspond to market conditions. Such measures either do not function/operate or in some cases even create negative side-effects that obstruct the development of market mechanisms. Indeed, an insurance system cannot disregard market realities nor the social and economic conditions that surround it.

In addition, lack of proper guidelines leads to repeated errors with similar causes in the various countries in transition and hinders a sound market development in the region.

The most common types of error in economies in transition are:

- The copying of a developed country's insurance system without due consideration;
- The introduction of a system that excessively limits powers of intervention.

For example, Poland at one point introduced a new insurance law that was influenced by the UK insurance system. In this law, the supervisory authority did not have any power of intervention on a specific insurance product before or after its sales. Government intervention was minimised and respected market force and consumers self-responsibility.

It soon became evident that this system would not function effectively in the Polish insurance market during the initial stage of transition. In Poland, a specific accounting system had yet to be established for the insurance sector. In other words, a proper system for ensuring disclosure of essential information had not been prepared. Professionals, such as actuaries and auditors, had often not had sufficient knowledge and experience in insurance business. A law on intermediaries is in the course of being established. The UK insurance system is based on a multi-layered system of supervision, *i.e.* based on insurance legislation, insurers' internal controls, appointed actuaries, auditors and insurance supervisors. The task of controlling products and tariffs is fulfilled by actuaries. In addition, insurers' and insurance intermediaries' obligations relating to information disclosure are clearly prescribed and controlled. Since intermediaries are strictly controlled, a sound environment is created in which consumers may select appropriate products. Such circumstances ensure the proper functioning of the UK supervision principle of freedom with publicity.

It was precisely the introduction in Poland of some aspects of the UK insurance legislation without taking such differences into account that caused the market confusion experienced during early 90's.

Another typical reform mistake observed in many economies in transition is the introduction of a system that emphasises liberalisation measures at the initial stage of transition and excessively limits supervisory powers. This mistake is often due to a misunderstanding of the nature of the insurance business. However, for economies in transition where such systems have yet to be prepared, liberalisation measures are often identical to no control and cause instability of the whole insurance system. For example, not controlling investment abroad, without any supervision, leads to market confusion. This resource of vulnerability analyses more in detail below.

6.2.2 Specific problems in the market

Lack of policy measures and their implementation aggravated, by the particular nature of the markets in transition, has slowed market reform. The following are the main problems observed in insurance markets in economies in transition.

6.2.2.1 Lax control and supervision

Supervision and regulation are essential for insurance market stability. As the working party on financial stability in emerging market economies points out, regulations can themselves be a source of vulnerability where they are too lax, too intrusive, poorly designed, outmoded or inadequately implemented. For, example, lax regulations can undermine financial systems by allowing unqualified owners and managers entry into the industry, or by failing to take appropriate steps in when weak internal governance has led to excessive exposures and risk taking. Too free an entry of new insurance products to the market without any control may also disturb the market stability during the initial transition stage. Reckless insurance companies often target on expansion of their market share without taking the sufficient account of the future costs.

A common and serious problem in supervision is forbearance, which allows weak insurance companies with distorted incentives to continue operating, or invites looting by insiders, leading eventually to much larger clean-up costs. Specific examples for these problems below provide a deeper insight into real problems and their causes.

In Poland, until the amendments to the insurance law came into force in 1995, regulations concerning supervision were both incohesive and unclear. Many supervision problems resulted from the limited influence of the supervisory authority over granting a license. Also supervisory rights concerning companies already conducting insurance activities proved inadequate for proper control of those companies. The following are examples of such problems: The supervisory authority was unable to control the material standing of insurance companies. Since the principles, procedure and scope of control, and rights and obligations of the parties were not clearly defined, after the completion of an inspection the supervisory authority did not have the right to issue binding orders. The supervisory authority had the right to request various data. However, there existed no sanctions in the event of a company refusing to provide that data. The supervisory authority had no approval of new shareholders of insurance companies and likewise had no voice in the selection of appointed management. In general, the act did not provide any indirect sanctions for legal violations which meant that there was no means of pressuring those insurance companies that considered themselves above the law, knowing that a decision to revoke its permit would not be issued at once, in the interests of policyholders. The supervisory authority had no influence on a company's premium rates, its costs or reinsurance coverage.

In particular, markets suffered from the weak control of the following:

Licensing control

In the case of several CEECs, the licensing authority's influence on the development of the insurance market during early 90's was very limited. Where an applicant fulfilled all the general conditions to obtain a license, this license had to be issued automatically. There was no margin allowing for the judgement of the licensing authority. It was sufficient to prove the possession of insignificant (in terms of insurance) financial assets, present an illusionary plan and commence business. This is why in Russia and Ukraine the number of insurance companies increased considerably in a relatively short period.

In the case of Poland, licensing control was also lax during the initial stage of the new insurance system. All five companies that went bankrupt in Poland obtained their licenses during this period. Westa and Hestja received licenses when there were still no regulations defining the specific conditions for commencing business (Westa in 1988 and Hestja in 1990, while the insurance law came into force in 1990) and Gryf, Fenix and Westa-Life obtained their permits during the initial period of the market (Gryf in 1990, Fenix and Westa-Life at the beginning of 1991). Later proceedings proved that in reality, none of these insurance companies had the required assets when they obtained their licenses and that they submitted false statements when applying for the licenses.

In the case of most of the bankrupt companies in this region, the managers, directors and shareholders of those companies were completely unprepared professionally and ethically to manage an institution of social trust such as an insurance company under market conditions. Incompetencies included unskilful accounting, insurance market assessments, calculations of technical provisions, investments (especially of assets covering technical provisions) and the internal governance of the insurance companies. As the Slovenian supervisory authority pointed out, the most difficult task in treating a troubled company is to impress upon the board of directors and supervisory board that their insurance company is in trouble.

In the case of Poland, the collapse of all five bankrupt companies involved the criminal activity of the managerial staff or the owners. That activity was based on taking assets from the insurance company and transferring them to companies tied with the company's owners or depositing them directly into foreign accounts, concluding fictitious insurance contracts, conducting insurance activity without a license, falsifying financial statements submitted to the supervisory authority and providing the supervisory authority with false data concerning the company's situation. The supervisory authority was not able to counteract these crimes and as a result of the false information presented, most of the crimes were only discovered during direct inspections of source documents.

Product and tariff control

In Poland, the supervisory authority has not had any legal competence to intervene on issues of premium rates and the risk accepted by insurance companies. In accordance with the insurance regulations adopted in 1990 and resulting from compliance with part of the European Union's Third Generation Directives related to this supervision, issues of premium rates and risk have been left to the sovereign decision of the insurance companies themselves. According to those regulations, supervision focuses on examining the financial solvency of insurance companies, *i.e.* on analysing their coverage of certain legally defined indices. The lack of power to control premiums has caused considerable problems.

Insurance companies competed ruthlessly over clients in order to increase their revenues from premiums, which resulted in a premium reduction below their risk and financial capacities. Many insurance risks were also accepted irrespective of their quality and the probability of eventual damages. This caused an extreme growth in premiums without a sufficient corresponding increase in solvency margins and technical provisions.

The bankruptcy of Westa in 1992, the third largest insurance company in Poland is a typical example. Since insurance premiums were not controlled, Westa could offer various kinds of products without risk evaluation. The company was prepared to insure anything that was of any value to a client. For example, it offered insurance against AIDS, insurance against inflation and insurance against delayed customs duties. The products offered by Westa were often underpriced. Booth and Stroinski (1994b) describe:

"In order to capture a large share of the market, Westa offered cheaper rates than the state companies. The premium income was growing so fast that it misled Westa's management and supported false confidence about the company's financial state. Westa accepted risks even where other companies would have rejected them. Allegations were made that risks were sometimes accepted without thorough inspections of what was actually being insured. Large losses were also incurred on many credit guarantee insurance policies due to inexperience in that line of business."

PTU Gryf S.A., another of the largest companies in Poland going bankrupt in 1996 committed the same error as that of Westa. An agent of Gryf explained that

"The firm was paying up to 46% commission on policies. Consumers were willing to buy Gryf products since they were much cheaper, even 40-45% cheaper than those in other companies." (Polityka (1996))

This situation is aggravated by the fact that the amount of insurance claims data available is generally limited in economies in transition. This makes tariff calculation difficult. Without adequate data, supervisors also find it difficult in monitoring premium levels. In the past, only the state monopoly possessed historical claims data. However, even these are no longer reliable as the situation has been changing rapidly over the past few years.

Inadequate information on companies

Accounting information on companies is far from perfect. In addition accounting practices often fall short of international standards. This prevents stakeholders from exercising proper control and complicates the task of insurance supervisors. Accounting information is difficult to interpret in the early stages of transition. Inadequate disclosure is also an impediment to effective market discipline. In addition, organisations such as rating agencies which could provide financial analysis of economic entities are not yet active. These make it difficult for consumers to choose a sound insurance company and for insurance companies to evaluate the credit risk of other companies.

The majority of the economies in transition have not yet established a specific accounting system for the insurance sector. The difficulty in evaluating the financial condition of insurance companies often causes delays in intervention by the supervisory authority and eventually prolongs the problems of insurance companies.

The insurance supervisory authority in Poland emphasises that the following modifications are urgent and essential for preventing further irregularities in the market:

- the immediate introduction of accounting models for insurance companies;
- the specification in a single legal act of binding accounting principles for insurance companies, providing precise principles for the creation of technical provisions;

Financial control

The financial control of insurance companies is in many cases also not stringent enough. This aggravates the problems of insurance companies. For example in Poland, Westa's technical provisions in 1991 and 1992 were seriously under-reserved and asset investment was in-sufficiently controlled. Booth and Stroinski (1994b) describe:

"Westa's reserves constituted only 20.8 % of its premium income, while Warta's (a former state-owned company) reserves were over 100%. This, combined with the defaulting of risky investments, as well as minimal cash assets, resulted in Westa losing its financial liquidity. Major loans were made to private companies which then defaulted. No attempt was made to match assets and liabilities. The reserves backing short-term policies were often devoted to buying real estate, a long-term investment."

Inappropriate reinsurance also caused financial instability. Many insurers do not understand the necessity of reinsurance treaties and treat them as an unnecessary cost. Some bankrupted insurance companies had no reinsurance contracts what so ever. Others had often insufficient reinsurance for their most damaging risks.

At the same time reinsurance is in general a difficult area for supervisors to control. The Latvian authority mentioned that Latvian insurers often co-operate with quite obscure insurance companies, the financial situation and stability of which are unknown quantities (particularly, companies registered on offshore territory).

Financial difficulties of insurance companies and limited remedial measures and experience

As there was little experience of remedial measures, insolvency or winding up during the command market, the insurance authorities have often faced difficulties in managing financial troubled companies. In addition, the remedial measures have often not yet well established.

For example, in Romania the remedial procedure is usually slow and inefficient due to the lack of legal provisions regarding the treatment of a troubled company. The recovery plans drawn up for the troubled companies are based on the insurance supervisor's recommendations but the insurance companies hardly ever accept the terms of these recovery plans.

In most of the economies in transition, an appointed management board is introduced too late. This possibility depends on situations wherein a company's own funds are lower than the required minimum guarantee capital, resulting in a loss of liquidity, and for this reason, the appointed management board cannot rescue the insurance company in time. In practice, the function of the appointed management board is limited to taking inventory of the company's assets and looking for an investor. It is already too late for any type of remedial action. Furthermore, it is not clear who is the appointed management board's employer and what its responsibilities are in the event of the announcement of an insurance company's bankruptcy. There is also the very serious problem of finding appropriate candidates for appointed managers. The emerging market does not in general, have enough appropriate personnel with the relevant knowledge and experience needed to fill such a position. Persons with such knowledge have long been employed elsewhere and are not usually prepared to engage in such uncertain and unappreciated work.

In the case of Poland, protection of policyholders' interests is even more difficult, since the legislation prescribes that an insurance company's technical provisions be transferred along with an equivalent value of the portfolio. In view of the fact that in principle, it becomes necessary to transfer the portfolio when the insurance company does not have sufficient assets to cover the technical provisions, one of the best ways of protecting the interests of insured parties cannot be properly applied.

In Russia, there are no provisions with regard to transferring the portfolio of troubled companies.

The situation is similar in respect of sanctions applied by the supervisory authority. Fines imposed upon management boards are sometimes refinanced by supervisory boards and fines imposed on companies are refinanced by their clients.

In several economies in transition, the regulations concerning the reimbursement of claims in the event of an insurance company's insolvency require improvement in order to protect policyholders. In many cases, such claims are reimbursed only when bankruptcy is announced. While in cases where bankruptcy is not announced because the company's assets do not suffice to cover bankruptcy procedure costs, this means that claims can not be reimbursed by the insurance guarantee fund. In several economies in transition, there are no policyholder protection measures which enable reimbursement of claims in the event of an insurance company's insolvency.

6.2.2.2 Shortage of insurance experts

An insurance system will not function properly without capable and experienced professionals. At the initial stage of economies in transition, however, there is usually a shortage of insurance experts, a situation which allows any person with a few years of limited experience in insurance to be considered an expert. This situation, combined with lax control and supervision of the market has made insurance markets in this region vulnerable. This is a problem for the insurance market as a whole, *i.e.* not only for insurance supervisors but also insurers and professionals such as actuaries and auditors.

According to the Latvian insurance authority, there is a considerable shortage of well-trained insurance specialists since even now, professional education in insurance is not available. The Polish insurance supervisory authority has insisted that the first priority for market stability is continued effective professional training for the employees of the supervisory authority, insurance companies, investigation authorities, state treasury organisations, state inspection authorities, chartered auditors and consumer organisations.

For example, in Poland the financial statements of all of the five bankrupted insurance companies were approved by chartered auditors who did not perceive any irregularities or risks and thus gave the supervisory authority their assurance that the companies' situation was as presented in those statements. Only later inspections by the supervisory authority showed that the chartered auditors failed to audit certain balance sheet items, in particular, the technical provisions. Even internationally recognised auditing firms have been known to make punishable errors, which have resulted in the financial statements of insurance companies being untrustworthy.

6.2.2.3 A narrow capital base

Capital shortage is a major problem in insurance markets in the economies in transition though the situation is improving gradually. The main reasons for it are the unstable economic situation, limited savings and the underdeveloped state of capital markets.

For many insurance companies in this region, even strict cost savings and the achievement of reasonable profit with a growth in premiums are not enough to create a sufficient capital base that supports rapid business increase. Economic entities are, in general, not interested in investing in insurance companies. In particular, in times of insurance company's financial difficulty, there are usually no entities which could take over the company.

In several countries, the situation has been aggravated by extremely prudent policies for introducing foreign capital. Russia, Belarus and Ukraine do not permit majority share holdings by foreign investors. Poland was also prudent in the introducing of foreign capital until the beginning of 1996. For example, Polityka (1996) describes:

"When PTU Gryf was in financial trouble in 1995, the consortium PBK-Winterthur (a Swiss insurance company) had almost decided to take over PTU Gryf's portfolio as well as its liabilities, employees and insurance agents with a low interest loan provided by the policyholder protection fund. However, PZU (the former state monopoly) and some other Polish insurance companies formed a consortium proposing a counter-offer to take over only the liabilities from compulsory insurance policies issued by PTU Gryf with expenses lower than those proposed by PBK-Winterthur. Finally, PZU's offer was chosen but PZU withdrew its proposal after the final decision. Thus Gryf had no other choice but to go bankrupt."

From mid 1996, foreign capital has been accepted more positively in the Polish insurance market and has contributed to saving possible policyholder losses, for instance, in the case of Allianz-BGZ's arrangement with the bankrupt company, Fenix.

6.2.2.4 The dominance of the former state monopoly

In most of the countries in transition, the former monopolies still possess dominant market shares. Several countries in transition have converted their state insurance companies into joint stock companies. However, in general the speed of privatisation is slow and the state still owns the majority of shares. State-owned companies have a long tradition and are well known in the country. They are believed to be secured and safe from bankruptcy. In such circumstances, it is difficult to introduce competition.

Under the circumstances existing in the early 90's in Poland where the supervisory authority had no power to control insurance premiums and no statistical base for calculating premiums had been established, most of the companies based their premiums on PZU (the former state monopoly) premiums, offering their own rates which were usually lower than those of PZU. Otherwise they could not have competed with PZU. This in all certainty meant that they were below cost, because PZU (due to its organisational structure) has relatively low solicitation and administration costs and none of the new companies could equal PZU in these terms and simultaneously build sales networks. Moreover, taking into consideration the fact that PZU premiums were in many cases (especially that of automobile insurance) lower than cost, it is obvious that it was this practice of reducing premiums to gain sales against PZU ruined the new companies financially.

CHAPTER 7: EVALUATION OF EXISTING SYSTEMS AND INTRODUCTION TO REGULATORY MODEL

This chapter first evaluates existing systems in economies in transition using the analysis in Chapters 3,4 and 5 and classifies the development of economies into three stages. Based on this evaluation and the analysis of failure presented in Chapter 6, the author argues that the insurance system in economies in transition did not function properly because regulators and supervisors did not follow appropriate policy measures in each development stage. This policy mismatch, i.e. the mismatch between market situations and appropriate policy measures, was a major factor in the failure of market reform. The author then proposes a model for the insurance market reform taking into account the different levels of development.

The last section of this chapter points out the prerequisites for implementing this model, which are:

- an insurance system based on a market economy should be the goal of reform;
- macroeconomic structural policies should be sound and national authorities should commit themselves to market reform;
- reform of the system should be gradual and progressive.

7.1 Three levels of insurance market development

As seen in the previous chapters, the insurance markets in economies in transition have reached different levels of development, even though they have common characteristics, mainly due to the same origin of the command economies. The author classifies economies in transition into three levels according to the development of their insurance systems. In addition to the analysis conducted in Chapters 3, 4 5 and 6, this classification is the basis for the proposal of policy measures for insurance regulations and supervision in economies in transition as presented in the following section. The countries examined in this chapter are Russia and 10 countries signed an " European Agreement" with the European Union, i.e. Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The evaluation and tables which cover other countries in economies in transition (Albania, Belarus, Croatia, Moldova, Mongolia and Ukraine) in addition to above-mentioned 11 countries are found in the Appendix 3.

7.1.1 Criteria and analysis

In order to analyse the level of development of each economy in transition, the author has used the following four criteria for analysing insurance systems in economies in transition.

(1) Economic and market environments (see Table 7-1)

The sub-criteria in this part covers inflation rate, GDP growth rate, Market capitalisation/GDP and Private sector share/GDP.

(2) Market structure and development (see Table 7-2)

The sub-criteria in this part covers privatisation, market share of the former monopoly, market share of foreign companies, total premium/population and total premium/GDP.

(3) Licensing control system (see Table 7-3)

The sub-criteria in this part covers life and non-life activities, foreign establishment and minimum capital requirements.

(4) On-going supervision system (see Table 7-4)

The sub-criteria in this part covers control of technical provisions, audits, control of assets, control of solvency margin, control of motor third party liability, control of products and tariffs and policyholder protection measures.

Economies in transition are evaluated in each criterion and the overall evaluation taking into account the result of the evaluation by four criteria are analysed at the end (see 7.1.6 Conclusion).

As examined in the following chapters, these criteria are essential for evaluating insurance market developments for economies in transition.

7.1.2 Economic and market environments

Sound economic and market environments are preconditions for the development of insurance markets. These are examined according to the following four sub-criteria which relate in particular to the insurance business: growth in real GDP, inflation rate, private sector share of GDP and market capitalisation divided by GDP (see table 7-1). Analysis of each sub-criterion is explained below. In terms of economic and market environments, countries in this region are classified into the following three levels. Level III relates to those countries which have achieved robust GDP growth, a moderately low inflation rate, a market in an advanced stage of privatisation and a growing and relatively large capital market according to the standards for transitional economies. Countries corresponding to this level are the Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia. However, weaknesses have been observed

Table 7-1

Economic and market environments					
Country	**GDP growth**	**Inflation rate**	**Private sector share/GDP**	**Market capitalisation /GDP**	**Total**
Bulgaria	I	I	II	NA	**I**
Czech Republic	II	III	III	III	**III**
Estonia	III	II	II	II	**III**
Hungary	II	II	III	III	**III**
Latvia	II	III	II	II	**II**
Lithuania	III	II	II	I	**II**
Poland	III	II	II	II	**III**
Romania	I	I	II	I	**I**
Russia	II	II	II	II	**II**
Slovakia	III	III	III	I	**III**
Slovenia	II	III	II	NA	**III**

Note:

Inflation rate (1997)
less than 10% III
between 10%-20% II
over 20% I

GDP growth (1997)
more than 4% III
between 0%-4% II
less than 0% I

Market capitalisation / GDP (1998)
more than 0.25 III
between 0.10 and 0.25 II
less than 0.10 I

Private sector share/GDP (mid-1997)
more than 70% III
between 50%-70% II
less than 50% I

NA - data not available

Data sources: Transition report 1997 (EBRD)
Emerging Europe (ING Barings: April, 1998)
Baltic Securities Market (TALINVEST SUPREMA SECURITIES, April 1998)

in some areas of these economies: the Czech Republic's economic growth was rather slow in 1997 (1.0% growth) mainly due to difficulties in its financial markets. The inflation rate in Hungary (17%) and Poland (15%) was relatively high in 1997. At present, Slovakia's capital market is rather small in proportion to its economy.

Level II relates to countries with slow economic growth, a relatively high inflation rate and steady implementation of privatisation measures. Latvia, Lithuania and Russia belong to this level.

Level I are groups of economies with negative GDP growth, high inflation rates and slow privatisation . Bulgaria and Romania fall in this group.

7.1.2.1 GDP growth

Constant growth of the economy is essential for insurance market development. GDP growth is classified into the following three levels. Level III is that group of countries whose GDP growth is more than 4%, in other words, countries with high economic growth, more than 1% higher than the OECD average. Estonia, Lithuania, Poland and Slovakia belong to this group. Level II is that group of countries which have steady but slower economic growth of between 0 and 4%. The Czech Republic, Hungary, Latvia, Russia, and Slovenia fall in this group. Level I include countries whose GDP has been decreasing. The countries belonging to this level are Bulgaria and Romania (see table 7-1).

7.1.2.2 Inflation rate

Low inflation is an important macroeconomic precondition for sound insurance market growth, in particular, with regard to life insurance. The countries are divided into three levels in respect of this criterion. Level III is that group of countries with a relatively low inflation rate according to the standard for economies in transition (less than 10%). The Czech Republic, Latvia, Slovakia and Slovenia come within this category. Level II includes countries whose inflation rate is rather high but not so high as to have a serious negative effect on the economy (between 10 - 20%). Estonia, Hungary, Lithuania, Poland and Russia belong to this level. Level I is that group of countries which have suffered from high inflation (more than 20%). Bulgaria and Romania belong to this group (see table 7-1).

7.1.2.3 Private sector share in GDP

The progress achieved in privatisation is of vital importance to the insurance industry. Indeed, private ownership is a precondition for a developed private insurance system. Privatisation progress is classified into the following three levels according to private sector share in GDP. Level III includes those countries whose private sector share in GDP is more than 70%, equivalent to the private sector share in many OECD countries. Countries belonging to this category are the Czech Republic, Hungary and Slovakia.

Level II includes those whose private sector share is between 50 - 70%. This group consists of countries where the privatisation process has been in progress but has yet to reach the stage of developed economies. Bulgaria, Estonia, Latvia, Lithuania, Poland, Romania, Russia and Slovenia belong to this group (see table 7-1).

7.1.2.4 Market capitalisation by GDP

Development of the capital market is essential for sound insurance business, since this ensures good and various investment opportunities. An appropriate index of this aspect is market capitalisation by GDP, although available data is limited. The countries are divided into three levels. Countries in this region with relatively well developed capital markets in terms of the size of their economies are the Czech Republic and Hungary (Level III). Countries whose capital markets are relatively small in terms of their economies are Lithuania, Romania and Slovakia (Level I). Estonia, Latvia, Poland and Russia belong to the middle group (level II) (see table 7-1).

7.1.3 *Market structure and development*

Market structure and development in particular, the situation of former insurance monopolies, the presence of foreign insurers in markets, expenditure on insurance per capita and share of insurance industry in GDP are important barometers for judging the level of market competitiveness and development. Thus, in this section, market structure is examined by the following five sub-criteria, *i.e.* the level of privatisation of the former insurance monopoly, the present market share of the former state insurance monopoly, the market share of foreign insurance companies, total premium divided by population and total premium divided by GDP.

Table 7-2 shows that premium level per capita and premium divided by GDP for most of the countries are far lower than the EU average. The insurance market in those countries in general is still less developed than that in the EU. The countries examined have been classified into the following three levels with regard to market structure (see table 7-2). Level III is that group of countries where the former state insurance monopoly has already been privatised and its market share is nearly or already less than half. At the same time, new entities, in particular, foreign insurance companies are steadily gaining ground. Countries at this level are the Czech Republic, Estonia, Hungary, Lithuania and Slovenia. Level II is the group of

Table 7-2

Market structure and development						
Country	**Privatisation**	**Market share of the former monopoly**	**Market share of foreign companies**	**Total premium/ population (USD)**	**Total premium/ GDP (%)**	**Total**
Bulgaria	NA	III	I	I	II	**II**
Czech Republic	III	II	II	I	II	**III**
Estonia	II	III	III	I	II	**III**
Hungary	III	III	III	I	II	**III**
Latvia	II	II	NA	I	II	**II**
Lithuania	II	III	NA	I	I	**II**
Poland	I	II	II	I	II	**II**
Romania	I	II	II	I	I	**II**
Russia	I	III	I	I	I	**I**
Slovakia	II	I	II	I	II	**II**
Slovenia	II	III	NA	II	II	**III**

Note:

Privatisation
privatised (state minor share-holding) III
privatised (state major share-holding) II
not privatised I

Market share of the former monopoly (1995)
less than 50% III
between 50% - 70% II
more than 70% I

Market share of foreign companies (1995)
more than 20% III
between I and III II
less than 5% I

Total premium/population (1996)
more than 1600 USD (EU level) III
between 400 and 1600 USD II
less than 400 USD I

Total premium/GDP (1996)
more than 7%(EU level) III
between 1.5% and 7% II
less than 1.5% I

NA - data not available

Data sources: OECD Questionnaire (1997 &1998), drafted by the author
Hearings of the supervisory authorities by the author (1998)
Sigma 1994, 1995, 1996 (Swiss Re)
EEIR (1996)

economies where the former state insurance monopoly has been only partially privatised or not yet privatised. The market share of the former state insurance monopoly has steadily decreased and foreign companies have slowly increased their market presence. Bulgaria, Latvia, Poland, Romania, Russia and Slovakia belong to this group. However, Bulgaria and Russia do not admit foreign companies with major share holdings. Thus competition has been created only among domestic companies.

7.1.4 Licensing control

Strict licensing control is central to insurance supervision. The control of licensing is examined according to the following four sub-criteria: clear licensing control criteria, minimum capital requirements, regulation of foreign company establishment, and separation of life and non-life insurance activities, as shown in table 7-3.

Licensing control falls within the following three levels. Level III is comprised of countries which have developed licensing control approximately equivalent to that of developed insurance markets and do not discriminate against foreign insurance companies. The countries belonging to this group are Bulgaria, the Czech Republic, Hungary and Poland.

Level II consists of countries which have a reasonably well developed licensing control system but partly discriminate against foreign insurance companies. In particular, they do not admit branches of foreign insurance companies. Estonia, Latvia, Lithuania, Slovakia, and Slovenia belong to this category, although Slovenia's licensing criteria for foreign insurance companies do not admit fully foreign owned subsidiaries, nor branches of foreign insurance companies.

Table 7-3

Licensing					
Country	**Criteria**	**Life / Non-life activities**	**Foreign establishment**	**Minimum capital requirements**	**Total**
Bulgaria	II ; III	II ; III	III	III	**III**
Czech Republic	II ; III	I	III	III	**III**
Estonia	II ; III	II ; III	II	III	**II**
Hungary	II ; III	II ; III	III	III	**III**
Latvia	II ; III	II ; III	II	III	**II**
Lithuania	II ; III	II ; III	II	III	**II**
Poland	II ; III	II ; III	III(1)	III	**III**
Romania	II ; III	I	I(2)	I	**I**
Russia	II ; III	I	I	III	**I**
Slovakia	II ; III	II ; III	I	III	**II**
Slovenia	II ; III	II ; III	I	III	**II**

Note:

Criteria

clear criteria	II ; III
no clear criteria	I

Life / Non-life activities

separated	II ; III
not separated	I

Foreign establishment

100% foreign owned subsidiaries and foreign branches allowed	III
no foreign branch allowed but 100% foreign subsidiaries allowed	II
no 100% foreign owned subsidiaries and no foreign branches allowed	I

Minimum capital requirements

life equal or more than 0.8 million ECU and non-life equal or more than 0.4 million ECU (EU directives requirement)	III
between I and III	II
less than half of the level III (either life or non-life or both)	I

NA - data not available
(1) - foreign branches will be allowed from the beginning of 1999
(2) - foreign branches are allowed with limited business scope

Data sources: OECD Questionnaire (1997 &1998), drafted by the author
Hearings of the supervisory authorities by the author (1998)

Level I consist of countries whose licensing systems are weak and discriminate against foreign insurance companies. Countries belonging to this level are Romania and Russia.

7.1.5 On-going supervision

On-going supervision is essential for maintaining a sound insurance market. The level of on-going supervision is examined according to seven criteria: control of technical provisions, auditing examination, control of assets, control of the solvency margin, control of motor third party liabilities, control of products and tariffs and policyholder protection measures, as shown in table 7-4. The level of control is classified into the following three levels: Level III is composed of countries with a relatively developed control of technical provisions, assets and solvency margins. Motor third party liability insurance is compulsory on the basis of the market economy system and products and tariffs are properly controlled. Policyholder protection measures are well established. The Czech Republic, Estonia, Hungary, Lithuania, Poland, Slovakia and Slovenia are at this level. However, the Czech Republic and Slovakia constitute exceptions to this level by maintaining a compulsory motor third party liability insurance system that is carried on only by the former state monopoly on a non-contractual basis. Estonia and Poland do not control products and tariffs. The policyholder protection measures conducted by Hungary and Slovakia are weak in comparison with the other countries at this level.

Level II is comprised of countries with on-going supervisory systems that are less elaborate than those of level III. They will require much more improvement in order to reach the standards of developed on-going supervisory systems. Countries belonging to this level are Bulgaria, Latvia, Romania and Russia.

Table 7-4

On going supervision								
Country	**Control of technical provisions**	**Audits**	**Control of assets**	**Control of solvency margin**	**Control of MTPL**	**Control of products and tariffs**	**Policyholder protection measures**	**Total**
Bulgaria	II	II ; III	NA	II	III	NA	III	**II**
Czech Republic	III	II ; III	II ; III	III	II	III	NA	**III**
Estonia	III	II ; III	II ; III	III	III	I	III	**III**
Hungary	III	II ; III	II ; III	III	III	III	II	**III**
Latvia	II	II ; III	II ; III	III	III	III	III	**II**
Lithuania	III	II ; III	II ; III	II	I	II	III	**III**
Poland	III	II ; III	II ; III	III	III	I	III	**III**
Romania	II	II ; III	II ; III	II	III	II	II	**II**
Russia	II	II ; III	II ; III	III	I	III	I	**II**
Slovakia	III	II ; III	II ; III	III	II	III	II	**III**
Slovenia	III	II ; III	II ; III	III	III	III	III	**III**

Note:

Control of technical provisions
general principles and calculation guidelines III
general principles II
no control I

Audits
auditors examination II ; III
no auditors examination I

Control of assets
general principles and established evaluation measures II ; III
no control I

Control of solvency margin
effective solvency margin control (EU equivalent) III
simple solvency margin control II
no control I

Control of MTPL
MTPL system compulsory (not monopoly) III
MTPL is compulsory but dealt only by the former monopoly II
MTPL is not compulsory I

Control of products and tariffs
control based on statistics III
general control II
no control I

Policyholder protection measures
policyholder protection measures (both prior to bankruptcy and in liquidation procedures) III
policyholder protection measures (either prior to bankruptcy or in liquidation procedures) II
no policyholder protection measures I

NA - data not available

Data sources: OECD Questionnaire (1997 & 1998), drafted by the author
Hearings of the supervisory authorities by the author (1998)

7.1.6 Conclusion

According to the above analysis, economies in transition can be classified into the following three levels. The chief tasks and measures for insurance market reform at each level of development are analysed comprehensively in the following sections and Chapter 8.

7.1.6.1 Level I

This is the situation following the collapse of the command economy. These economies have still to recover from recession, following the market transformation. These countries are suffering from negative or low economic growth and high inflation rates as well as slow privatisation process throughout the economy. The insurance market has simply inherited the system of the former communist regime. The former state insurance monopoly has not yet been privatised and maintains a dominant market share. The new insurance system, *i.e.* an insurance law corresponding to a market-oriented economy, an insurance supervisory system and insurance accounting system, has yet to be established. The licensing system is weak and discriminates against foreign insurance companies. Experts on market-oriented insurance systems have yet to be found. The eleven countries examined in this Chapter do not fall in this level. (Countries corresponding to this level are Albania, Belarus, Moldova, Mongolia and Ukraine. However, it should be noted that Belarus, Moldova and Ukraine constitute exemptions in this group, having already established basic on-going supervisory systems. See Appendix 3)

7.1.6.2 Level II

With regard to economic and market environments, countries at this level maintain slow economic growth. Inflation rates are still high and privatisation is implemented steadily but rather slowly.

Although the basic market infrastructure and supervisory authorities have been established, there is still much to be done to build up a sound insurance market. Insurance laws are not yet comprehensive, or else, their provisions are still not stringent enough and fail to correspond to the dynamically evolving market. Insurance authorities are still on the way to establishing supervisory practices. A self regulatory system is not yet functioning. Internal control is carried out, but it is not yet sufficient. Privatisation of the state monopoly has not yet started or completed. Relevant information is not yet fully available for supervisors, insurance industry or customers. Customers still lack confidence in new insurance products and companies. The former state monopoly, although now not the only company in the market, still possesses a considerable market share. At the same time, small companies have been established and are struggling to win new customers. Some of them are already in financial trouble, due to lack of experience, lack of capital or mismanagement. Since supervision of intermediaries is not yet sufficiently stringent, illegal sales by unauthorised insurance companies are often observed in the market. The importance of obtaining expertise and foreign investment capital is recognised. However, the market in general behaves cautiously toward them.

Although co-ordination with other supervisors in other financial fields or in other countries is becoming important, the proper arrangements have yet to be established.

Countries belonging to this level are Bulgaria, Latvia, Lithuania, Romania and

Russia.

There are some deviations from the general situation explained above. In the case of Bulgaria and Romania, although they have already established a basic insurance supervisory system, they are suffering from troubled economic situations. Their GDP growth is negative and inflation rates are high.

7.1.6.3 Level III

Countries at this level have been achieving a robust GDP growth, moderately low inflation rates, advanced stages of privatisation and relatively large capital markets according to transitional economy standards. With regard to the insurance market, the former state insurance monopolies have already been privatised and their market share is relatively low, *i.e.* nearly or already less than half. At the same time, new entities, in particular, foreign insurance companies are steadily gaining ground. These countries have developed licensing controls that approximate those of developed insurance markets. They have likewise already developed controls of technical provisions, assets and solvency margins that approximate those of developed insurance markets. Motor third party liability insurance is compulsory, in line with the market economy system and products and tariffs are also properly controlled. Appropriate policyholder protection measures have been established. Since the market is sufficiently organised and well controlled, the insurance authorities are considering measures to liberalise the market and thus increase its efficiency.

Countries close to this level are the Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia. However, all these countries still have to further develop insurance infrastructure and regulations and to make regulations and supervision functional and effective in order to reach the level of developed insurance markets. Thus, this level is close to the level III but remains main characteristics of the level II. For example, the Czech Republic and Slovakia have a compulsory motor third part liability insurance that is only handled by the former state monopoly on a non-contractual basis. In addition, the insurance market in Slovakia is still dominated by the former state monopoly, whose market share is more than 70%. In the case of Estonia and Poland, no control of products and tariffs has yet been introduced. In Poland, privatisation of the former state monopoly has not yet been implemented and this still maintains a considerable market share. As regards policyholder protection measures, Hungary and Slovakia have yet to establish proper measures. Slovenia still maintains a licensing control system that discriminates against foreign insurance companies even in the form of subsidiaries. It does not admit fully foreign-owned subsidiaries.

7.2 Mismatch between the market situation and appropriate supervisory policy measures and introduction to the model

As examined in Chapter 6, the fundamental challenge for the insurance markets in economies in transition is that they have faced a situation unprecedented in history, i.e. the transformation from an insurance market based on a command economy to that of a market economy. As they have no experience of such a reform, the insurance policy-makers and supervisors have had difficulty in establishing effective policies that take into account their particular environments. We have seen that the unstable insurance market in economies in transition has only aggravated this situation. Similar mistakes have been repeated in the various countries in transition. In order to solve these problems, a concrete insurance market reform model that takes account of the social economic and legislative development of the market should be established.

7.2.1 The first stage (level I)

The initial stage for economies in transition relates to the situation where a country simply inherits the insurance system of the former communist regime after the collapse of the command economy and where a new insurance regulatory system on the basis of the market economy has yet to be established. As seen in Chapter 6, the most serious mistakes have been observed at this stage of the transition.

Taking into account the past mistakes by supervisors at the initial stage of the economies in transition, the regulator and supervisor should at this stage focus on creating an essential market infrastructure, including legislation, accounting standards and a reliable database. In particular, prudential insurance supervisory systems such as a strict licensing system, a proper financial control system, product and tariff control and a remedial system are essential. In addition, proper institutional governance should be fostered in order to ensure sound management. At the same time, the enforcement body of the regulations, i.e. the insurance supervisory authority, should be established and function effectively.

A mismatch frequently occurs between the market situation and appropriate supervisory policy measures at this stage is the failure to establish these essential infrastructures and systems in time. The analysis of Chapter 6 proves that lax control and forbearance in supervision, in particular with regard to licensing control, product and tariff control and financial control has often induced the failure of insurance companies. Lack of essential information on companies and products, limited remedial measures and experience and poor corporate governance aggravate the situation.

As analysed in Chapter 2, in order to encourage international insurance transactions, a liberal policy towards the transaction of insurance services that would be endorsed by a minimum control of products is important. However, as seen in Chapter 6 (see 6.2.2.1, Lax control and supervision), the lack of power to control products and premiums at the initial stage of economies in transition has led to financial difficulties in insurance companies. This situation is due to the fact that economies in transition have yet to establish attendant prudential regulatory and supervisory systems at the initial stage. Product and tariff control should be liberalised in parallel with the introduction of attendant regulatory and supervisory systems. The situation in Poland at the initial stage of transition, i.e. in the early 1990s, demonstrates that liberalisation before the establishment of prudential regulations creates an unstable market situation and, consequently, delays the insurance market reform. Thus, product and tariff control should be liberalised not at the initial stage of economies in transition (level I) but at the late stage (level III), once the basic regulatory and supervisory infrastructure has been established and is functioning effectively. This order should not be reversed, to ensure the sound transition of the insurance market.

7.2.2 The second stage (level II)

The second stage is where the minimum market infrastructure and supervisory authorities have been established, although there is still much room for improvement in order to establish a sound and robust insurance system. The goal at this level is to make regulation and supervision functional and effective and to foster market mechanisms that will ensure the system's operation.

A mistake often made at this stage in the past was the slow introduction of the policy on non-discrimination against foreign insurance companies. Financially stable insurance companies operated by reliable and prudent management are central to a sound insurance market. In this respect, an insurance authority should not discriminate against foreign insurance companies in its licensing control and other supervisory measures. Indeed, sound foreign insurance companies can be good sources of technological, organisational and managerial skills as well as capital, and can contribute to improving consumer services (see 8.2.4.2, Non-discrimination against foreign insurance companies). However, several economies in transition (Albania, Belarus, Romania, Russia, Slovenia and Ukraine) have yet to authorise wholly foreign-owned insurance companies. The majority of economies in transition have yet to authorise branches of foreign insurance companies. This is often due to political considerations to protect domestic insurers. However, in view of policyholders' interest, such discrimination cannot be justified. In particular, the countries whose insurance reform has generally made good progress, such as Slovenia, should not take any discriminatory measures against foreign insurance companies.

Another major mistake at this stage is delay in reforming the former state monopoly. Privatisation and reform of the former state monopoly are essential to market reform and should be implemented during the initial stage. But the majority of the CEECs have yet to privatise the former state monopoly and it still dominates the market. Even the countries in which market reform has generally been progressing well and has already passed the level II development stage, such as Poland, have not yet privatised the former state monopoly. This situation creates a considerable obstacle to sound market development. In the case of the Czech Republic and Slovakia, although the privatisation of the former state monopoly is under way, only the former state monopoly is authorised to deal with automobile third-party liability insurance. Given that this product is the major product in the market, this situation prevents proper competition and preserves the dominance of the former state monopoly in the market.

Taking into account these mismatches between the market situation and appropriate supervisory policy measures in the past, the regulator and supervisor at this stage should focus on reinforcing the regulatory and supervisory system and promoting market mechanisms such as ensuring information disclosure, non-discrimination against foreign insurance companies and completion of reform of the former state monopoly. Co-operation with insurance supervisors in other countries should be also strengthened at this stage so that insurance transactions with foreign countries can be properly monitored.

7.2.3 The third stage (level III)

The third level is where countries already have a relatively developed insurance market and where organised insurance regulations and a supervisory system have already been established. No economies in transition have yet reached this stage of development, although some countries (the Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia) are close to this level.

At this level, countries should start considering measures to liberalise the insurance market. The goal at this level is to foster competition in the insurance sector by removing unnecessary restrictions and at the same time to further strengthen prudential regulations and supervisory measures in order to ensure the system's efficiency. Countries at this level should examine the international codes or treaties, in particular the OECD Code of liberalisation of current invisible operations and the WTO General Agreement on Trade and Services (see 8.3, Third level of development).

7.2.4 Common task for all levels

Even if a sound insurance system has been created, it will not function without professional staff to manage the system effectively. Economies in transition at all levels of development are facing a shortage of such qualified staff and a functional training system to maintain and improve their skills. One of the essential tasks for the insurance supervisory authority is, therefore, to establish an employment system to hire, train and maintain professionally qualified staff. This is still underdeveloped in economies in transition, which creates difficulties in managing the supervisory authority and, consequently, conducting effective supervision. Thus, the employment system should be reinforced at all levels of development.

Table 7-5 on the next page summarises the three-level development model described above.

*7.3 **Basic premises for implementing the model for insurance supervision***

On the basis of the analyses in previous chapters including 7.1 Three levels of insurance market development, the author proposed appropriate policy measures for each development stage (level I, level II and level III), i.e. the model for the insurance supervisory system reform described in the previous section, and pointed out mismatches between the market situation and appropriate supervisory policy measures.

Before discussing the comprehensive implementation of the model in the next

Table 7-5 Model of the three levels development

Levels	Main characteristics(*)	Goals(**)	Name of countries(****)
Level I	– The continuing situation following the collapse of the command economy; – Not recovering from recession; – Simply inheriting the insurance system of the former communist regime; – A new insurance system (regulation and supervisory authorities) that has yet to be established	**Establishment of a system:** – Establishing the essential market infrastructure; – Introducing prudential regulations and a supervisory system; – Establishing training systems for supervisors and regulators	Albania, Belarus, Moldova, Mongolia, Ukraine
Level II	– Basic market infrastructure and supervisory authorities established; – Not yet establishing a robust insurance system; – Slow economic growth; – High inflation rate; – Slow implementation of the privatisation process; – Cautious concerning the entry of foreign insurance companies	**Ensuring the system's operation:** – Developing further infrastructure and regulation; – Making regulation and supervision functional and effective; – Fostering market mechanisms	Bulgaria, Croatia, Latvia, Lithuania, Romania, Russia
Level III	– A relatively developed insurance supervisory system; – Appropriate policyholder protection measures; – Robust economic growth; – Moderately low inflation rates; – Advanced stage of privatisation; – Relatively large capital markets; – Measures to liberalise the insurance market being considered	**Ensuring the system's efficiency:** – Fostering competition in the insurance sector by removing unnecessary restrictions; – Further strengthening prudential regulations and supervisory measures	Between Level II and Level III:(***) The Czech Republic, Estonia, Hungary, Poland, Slovak Republic, Slovenia

Notes: (*) Comprehensive analysis is described in the section 1 of Chapter 7
(**) Comprehensive analysis is described in Chapter 8
(***) These countries fall between level II and III
(****) See Section 1 of Chapter 7 and Appendix 3.

chapter, the author will review the basic premises for realising the model for insurance supervision in economies in transition. These are as follows:

7.3.1 The goal for reforms: an insurance system based on a market economy

The final goal for reform leading to a market economy is to establish and maintain an efficient, fair, safe and stable insurance market. For that purpose, subject to prudential regulations and supervision enforced by an effective supervisory authority, competition in the insurance market should be fostered by removing unnecessary restrictions, ensuring information disclosure and allowing the participation of sound insurance companies regardless of their nationalities.

7.3.2 Sound macroeconomic and structural policies and commitments from national authorities

Sound macroeconomic and structural policies are essential to the stability of the insurance system and in order to prevent serious market distortions. Without overall economic stability and the basic financial and legal infrastructure, the insurance industry will not be able to develop properly. There must also be a sufficient political and social consensus concerning the measures needed to establish and maintain sound insurance markets. National supervisors or regulators who are strongly committed to developing sound principles for their systems will be the key to market reform.

7.3.3 Step by step approach and flexibility

As past experience in the reform of insurance markets in economies in transition has proved, a sound insurance system can not be created by merely copying a developed insurance market's system or by depending only on market mechanisms.

A sound and robust insurance system takes shape through a combination of such elements as macroeconomic conditions, general legal systems, basic insurance infrastructure and accumulation of experience and expertise. An insurance system should correspond with market realities and thus requires time to become established. Since market situations can not be changed suddenly, reform of the insurance systems in economies in transition should be gradual and progressive. A step by step approach harmonised with market environments is essential to a smooth transformation. In addition, since market conditions are in a constant state of flux in transition economies, the system should be flexible so that it can adapt to them. Governments should not stick rigidly to particular policies which do not correspond to market realities. They have to modify their policies in the light of changes in the economy. The authorities should be constantly improving the system. In this regard, the basic framework should be stated in basic laws but detailed measures should be stipulated in governmental decrees or administrative regulations.

CHAPTER 8: IMPLEMENTATION OF REGULATORY MODEL

This chapter presents a way towards achieving a developed insurance market by demonstrating precise practical policy guidelines for insurance regulators and supervisors in economies in transition.

In 7.2, the author introduced the three-level development model for insurance market reform in economies in transition on the basis of the analysis presented in the previous chapters (see Chapters 4, 5, 6 and 7.1). This chapter develops comprehensively this model for insurance market reform and discusses how to implement it correctly.

Naturally, the points on which regulators and supervisors should focus differ depending on the development stage of the market. At the same time, some measures described with respect to a certain level of development are not necessarily limited in their effectiveness to that stage but are also relevant to development at other stages.

8.1 First level of development: establishment of a system

8.1.1 Goals

The goal at this stage is to establish an insurance system based on a market economy. In particular, insurance authorities should focus on the following three points:

- Establishment of the essential market infrastructure
- Introduction of prudential regulations and a supervisory system
- Establishment of training systems for supervisors and regulators

Since the insurance market is dynamically evolving even without any new rules or supervision, the crucial point at this level is to create an adequately sound, if not perfect system without delay. Slow implementation will result in problems accumulating and market deterioration.

8.1.2 Creation of essential market infrastructure

Without appropriate market infrastructure, insurance market mechanisms do not work effectively. The following infrastructure could be regarded as essential in this sense; legislation, accounting standards, reporting system, professionals (actuaries and auditors) and reliable databases.

8.1.2.1 Legislation

Insurance legislation is essential for a sound, robust insurance system. Other legislation indispensable to the insurance sector such as commercial codes, civil codes, company law and tax law should also be established at the same time. A legal environment should be fostered so that the terms and conditions of contracts are observed and legal recourse is possible without delay. High-quality insurance regulations and standards assure market participants that sound practices are being applied, thereby increasing market transparency and confidence.

Most countries in Eastern and Central Europe have already introduced basic insurance legislation which is compatible with that in EU countries. The main task for such countries is to introduce more specific prudential rules and to implement them effectively in their own markets.

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

8.1.2.2 Accounting standards

Accounting is a form of communication between an economic entity and other interested parties. OECD (1993) points out that in command economies, the central planning agencies and the government were the only interested parties. However, in market economies the range of interested parties should include investors and consumers as well. Indeed, accounting systems are central to the provision of the information needed by such interested parties with an actual or potential stake in the enterprise so that they can make reasonable assessments of the effectiveness of the enterprise' s operations and assess its future prospects.

Insurance legislation can only play its intended role where reliable information exists. The supervisory authorities should have regular access to reliable information on insurance companies, since the lack of such information was often the reason for the belated discovery of financial problems in insurance companies, and why supervisors failed to prevent many companies from going bankrupt.

The accounting system should establish rules which will be applied uniformly to all insurance companies and which are compatible with internationally accepted accounting standards. As mentioned earlier, the accounting system in a command economy was a cash-basis system since it focused on cash received and paid out. This needs to be changed to a system focusing on premiums earned and claims incurred (accrual basis).

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 understood without ambiguity. The information, provided should be accurate, relevant and transparent. It should also be comprehensive, timely and provided to the relevant parties on a regular basis.

8.1.2.3 Reporting system

The financial statements of insurance companies should be carefully designed, as should also the supervisory returns filed with the supervisory authorities. Many insurance companies face various types of problems, including inadequate reserves, under-capitalisation and inappropriate investment strategies. In such circumstances, obtaining the right information at the right time is critical to effective supervision.

The use of information technology should also be considered. The Polish supervisory authority is currently planning to introduce standardised comprehensive quarterly supervisory returns, to be filed by electronic mail by each insurance company.

In many OECD countries, the directors of insurance companies must be able to show a certificate attesting compliance with regulations. Actuaries must certify that assets cover liabilities. Such certification should be required for both life and non-life companies as well as for any reinsurance companies operating in the market.

8.1.2.4 Professionals (actuaries and auditors)

Actuaries and auditors play an important role in ensuring that accounting standards for insurance businesses are properly applied and maintained, and in monitoring the quality of internal control procedures. In the UK, for example, actuaries with recognised expertise are responsible for valuing long-term liabilities, checking that assets match liabilities and that the required solvency margin for long-term business is complied with. In addition, they are responsible for monitoring the financial statements of insurance companies. Auditing companies often hire actuaries to double-check the accuracy of valuations of reserves and assets. On top of that, the Department of Trade and Industry, in co-operation with the government actuary's department, supervises the financial soundness of insurance companies. Hence, an insurance company is monitored by a plurality of professionals, all of whom possess a high level of expertise. In some other developed insurance markets, the scope of the actuary's profession is even wider, covering the calculation of technical reserves of non-life insurance business and premium rates. In these countries, the qualifications of actuaries and auditors are regulated or there is a code of conduct.

The work of the actuaries thus backs up the work of the supervisory authority. Insurance supervisors in countries in transition should encourage the development of education and training for actuaries and auditors. They should also encourage the formation and development of strong professional bodies whose function includes enforcing professional standards, ensuring adequate professional development, taking disciplinary action against members when necessary, and developing and issuing appropriate standards of practice.

8.1.2.5 A reliable database

Reliable basic data are an essential tool for effective market discipline. In particular, insurance premiums are calculated on the basis of the law of large numbers. For this reason, the availability of reliable data such as loss frequency and loss severity is indispensable for calculating insurance premiums and technical provisions correctly. They are also crucial for monitoring the solvency of insurance companies and ensuring the stability of insurance markets.

The accurate assessment of the real cost of insurance products is an important challenge for economies in transition. In many cases, an insurance company does not have enough past insurance policies to create a reliable database, or the system of data collection itself is not yet functioning properly.

Insurance authorities and insurance companies should therefore establish a reliable claims database to enable them to determine the right prices for various categories of products. At the same time, insurers should co-operate on the collection of claims data.

Prudential methods of estimating influential factors such as the rate of inflation should also be established. The importance of such methods should not be underestimated as these factors still present great uncertainties and inhibit the development of an insurance market.

8.1.3 Creation of the insurance supervisory body

Insurance legislation can play its proper role only if an enforcement body *i.e.* an insurance supervisory body is established and functions effectively.

The insurance supervisory authority should:

- have the power to license insurance companies, apply prudential regulations, obtain and independently verify relevant information, engage in remedial action and execute portfolio transfer, and apply sanctions against insurance companies which do not comply with the injunctions of the supervisory authorities (*i.e.* restrict totally or partially 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).

- be independent of both political authorities and supervised companies in the daily execution of its tasks, and be accountable for the use of its powers and resources to pursue clearly defined objectives.
- have wide knowledge and experience ranging from actuarial science to contract law.
- have a reliable and stable source of funding to safeguard its independence and effectiveness.
- have the powers and sufficient resources to co-operate and exchange information with other authorities both at home and abroad.
- establish an employment system to hire, train and maintain a professionally qualified staff.

At the same time, the insurance supervisory authority must respect strict professional secrecy and arbitrary intervention by the administration must be prohibited by law. Except for 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 decisions it makes within the framework of the mandate conferred upon it by the owners of the company.

The supervisory authority should co-operate closely with other related government bodies or insurance institutions, such as ministries, tax offices or insurance guarantee funds so that its assigned tasks are properly carried out.

8.1.4 Introduction of prudential supervisory and regulatory measures

Given the high-risk (insurance risk, investment risk, credit risk...) environments in economies in transition and the limited experience and expertise of insurers, prudential regulations should be given particular emphasis.

8.1.4.1 Strict licensing system

Starting an insurance business requires a considerable amount of capital, special expertise, reliable management and an elaborate business strategy. For this reason, companies wishing to transact business in the insurance market must be licensed. In effect, licensing is the main means of preventing unsound insurance companies from entering the market. It allows supervisory authorities to concentrate on preventive measures rather than expending considerable time and energy on dealing with insurance companies which have got into trouble.

In several economies in transition, too many insurance companies were able to enter the market because the licensing requirements were too lax *i.e.* low initial capital requirements and inadequate examinations. For example, the number of insurance companies in one country increased by more than 200 during the first 3 months of 1994. The minimum share capital requirement was equivalent to only US$ 5 000. Some other countries were in a similar situation. Their basic logic was that a large number of insurance companies would encourage competition and thus help to establish a sound insurance market. However, this quickly proved not to be the case. As a result of inadequate licensing requirements, many undercapitalised and poorly managed companies entered the market. Those companies sometimes embarked upon aggressive expansion strategies without maintaining sufficient technical provisions and thus went bankrupt after collecting significant volumes of insurance premiums. Some countries have been trying to consolidate small insurance companies but in practice this is a very difficult task.

These examples show that it is essential to scrutinise the nature and adequacy of the financial resources of insurance companies by analysing their business plans and setting minimum capital requirements. Angerer (1993) explains that minimum capital comprises share capital or relevant funds and the organisation fund. The share capital or relevant funds must be permanently available while the organisation fund is used up over a number of years to meet the purposes for which it was intended. The minimum capital requirement should be set sufficiently high to prevent the establishment of undercapitalised companies.

The supervisor should also consider the suitability of owners, directors and/or senior management. In particular, they should not have been involved in any fraudulent or discredited activity, or have been associated with a company that has gone bankrupt or been in financial difficulties. They should also be able to demonstrate that they have employees with a high level of expertise that is relevant to the insurance business. The insurance supervisor should also monitor changes in the control of companies and establish clear requirements which must be met when a change in control occurs. These may be the same as or similar to the requirements for licensing.

The underwriting of insurance risks should be restricted to insurance companies which may only transact insurance business. Life and non-life insurance operations should be separated, so that one activity cannot be used to support the other.

A licence can also be a two-way street. Market exit is as important as market entry. In order to provide greater market stability and reassure consumers, it should not be possible for insurers to enter and exit a market at will. As part of the licensing process, regulators should investigate the extent to which an applicant is committed to a market. However, it is true that it is almost impossible to gauge and ensure the long-term commitment of all insurance companies at the time of licensing. Thus, it is also important to have appropriate procedures for dealing with transfers of portfolios from companies which wish to exit the market, or to run off portfolios which are no longer open to new business. This will be discussed later.

For licensing to be effective, supervisors should be in close contact with applicants, since such contact helps to ascertain their true intention and capability.

8.1.4.2 Introduction of financial control systems

(1) Technical (mathematical) provisions

The setting-aside of liability, particularly technical (mathematical), provisions which are 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 a challenge for both the insurance companies and the insurance supervisor in economies in transition. Inadequate technical provisions often cause financial difficulties or results in insolvency.

Cross-subsidisation is also common in the transition markets, *i.e.* over-reserved (over-priced) products offset losses on under-reserved (under-priced) products. Often, this practice has its origin in the accounting system of the former regime, *i.e.* reserves and profits and losses were not distinguished by products. Cross-subsidisation can eventually increase sales of under-priced products, which damages the company. Moreover, if it is carried out by a leading company, competition is distorted and the market seriously harmed.

Inadequate technical provisions may have several causes. First, since technical provisions were not a familiar concept in command economies, the legislative and practical framework is not yet properly established.

Second, the historical data needed to calculate premiums and technical provisions have not yet been built up. In addition, economic conditions such as the rate of inflation are not stable. Insurance companies tend to adopt short-term assumptions, which often results in under-priced products, inadequate technical provisions or cross-subsidisation. For example, life insurance companies tend to offer products with high interest rates even in a period of rapidly falling inflation. The adequacy of premium rates is a fundamental issue, since if they are not set at an appropriate level, no good practice regarding technical provisions will stop the company from making losses.

Third, actuarial and auditing systems are still under-developed.

In order to ensure that insurers have sufficient technical provisions, several measures should be considered.

The introduction of appropriate legislation and monitoring measures is the first step to be taken. Insurance supervisors should establish general rules:

- specifying what is to be included in technical provisions, for example, claims incurred but not paid, claims incurred but not reported, premiums received in advance, as well as mathematical provisions;

- laying down standards for calculating technical provisions.

In addition, supervisory authorities and insurance companies should be encouraged to build up expertise. Data should be compiled to assess the adequacy of technical provisions. The technical interest rate should be set in relation to the general economic situation. The supervisor should monitor premium levels in order to prevent the marketing of under-priced products. The development of the actuarial and auditing profession should be encouraged.

(2) Assets

Technical provisions must at all times be backed up by equivalent assets that belong in full to the insurance company and that are set aside to guarantee its commitments. 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.

The working party on financial stability in emerging market economies (1997) points out that economies in transition often suffer from limited investment opportunities, highly-volatile capital markets, limited investment management experience and primitive asset valuation measures. Information on the financial markets is often not transparent. In addition, where shareholder discipline mechanisms are under-developed, or historical circumstances have retarded the development of strong risk management as governance priority, the regulatory framework needs to pay special attention to insurance companies' procedures for assessing and managing risks, including credit risk and market risk.

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 held in financial instruments, property and receivables;
- the basis for valuing assets which are included in financial reports, the safe-keeping of assets;
- appropriate matching of assets and liabilities, and liquidity.

In addition, the admissibility of the value placed on assets for the calculation of technical provisions or solvency margin requirements may be specified. This is quite distinct from setting limits on the investments or admissibility of particular classes of investment, since it effectively leaves the insurance company free to invest in what it likes while ensuring that the value of certain assets can be taken into account only to a certain extent or not at all. By specifying the assets covering technical provisions and solvency margins, it can be ensured that the assets held to back those "liabilities" are of the highest quality with appropriate liquidity and diversification. It would also be appropriate for the value of unlisted assets and real estate to be certified by independent professionals.

Investment regulations for insurers should be co-ordinated with regulations in other financial sectors so that they do not distort competition and impede the development of the financial sector as a whole.

Economies in transition tend to adopt highly restrictive rules on investment abroad. This is understandable for countries which have severe foreign currency reserve constraints.

On the other hand, investments abroad can provide access to a healthy diversified portfolio and long-term investments, which are sometimes difficult to find in economies in transition. Investment in foreign currencies, particularly in those of stronger economies, might be appropriate for long-term business such as pensions, where only a small part of the benefit is guaranteed, unit-linked products where investment risks are passed directly to the policyholders, and universal life-type products where the insurance company has discretion in the distribution of investment income to policyholders.

Foreign investment policy should therefore be gradually liberalised in parallel with the implementation of prudential regulations. In this regard, it is also appropriate to follow the principle of currency matching in order to provide protection against exchange rate risks. The EU directives, for example, stipulate that insurance companies are authorised not to hold matching assets to cover an amount not exceeding 20 per cent of their commitments in a particular currency.

(3) Solvency margin (Capital adequacy)

Both in the licensing process and in on-going supervision, the insurance supervisor needs to pay particular attention to the solvency margin (capital adequacy). The solvency margin comprises the financial sources (margin) needed to provide a buffer against possible adverse changes in liabilities and other adverse circumstances such as changes in the litigation system, unforeseen expense overruns etc. Thus, it provides information about the financial standing of the company and alerts supervisors to the need to take preventive action to protect policyholders. Solvency margin requirements should be clearly defined and specify the minimum levels of capital or levels of deposits that should be maintained. They should reflect the size, complexity and business risks of the insurance company.

Solvency margin criteria and their use by supervisors should take into account the particular environment surrounding asset investment and evaluation of technical provisions in economies in transition. Supervisors should not simply adopt the standards found in other industrial economies.

For example, solvency margin requirements for countries in transition should be set above the current somewhat inadequate EU solvency margins, particularly for general insurance business, in order to provide additional protection in case technical provisions are understated or assets are overstated (either because of inadequate professional expertise or poor information) and also to act as a deterrent to the setting-up of undercapitalised companies. In addition, the particularities of economies in transition such as high inflation should be also taken into account. The EU claims-based solvency margin does not take the inflation rate into consideration: it is based on the average burden of claims for the past three financial years. However, in transition economies the results are strongly influenced by the inflation rate. Given the particularities of transition economies, it is better to use an index-linked system of calculation. Indeed, some EU countries use even stricter criteria than the EU directives for control purposes. As EU supervisors have been discussing modifications to the EU solvency margin regulations in order to match them better to actual business environments, regulators in transition economies with EU-type supervisory systems should keep track of how these discussions are progressing.

At the same time, it should be emphasised that the solvency margin is just an instrument for measuring and monitoring solvency. It should not be regarded as the end-result of asset liability management or as a fool-proof indicator of the financial soundness of the company concerned. Adequate tariffs and technical provisions covered by sufficient assets remain the main pillars of solvency.

(4) Reinsurance

Reinsurance business has taken off strongly since the collapse of communism. In the command economies, trade in hard currencies was tightly controlled. Reinsurance was dealt with by a special division of the state monopoly or a separate entity of the state monopoly. Their activities were limited exclusively to hedging risks with respect to foreign currency-related business. The insurance monopoly held all risks related to domestic insurance. Thus, the scope of reinsurance was limited and its turnover small. Since the introduction of a free-market economy, reinsurance business has grown remarkably, mainly due to the development of the insurance market as a whole, the commencement of reinsurance transactions in domestic business by the former state monopoly, and the establishment of new insurance companies.

In addition to the normal roles of reinsurance, (*i.e.* maintaining stable underwriting results by spreading risks), insurance companies in transition economies have particular incentives to purchase reinsurance.

Reinsurance can be placed in foreign currencies, which are often more stable and stronger than the currencies of economies in transition. Reinsurance transactions can thus be used to prevent the erosion of the retention capacities of insurance companies.

In addition, as capital markets in transition economies are underdeveloped, they usually provide limited investment opportunities; at the same time, many countries impose compulsory investment requirements which limit investment returns. Ceding reinsurance abroad can free ceding companies from these constraints.

Moreover, many companies are still struggling to strengthen their capital base. A reinsurer with a strong capital base can help them to do so to some extent. Reinsurers also usually provide direct insurers with essential technical knowledge of reinsurance and insurance, which encourages insurers to transact business with experienced reinsurers.

Current situation in the economies in transition

Market situation

Notwithstanding the strong market forces, reinsurance business in the transition economies is facing serious challenges.

Since many insurance companies do not possess a large capital base, they tend to be too dependent on reinsurance treaties. It is often the case that only a limited portion of risk is retained in a company in proportion to the risk undertaken. Specific knowledge and experience, which are crucial for reinsurance transactions, is lacking since reinsurance business is a rather new activity. Insurers do not always carefully examine the quality of reinsurers or the contents of treaties.

Regulations and supervision

Although reinsurance transactions in transition economies need to be closely monitored, the majority of countries have done little to regulate them. Few countries monitor reinsurance security. In some countries where investment abroad is still strictly controlled, some insurers use reinsurance contracts only as a means of cash transfer.

Falush (1997) points out that a frequent regulation in these markets is that reinsurance may be placed abroad only when it is not possible to place it with domestic companies, even though there are difficulties in monitoring such contracts. Cession to domestic reinsurers is also compulsory in some countries. Some countries also require deposits corresponding to ceded premiums.

General principles

Expertise

Insurance companies and supervisory authorities should accumulate expertise and statistical data so that insurers can find the most suitable reinsurance and so that supervisors can check whether insurers have placed reinsurance in a proper manner. For example, once statistical data have been built up, an insurance company can increase retention selectively and adjust it between various risks. As the skill and expertise of insurers improves, they will become better at selecting reinsurers.

International reinsurers and brokers could assist in transferring expertise and experience.

Supervision of reinsurance

Reinsurance transactions in economies in transition should be closely monitored. Supervisors should have the power and capacity to intervene if the reinsurance transactions of a company are not conducive to sound management. In other words, supervisors should monitor risks ceded and accepted in order to ensure that the company remains solvent. In particular, the acceptance of reinsurance from overseas markets can be a high-risk business. Falush (1997) notes that some types of reinsurance are subject to large fluctuations in annual loss experience and/or exposure to long-term liabilities and many reinsurers have suffered large losses by naively underwriting international reinsurance business. The acceptance of reinsurance business by a direct insurance company may imperil the security of its policyholders. Therefore, the activities of companies accepting reinsurance business, including those of specialist reinsurance companies should continue to be subject to close supervisory oversight.

At the same time, the insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them. A method of collecting and monitoring information on reinsurance companies should be established. International co-operation is particularly important in order to obtain accurate information. Moreover, in order to rate reinsurance companies, transparency is important. In this regard, Falush (1997) suggests that it is desirable that in the annual supervisory accounting returns for direct insurance companies, the premiums, claims, etc. relating to reinsurance business accepted should be shown separately from direct insurance business.

It is very important to establish accounting rules which:

- apply uniformly to all insurance companies,
- ensure the relevant financial information is disclosed without ambiguity,
- are compatible with internationally accepted accounting standards.

Establishment of a strong capital base

As explained above, a strong capital base is essential for the sound operation of an insurance company. It is also important from the standpoint of reinsurance. Companies with limited capital are obliged to cede risks to reinsurers. This is particularly true concerning large or accumulated risk. However, UNCTAD (1993a) insists that an insurer grows, the proportion of ceding (fronting) business should decrease in relation to business written for the company' s own account. This means that an insurance company should reinforce its capital base as its business expands.

Solvency margin requirements can be an important tool of control in this aspect. Current EU solvency margin requirements take into account up to 50 per cent of the calculation of the margin. They require that the capital base be increased in proportion to the increase in turnover and discourage over-dependence (above 50 per cent) on risk cession.

Minimising intervention regarding reinsurance placement

Reinsurance placement should not be over-regulated. In principle, the market should be left to decide the destination of placement. For the management of an insurance company, the primary concern in reinsurance placement is security at an appropriate price. Regulation should not interfere with sound decisions taken by insurers. Compulsory cessions to national reinsurers or discriminatory tax regimes against foreign reinsurance placement should therefore be avoided.

8.1.4.3 Product and tariff control

Premium rates should be adequate, not excessive and not discriminatory. In economies in transition, however, inadequate experience of 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 been hit by bankruptcies which were often caused by under-pricing. Information asymmetry between insurers and consumers is even greater in economies in transition due to insufficient disclosure of information on products and companies. It is difficult for prudent companies to compete against companies that charge below-cost prices in order to gain market share. Because consumers are still getting used to the new market mechanisms, they tend to buy the cheaper product without considering other factors. Thus, initially at least, it may be appropriate for economies in transition to require submission of premium rates to insurance supervisory authorities for prior approval.

Similarly, insurance products offered for sale should 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 tailored to the particular situation of each country and reviewed at a later stage as the market develops.

8.1.4.4 Intermediaries

Intermediary systems play a key role in ensuring that consumers benefit from a market-oriented economy and thus choose the most suitable products from a wide product range. Proper regulation of insurance intermediaries is particularly important in economies in transition where abuses in the distribution network often occur, to the detriment of policyholders' interests.

Regulations on intermediaries should clearly state the scope of business, rights and responsibilities of intermediaries. Normally, insurance legislation distinguishes between brokers who represent the buyer and seek to obtain the best cover for their clients from insurers, and agents or direct salesmen who represent the seller(s).

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

Insurance intermediaries should be registered or be required to obtain authorisation prior to commencing business. Insurance intermediaries should possess professional qualifications that prove general, commercial and professional knowledge and the 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 their status to their clients and provide extensive information on and comprehensive explanations of the insurance products they are selling.

8.1.4.5 Third-party motor liability insurance

Third-party motor liability insurance is one of the most widely purchased insurance products in the market economies. This is also the case in the economies in transition, though in many of them the system is rather different from that in the market economies. Since this product is a fundamental one and impinges directly on people' s daily lives, any major reform of it would have a significant impact on society. The economies in transition should establish a proper third-party motor liability insurance system.

(1) Current situation

The current situation in economies in transition is as follows:

Non-compulsory basis

In several countries of the former Soviet Union, third-party motor liability insurance is not compulsory. With a social security system that covers all the costs of accidents, it might be appropriate not to make third-party motor insurance compulsory. For this reason, such insurance was not obligatory and did not develop in the Soviet Union. Although the economic environment has changed dramatically since the introduction of the market and individuals are increasingly obliged to cover themselves against accidents, third-party motor liability insurance has not yet been reformed in some ex-communist countries.

Non-contractual basis

In some countries in transition, third-party motor liability insurance is compulsory but non-contractual. In Hungary, it was non-contractual until 1991. (Third-party motor liability insurance premiums were collected in the form of a tax on gas (petrol). When drivers filled up at a gas station, they had to pay a surcharge which was allocated to the premium for third-party motor liability insurance).

In 1991, Hungary introduced contractually-based compulsory third-party motor liability insurance. It has a regulated tariff and uniform product conditions. Insurance companies are obliged to provide insurance cover and they are not allowed to make profit above stipulated amounts. The insurance company or the association of the Hungarian Insurance Companies is obliged to meet the claims of a damaged party if no insurance contract has been concluded or if it has expired (Decree 58/1991 and Decree 17/1992). The Czech and Slovak Republics are planning to place their existing non-contractual third-party motor liability insurance systems on a normal contractual basis. It is not clear how this will be done but in the initial stage it would be most likely that the system will be rather strictly controlled, as in Hungary.

(2) General principles

Taking into account the current situation mentioned above, the following measures should be taken in the economies in transition.

Compulsory insurance

Because of the frequency and severity of car accidents, victims need particular protection. At the very minimum, a scheme is needed to ensure that victims receive adequate compensation. Third-party motor liability insurance should therefore be compulsory. Under such a system, all victims are covered by insurance. Indeed, third-party motor liability insurance is compulsory in almost all OECD countries.

Contractual basis

Fontaine and de Rode (1997) note that since third party motor liability insurance is offered by a private insurance company in the form of private insurance along with other insurance products, the law should specify in greater detail what the requisite cover must include. The legislation making third-party motor vehicle insurance compulsory should define the liabilities for which cover is to be provided, but could probably leave to ordinary law matters such as the penalties for failure to pay premiums etc.

Monitoring system

A suitable monitoring system to ensure that all parties have insurance is an essential component of a compulsory insurance system. Fontaine and de Rode (1997) point out that because car use itself is subject to prior authorisation, proof of insurance cover should be required as a precondition for such authorisation. Insurers would have to issue a special certificate attesting that insurance has been taken out. For example, in France a sticker indicating that the vehicle is insured must be displayed on the windscreen. Procedures for checking that insurance cover has not lapsed must also be put in place. In addition, penalties for failure to comply with obligations must be introduced. To establish an efficient monitoring system, co-ordination with other government bodies such as the Ministry of Transportation or the Ministry of Interior is necessary.

Claims data collection

As mentioned before, under-priced products, and especially widely-purchased products like third-party motor liability which are under-priced, insurance damage the whole market. Industry-wide data should be collected jointly by insurance companies, as is done in Hungary, in order to help calculate suitable premium levels.

Other major issues

Guarantee funds should be set up in order to provide compensation for accidents caused by uninsured cars, unidentified cars or cars whose insurance cover is provided by a bankrupt company. If insurance companies are not legally obliged to provide compulsory insurance for every consumer who wants it, some drivers may be unable to purchase cover. It is therefore necessary to take steps to ensure that such consumers can obtain cover. In order to minimise moral hazard and to prevent accidents, bonus/malus systems should be used.

8.1.4.6 Remedial actors

(1) Remedial procedures

Even in well-supervised insurance markets, it may happen that a company encounters financial difficulties that lead to insolvency. For this reason, there should be clearly-formulated policies regarding corrective action, and in cases where an insurance company is not viable as a going concern, orderly exit policies are essential to the effective exercise of insurance supervision.

Of particular importance in this context are remedial procedures to deal with the financial problems of individual insurance companies. The working party on financial stability in emerging market economies (1997) argues that 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 grounds for choosing between reorganisation and liquidation, 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 a long delay can increase the cost of resolving a crisis, it is of great benefit to have practical procedures in place for prompt corrective action. Permanent supervision focused on preventive control through on-site and off-site inspection will play a key role. Corrective procedures based on rules can help to reduce political pressures to show undue forbearance.

At the same time however, authorities need to retain sufficient discretion to be able to deal flexibly with problems that arise and to be able to adapt remedies to market circumstances.

(2) Design and application of safety net arrangements

The need to protect policyholders and the high cost of a possible collapse of the insurance system are the principal reasons why in some 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, the creation of a safety net could be considered. However, such an arrangement inevitably creates moral hazards because it holds out the prospect that policyholders will be at least partially indemnified from losses caused by failing institutions. In order to minimise the moral hazard, it is essential to design and apply safety net arrangements in which the incentives of policyholders to act prudently are not undermined.

8.1.5 Proper institutional governance

The foundation of good governance is a sound business strategy along with competent and accountable management. An ownership structure that fosters shareholder oversight should be encouraged.

8.1.5.1 Effective internal control

Good governance of insurance companies requires comprehensive internal control procedures and policies implemented by skilled personnel and carefully monitored by management. Even capable management can commit errors in the fulfilment of its duties. Effective risk management of insurance companies is thus crucial. Insurance companies should have effective means of measuring, monitoring and controlling the various business risks they face.

8.1.5.2 Privatisation

Many former state insurance companies in transition economies are still owned by the government, *i.e.* privatisation has not yet been completed. Private ownership of insurance companies is essential in order to monitor management performance, reduce distortions in incentives and avoid political interference in management. Private ownership and competition can promote innovation and reasonable risk-taking, which is crucial for economic transformation. It would also lead to an injection of new capital and reduce the burden on public funds. Privatisation may thus be the most effective way of implementing the management changes required to ensure that insurance reform meets its objective.

It is important that privatised insurance companies start off on a sound financial basis and with diverse ownership. Privatisation can only be accomplished if the whole economic environment is organised to support private institutions. At the same time, privatisation should be carried out without delay, since failure to act promptly would delay market reform and be costly in the end.

8.1.6 Introduction of training systems and co-operation with foreign governments

The effectiveness of a supervisory body depends mainly on the human resources at its disposal. Even if a sound insurance system has been established, it would not function without a staff of professionals to manage the system properly. Taking into account the shortage of qualified staff and proper resource development strategies, well-organised training schemes for supervisors are crucial to economies in transition. For this purpose, close contact with international organisations, foreign co-operation agencies, foreign insurance authorities, academic societies and private insurance associations would be useful. Training for supervisors should cover all the theoretical, practical, legislative and supervisory aspects. It should be on-going, not a one off affair, dispensed via well-designed programmes.

8.2 Second level of development: ensuring the system's operation

8.2.1 Goals

After establishing a basic infrastructure with supervisory authorities, the goal at this level is to ensure that the insurance system functions properly. In order to achieve this goal, the economies in transition should:

- develop further infrastructure and regulations,
- make regulation and supervision functional and effective,
- foster market mechanisms.

8.2.2 Establishment of comprehensive regulations and supervision

In view of the high risk environments (insurance risk, investment risk, credit risk...) of economies in transition and their limited experience, comprehensive prudential regulations and supervision should be given particular emphasis. After having introduced the basic framework for legislation and a supervisory system at the initial stage, this should now be modified and reinforced on the basis of actual market experience. Supervisors will soon recognise any deficiency or weakness in their insurance legislation or any component that is unsuitable for their market. Supervisors should prepare concrete and practical rules relating to the market situation and ensure that those regulations function properly. For example, in order to maintain suitable management of insurance companies, the insurance supervisor should establish an information exchange system with other government institutions.

Precise guidelines for the calculation of technical provisions or of asset evaluation and a detailed data system for controlling tariffs and products should also be established. Functional rules and practices concerning the winding up of insurance companies are essential tools for the establishment of a sound insurance system.

8.2.3 Ensuring effective regulation and supervision

8.2.3.1 Further development of training programmes

Following the initial transition period, with the experience of actual practice, these countries will have a better view of their training programme requirements. Thus the insurance supervisors in economies in transition should prepare more structured and better targeted training programmes on the basis of their experience. They should create a training scheme that goes beyond simply accepting assistance programmes from outside.

Training programmes at this level will differ from those at the initial stage of transformation. Not only will knowledge of insurance supervision be more advanced but also practice oriented on-the-job training programmes will be more effective. Case study of supervision is also helpful in developing the practical supervisor skills.

At the same time, insurance authorities should establish well organised internal training systems. New employees always need training and can be instructed by experienced supervisors. A self-learning scheme should be also prepared.

8.2.3.2 Reinforcement of on-site inspection

Supervision should be exercised over the entire operations of the insurance company and should encompass all the various aspects of its business -- moral, legal, technical and financial. In particular, the insurance supervisor should ensure that insurance companies comply with the regulations applicable to insurance. More specifically, it should ensure that insurance companies:

- meet their contractual commitments to the insured (legal control)
- are at all times in a financial position to meet their commitments (solvency control).

To this end, the insurance supervisor should examine not only the financial position of an insurance company at any given moment but also the operating conditions that will 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 future commitments.

Preventive control requires regular contact with the insurer's management and a thorough understanding of its business. There must be an independent and reliable means of verifying the information that has been reported or disclosed, in particular, the adequacy of technical provisions and asset valuations. On-site inspections are particularly important in this respect; they enable 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, calculation of insurance premiums, follow-up of claims and of results, risk selection, administrative organisation, financial management, adequacy of reinsurance, internal control etc. Such inspections are essential in order to assess the skills and efficiency of the insurer' s managers and the degree to which it meets capital requirements. To some extent, external auditors or actuaries can be used if well-developed auditing and actuarial profession exist and if they are fully accountable.

8.2.3.3 Introduction of a self-regulatory system

The insurance industry should be encouraged to set up private mechanisms and institutions which would draw up business guidelines and a code of conduct, the aim being to eliminate harmful practices. Self-regulatory arrangements and organisations, including professional bodies, can be a useful complement to the public supervisory structure. However, supervisory authorities need to scrutinise such arrangements in order to ensure that they are conducive to the efficient functioning of the market.

8.2.4 Promotion of market mechanisms

Insurance markets in economies in transition should promote market mechanisms so that owners, investors and other interested parties exercise adequate discipline over insurance companies. To this end, crucial information should be disclosed, and competition introduced.

8.2.4.1 Information disclosure

Under a command economy, it was often not the individual's responsibility to purchase insurance but the insurance monopoly's responsibility to cover risks for individuals. There was no choice of insurance company and the choice of products was very limited. Since the insurance company was owned by the state, there was no need for disclosure of information to investors. At the same time, consumers did not have to worry about the state monopoly going bankrupt.

In a market economy, it is crucial to ensure the quality, timeliness and relevance of the information that is disclosed for the purpose for credit analysis and investment decisions. Information disclosure is also essential for consumers so that they can select appropriate insurance products from the right insurance companies.

8.2.4.2 Non-discrimination against foreign insurance companies

Financially stable insurance companies operated by reliable and prudent management are central to a sound insurance market. In this respect, insurance authorities should not discriminate against foreign insurance companies in its licensing control and other supervisory measures. If an insurance company is financially stable, technically and managerially competent and committed to the market, insurance authorities should consider authorisation of that company regardless of its nationality. In a market where the above mentioned prudential regulations and a proper supervisory system are established, sound foreign insurance companies can be good resources for technological, organisational and managerial skills and can contribute to improving consumer services.

8.2.5 Co-operation with insurance supervision in other countries

Once foreign companies begin to obtain authorisation to carry on insurance business on his territory as a branch or as a subsidiary, or domestic insurance companies in his territory start to operate in foreign countries, the insurance supervisor should arrange an information exchange scheme with the relevant authorities abroad in order to ensure the financial soundness of such insurance companies.

IAIS (1997d) states that the initial opportunity for collaboration between host supervisors (supervisors for a branch or a subsidiary of a foreign insurer) and home supervisors (supervisors for a main office of insurance companies) occurs when an individual application is made by an insurer to establish a new foreign presence. The licensing procedure also offers a good opportunity for host and home authorities to create the basis for future collaboration. The host country should always consider checking that the home supervisor has no objection before granting a licence.

The home and host supervisors should furnish each other with the documents and information necessary to exercise supervision. For this purpose, the confidentiality of information transmitted must be legally protected and all insurance supervisors must, of course, be subject to professional secrecy constraints in respect of information obtained in the course of their activities.

Where a branch or a subsidiary in his territory is judged to be in financial trouble, the host supervisor should inform the home supervisor and co-ordinate necessary measures to safeguard the interest of policyholders. The host supervisor should consult the home supervisor before withdrawing the authorisation of the branch or the subsidiary.

In the event of the withdrawal of authorisation for an insurance company's main office, the home supervisor should notify such withdrawal to the host supervisors. In such cases, the home supervisor, in conjunction with the host supervisors, should take all necessary measures to safeguard the interest of the policyholders and in particular, should restrict the free disposal of the company's assets.

8.3 Third level of development: ensuring the system's efficiency

8.3.1 Goals

At this level, competition in the insurance sector should be fostered by removing unnecessary restrictions and allowing the participation of sound insurance companies in the insurance market. In this respect, the country should consider complying with the liberalisation measures of the cross border service provisions prescribed in the General Agreement on Trade in Services and the OECD Code of Liberalisation of Current Invisible Operations.

At the same time, liberalisation without attendant prudential regulations and supervisory measures might result in chaotic market conditions. Strengthening of the regulation and supervision framework in parallel with liberalisation measures is essential for improving the efficiency of the insurance market.

8.3.2 Cross border services provisions

8.3.2.1 Cross border services provisions in the OECD Code and GATS

Taking into account the merits brought by cross border insurance transactions, the counties at this level of economic transition should consider implementing such measures. However, they must also introduce prudential regulations in parallel with this liberalisation measure.

Liberalisation of cross border services provisions are prescribed in the articles of the OECD Code of Liberalisation of Current Invisible Operations and in the General Agreement on Trade and Services (GATS).

The OECD Code, on the basis of non-discrimination and the standstill principle, requires that members shall eliminate restrictions on insurance transactions and transfers. This includes insurance, reinsurance and retrocession transactions. The Code provides for members to be able to regulate the activities of the insurer itself and any third party in seeking insurance business (mainly brokers and agents) on a non-discrimination basis.

The general obligation under GATS is that "each Member shall accord services and service suppliers of any other Member treatment no less favourable than that it accords services and service suppliers of any other country" (Art. XVI Market Access) However, GATS provisions allow each Member to schedule specific commitments covering conditions of market access and national treatment, distinguishing between modes of supply.

Under GATS provisions, there is a distinction between cross-border provision of services (mode I) and consumption of services abroad (mode II). There is also a specific prudential carve-out for all financial services allowing for policyholder protection as long as measures to be taken are not used as a means to avoid commitments or obligations under the Agreement (Annex on financial services: 2. Domestic Regulation). This would enable countries to take or maintain measures to regulate cross-border provision of insurance.

The Understanding on Commitments in Financial Services enables GATS members to take on specific commitments on the basis of an alternative, but not inconsistent approach. In effect it enables those countries that wish to do so to take on a higher level of commitments in respect of market access and national treatment. In respect of cross-border trade in insurance, the Understanding provides that each Member shall permit non-resident suppliers to supply as a principal, through an intermediary or as an intermediary and under terms and conditions that accord with national treatment, insurance of risks relating MAT business, reinsurance and retrocession and certain insurance-related services. Consumption abroad of insurance services is also covered by these categories (Understanding 3,4).

8.3.2.2 Prudential regulations in parallel with cross-border services provisions

Prudential regulations on cross border business are essential for the protection of policyholders. Policyholders are entrusting their premiums to an insurer or reinsurer over which there is no local supervision to ensure that future claims can be met and where information on underlying security may be difficult to obtain. For this reason, the OECD Code and GATS allow control of the above mentioned cross-border insurance transactions.

One measure of such control is to lay down a rule on advertising. The insurance supervisor may require insurance companies selling insurance on a cross-border basis to warn potential policyholders that the company is not authorised to carry on insurance business in the country and that the regulations and protection measures established by the insurance law in the country do not apply.

Another measure is that regulations do not prohibit cross-border insurance services provision only to the extent that policyholders seek to place their business abroad on their own initiative. In such cases, policyholders who seek to place their businesses abroad on their own initiative are considered to have excluded themselves from the protection afforded by national law and thus are not necessarily protected by the law.

8.3.3 Gradual liberalisation of products and tariffs

At this level of development, insurance companies in principle, possess accumulated data and business experience and expertise which enable them to design their own insurance products and tariffs. Indispensable information is disclosed and consumers are gradually acquiring an eye for selecting the most suitable products for themselves. Insurance supervisors should therefore take measures to gradually liberalise product and tariff control, so that consumers can choose from a broader range of insurance product. However, liberalisation of insurance products also involves a certain prudential considerations.

An insurance authority should ensure that it always has the power to prevent an unsuitable insurance product being distributed on the market.

CHAPTER 9: CEECS INTEGRATION INTO THE EU INSURANCE MARKET

This chapter first analyses the general situation of the CEECs' (Central and Eastern European Countries') integration process into the EU insurance market. This analysis aids in comprehending the specific requests for CEECs to be a member of European Union. On the basis of the analysis, the author then uses the model proposed in the previous chapters into the European framework. In addition to the three level model proposed in the previous chapters, the CEECs should take one step further in order to join the European Union. This special arrangement is necessary to comply with the European Union's third insurance directives and establish a single EU insurance market.

In addition, Russia, the largest insurance market in Central and Eastern Europe, signed the Partnership and Co-operation Agreement with the European Union in 1994 (EUROPE UNION (1994a)). This co-operation agreement is also reviewed in this Chapter.

9.1 General situation

9.1.1 Overview

During the early and mid nineties, ten countries of Central and Eastern Europe signed an Agreement (EUROPE UNION (1994b)) with the European Union, an agreement which provides a framework to promote integration of these economies into the European Union. Those ten countries are Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. (These ten countries are hereafter called CEECs (Central and Eastern European Countries).) (The date of the Agreements signed, their effective date and the length of transition periods are shown in the table 9-1 at the end of this section.)

In addition, the EU Commission drew up a White Paper (COMMISSION OF THE EUROPEAN COMMUNITIES (1995a)) at the request of the European Council with the objective of creating a programme which would allow those ten countries to prepare itself for fulfilment of the obligations of the EU internal market. All the associated countries applied for European Union membership.

In 1996, the EU Commission sent a questionnaire to the Europe Agreement signatories in order to collect the necessary information for preparation of an opinion on their membership application to the European Union. Based on the results of the questionnaire and other relevant information, the EU Commission prepared its opinion in July 1997, analysing each Europe Agreement signatory on its merits according to the same criteria for all the countries. Agenda 2000 (COMMISSION OF THE EUROPEAN COMMUNITIES (1997a)), published in July 1997 and including the EU Commission's opinion is the EU Commission's comprehensive analysis of the EU enlargement issue. It recommends the European Council to open negotiations with five of the countries that signed the Europe Agreement, *i.e.* Hungary, Poland, Estonia, the Czech Republic and Slovenia. Enlargement policies were discussed by the European Council in Luxembourg in December 1997 and above-mentioned 5 countries were decided to start membership negotiation from the end of March 1998. The other five countries which signed the Europe Agreements and applied for European Union Membership, *i.e.* Bulgaria, Latvia, Lithuania, Romania and Slovak Republic, will start membership negotiation as soon as they are ready.

As regards the EU integration programme in the insurance field, the Europe Agreement and the White Paper are the basic documents to consider. However, these two documents are not sufficient to enable the signatories of the Europe Agreement to prepare concrete measures to establish a sound insurance system compatible with that in the European Union.

Thus, following analysis of the general nature of the Europe Agreement and the White Paper, a specific programme toward European Union Membership with regard to insurance is described.

With regard to Russia, the Partnership and Co-operation Agreement between Russia and European Union was signed in June 1994. The agreement states that upon the expiry of five years from signature of the Agreement, Russia shall abolish the maximum foreign shareholding limit of 49% in company capital. However, even after this expiry date, Russia has not yet implemented this agreement.

Table 9-1 Timetable of the European Agreements

	Signature	Effective date	End of transition period
Poland	16.12.91	01.02.94	31.01.04
Hungary	16.12.91	01.02.94	31.01.04
Czech Republic	04.10.93	01.02.95	31.01.05
Slovakia	04.10.93	01.02.95	31.01.05
Romania	01.02.93	01.02.95	31.01.05
Bulgaria	08.03.93	01.02.95	31.01.05
Estonia	12.06.95	Spring 1998	Spring 1998
Latvia	12.06.95	Spring 1998	31.12.99
Lithuania	12.06.95	Spring 1998	31.12.99
Slovenia	15.06.95	Early 1998	Early 1998

Note: 31.01.04 means 31.01.2004

9.1.2 The Europe Agreements

The Europe Agreements are association agreements between the European Union and the ten Central and Eastern European countries individually, providing a framework to promote integration of the CEECs into the European Union. Even though the Europe Agreements themselves do not formally guarantee the signatories future membership in the European Union, the Agreements are aimed at supporting the signatories' European integration process. The Preamble states:

"The Community (European Union) and an associated country wish to strengthen these links (the existing traditional links between the Community, its Member States and an associated country) to take part in the process of European integration, thus strengthening and widening the relations established in the past" and "the final objective of an associated country is to become a member of the Community and that this association, in the view of the Parties, will help to achieve this objective." (see preamble of Europe Agreement, Establishing an Association Between the Republic of Poland, of the One Part, and the European Communities and their Member States of the Other Part (1994) (Europe Union (1994b). The Agreement with Poland is used as the reference. As mentioned below, Agreements are not completely identical with regard to their contents.)

In addition to an associated country's integration into the European Union, the aims of the Agreements are:

- *to provide an appropriate framework for the political dialogue, allowing the development of close political relations between the parties (European Union, its Member States and an associated country);*
- *to promote the expansion of trade and the harmonious economic relations between the parties and so to foster the dynamic economic development and prosperity in an associated country;*
- *to provide a basis for the Community's financial and technical assistance to an associated country;*
- *to promote co-operation in cultural matters* (see article 1 of European Union (1994b).)

The Agreement is a treaty and thus legally binds the Parties. In this it essentially differs from the White Paper, which does not have any legal power.

The Agreement includes a transition period of a maximum ten years divided into two successive stages, each in principle lasting five years (art.6-1).

Although the goals and principal elements are identical in all the Agreements, each of them was negotiated individually with an associated country. For this reason, there exist certain variations between the Agreements.

The provisions relating to insurance in the Agreements are limited. The Agreements set out specific terms and conditions for the gradual and progressive achievement of the free circulation of goods, workers, services and capital which includes insurance, *i.e.* creation of a free trade zone.

The issue of establishment is particularly important to insurance business. Article 44 describes national treatment in respect of establishment and operation of European Union companies and nationals. Article 44 (1) reads:

"An associated country shall grant for the establishment of Community companies and nationals a treatment no less favourable than that accorded to its own nationals and companies, (gradually and at the latest by the end of the ten year transitional period)". (see Europe Union (1994b).)

Article 44(2) reads:

"An associated country shall grant, from the entry into force of this Agreement in the operation of Community companies and nationals established in an associated country a treatment no less favourable than that accorded to its own companies and nationals." (see Europe Union (1994b).)

In other words, national treatment in respect of the establishment of Community companies shall be granted within ten year transitional period but national treatment in respect of the operation of Community companies shall be assured from the date of the Agreement.

The Agreements also include a standstill provision with regard to the establishment and the operation of Community companies and nationals (art. 44-2).

With regard to freedom to provide services, the Agreement requires gradual introduction without stating any clear obligation. The article 55-1 reads:

" The Parties (the European Union its Member States and an associated country) undertake to take the necessary steps to allow progressively the supply of services by Community or an associated country's companies or nationals who are established in a Party other than that of the persons for whom the services are intended taking into account the development of the services sector in the Parties. "(see Europe Union (1994b).)

9.1.3 The European Council in Copenhagen in June 1993

The next important issue for the associated countries of the European integration is the declaration of the European Council in Copenhagen in June 1993. This spelled out the political and economic criteria for examining the accession requests of the CEECs. The Council concluded:

The associated countries in Central and Eastern Europe that so desire shall become members of the Union. Accession will take place as soon as a country is able to assume the obligations of membership by satisfying the economic and political conditions. Membership requires:

- *that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;*
- *the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union;*
- *the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.*

9.1.4 The White Paper

9.1.4.1 General contents

The European Council held in Essen in December 1994 adopted a pre-membership strategy for the CEECs. It requested the European Commission to draw up a White Paper entitled Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union (COMMISSION OF THE EUROPEAN COMMUNITIES (1995a), White Paper - Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of Union, Brussels, 3 May), the purpose of which is to provide a guide to assist the CEECs in preparing to operate under the requirements of the European Union's internal market.

Of course, the task of approximation to the EU system can only be carried out by the

CEECs themselves. However, to assist the CEECs in their planning and programming, the White Paper identifies key measures in each sector and suggests the sequence in which approximation could be tackled.

The White Paper provides a presentation of current Union legislation relating to the Internal Market. The Commission's presentation of the legislation has been based on four principles:

- *the White Paper should focus on the Internal Market and not attempt to cover the whole "acuis communautaire";*
- *within the areas selected legislation should be presented not as a single list or block but should show which measures are more fundamental and which should logically be tackled first;*
- *the White Paper should serve as a reference document for the associated states and its recommendations are not fine-tuned to the needs of any particular one;*
- *the legislation should be presented to the associated countries in a way which makes clear the measures and structures which are required to ensure effective legislation* . (see COMMISSION OF THE EUROPEAN COMMUNITIES (1995a), White Paper p. 17)

The Commission presents the legislation for each area in a way that distinguishes "key measures" from all the measures applicable and then proposes a further breakdown of key measures into two stages, *i.e.* Stage I and Stage II.

9.1.4.2 Insurance Issues

The insurance directives included in the key measures are the EU first and third non-life and life insurance directives and the EU insurance accounts directive.[1]

The measures included under Stage I are the EU first non-life and life directives and the EU insurance accounts directive. All concern an EU-wide harmonisation of the conditions for allowing an insurance company to establish itself in another Member State in order to carry out insurance business.

The Stage II measures are the EU third non-life and life directives, *i.e.* single passport directives which allow insurance companies to freely decide whether to sell their insurance products through an establishment in another Member State or directly, without being established.

9.1.5 Negotiation for EU membership

The Madrid European Council in December 1995 reaffirmed that the necessary decisions for launching the accession negotiations with the countries applying for European Union membership would be taken within six months of the conclusion of the Intergovernmental Conference (IGC) and in the light of its outcome. For this purpose, the EU Commission submitted to the European Council, the paper, Agenda 2000, covering its opinions on the individual applications and its analysis of the enlargement. Agenda 2000 includes in a single framework broad perspectives for the development of the European Union, and its policies beyond 2000 and horizontal issues related to enlargement. Agenda 2000 recommends the European Council to open negotiations with five of the signatories to the Europe Agreement, *i.e.* Hungary, Poland, Estonia, the Czech Republic and Slovenia. The enlargement policies were discussed by the European Council in Luxembourg in December 1997. It was agreed that the above-mentioned five countries would start membership negotiation from the end of March 1998. The other five countries which signed the Europe Agreements and applied for European Union Membership, *i.e.* Bulgaria, Latvia, Lithuania, Romania and Slovak Republic will start membership negotiation as soon as they are ready.

During the period required to successfully complete the accession process with all the applicant countries an improved framework is needed for relations between the European Union and each applicant country in order to clarify the accession preparation and implement the same. For this reason, the new instrument of the Accession Partnership is prepared by March 1998. The Accession Partnership, which includes multi-annual programming, takes the form of a Commission decision after consultation with the applicant country and is worked out jointly by the EU Commission and each applicant country. It is a key feature of the reinforced strategy and mobilises all forms of assistance to the applicant countries within a single framework for the implementation of national s to prepare them for EU membership.

9.1.6 CEECs' compliance with key measures suggested in the White Paper

The table 9-2 in the next page shows that with regard to the countries examined the in CEECs (Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic), all of them have partially complied with the measures prescribed in the Stage I in the White Paper. Any of them have yet to comply with any measures prescribed in the Stage II.

9.1.7 The Partnership and Co-operation Agreement between Russia and European Union

The Partnership and Co-operation Agreement between Russia and European Union was signed on 24th June 1994. There are three important provisions with regard to insurance:

(1) Article 28 regarding MFN(Most Favoured Nation) treatment with regard to establishment and operation of EU insurance companies;

(2) Article 29 regarding standstill clause

(3) Annex 7 regarding commitment to abolish the maximum foreign shareholding limit of 49% in company capital.

The Article 28 states the following two issues.

Table 9-2 CEECs compliance with the key measures in the White Paper

Country	Implementation		Comments (laws and regulation)
	Stage I	Stage II	
Estonia	Partly implemented.	No	Insurance activities in Estonia are regulated by the Insurance Act passed in November 1992, forming the basis for several regulatory acts governing the insurance market and securing the development and stability of insurance activities. In 1993 international standards of insurance accounting were introduced, the orders for determining the solvency of insurance companies and forming technical reserves, as well as the order and terms for the transfer of insurance contracts upon compulsory liquidation of an insurance company were established. Control over the activities of insurance companies is exercised by the Insurance Supervisory Authority formed specially for this purpose within the administrative jurisdiction of the Ministry of Finance on January 1st 1993. As to White Paper I measures, the following three main preconditions have been fulfilled: – A competent authority has been established to supervise insurance undertakings and to ensure protection of policyholders; – Regular insurance related training programs are being organised, thanks mostly to the help of foreign aid; – In the co-ordination of legal acts with those of the EU, three main EU directives on forming a full background to insurance activities of White Paper I measures have been used.
Hungary	Partly implemented.	No	The aims specified in the First Directive have been implemented in respect of launching and pursuing insurance activities with the coming into force of the Act on Insurance. The rules aimed at creating the conditions for freedom of establishment, liberalisation of services and a single domestic market as specified by the Third Directives cannot yet be adopted. An Act on Accounting has already been passed as a result of the EU Directives. Government Decree No.182/1991(XII.30), issued its enactment, was based on Directive 91/674/EEC of the Council on the annual and consolidated balance sheets of insurance companies (amended and supplemented by Government Decree No.16/1993(I.27). The regulation governing preparation of a consolidated annual report and consolidated annual business report are included in Article 8 of the Act on Accounting and in its amendment of 1995 (Act XX of 1995).

Sources: Questionnaires drafted by the EU commission and the author (1998) Hearings of the supervisory authorities by the author (1998)

Table 9-2 CEECs compliance with the key measures in the White Paper (continued)

Latvia	Partly implemented.	No	The Insurance Act of January 12th 1993 states that insurance companies shall inform the State Insurance Supervision Inspectorate of their shareholders. The State Insurance Supervision Inspectorate was founded on September 15th 1995. The Insurance Act (January 12th 1993) regulates the establishment of direct insurance, including separation of life and non-life insurance. The Statute on "General Principles for Annual Report, Balance Sheets, Profit and Loss Accounts Calculations by Insurance Companies" (December 21st 1995) regulates the form of annual reports, balance sheets and profits and loss accounts.
Lithuania	Partly implemented.	No	The new Law on Insurance was passed by the Seimas on July 10th 1996. Additional regulations to this Law were approved by the end of 1997. Also the Draft Law on Motor Vehicle Third Party Liability Insurance is at the preparatory stage. These regulations include the provisions prescribed in the EU Directives (EU first life and non-life directives, EU insurance accounts directives).
Poland	Partly implemented.	No	The White Paper's Stage I measures have already been implemented in Polish insurance law. However some issues, due to their unique character, have not been regulated in exact accordance with the directives. The most important of these concerns the establishment of EU insurers' branches. This matter shall be regulated in accordance with the first EU directives on insurance by the end of the first transitional period (December 31st 1998). Full freedom for performance of insurance services as well as uniform licence permits for the same shall be introduced by the end of the second stage, on February 1st 2004.
Romania	Partly implemented.	No	Measures of the White Paper's *first stage will be accomplished by 1998*. The measures prescribed in the second stage will be partially complied with during the period 1998 – 1999.
Slovak Republic	Partly implemented.	No	Act no.306/1995 on the Insurance Industry introduces the term of solvency of insurance companies, and their duty to disclose and control the same. It also provides for transition from the system of special insurance funds to a system of insurance reserves. The regulations on these issues are fully in accordance with the EU directives (EU first non-life and life insurance directives and the EU insurance accounts directive). Stage II of the White Paper can only be implemented just before the assumed accession of the Slovak Republic to the European Union. Similarly, implementation of several other measures depends on the development of the Slovak Republic insurance market and the amendment of some related laws (the Civil Code, control and approval of general insurance terms).

Sources: Questionnaires drafted by the EU commission and the author (1998) Hearings of the supervisory authorities by the author (1998)

- MFN treatment with regard to conditions affecting the establishment of companies in their territories and this in conformity with the legislation and regulations applicable in each party, European Union and Russia;
- MFN with respect to the operation of subsidiaries in Russia of EU companies and the operation of branches of EU companies.

The Article 29 includes standstill clause. The parties, i.e. European Union and Russia shall not adopt any new regulations or measures which would introduce or worse discrimination as compared to the situation existing on the date of the signature of the Agreement as regards conditions affecting the establishment of the other party's companies in their respective territories in comparison to their own companies.

The Annex 7 prescribes that upon the expiry of five years from signature of the Agreement which was by June 1999 at the latest, Russia shall abolish the maximum foreign shareholding limit of 49% in company capital.

The most relevant provision in terms of insurance business transaction is Annex 7.

However Russia has not implemented the commitment stated in Annex 7. Indeed, the Parliament passed a law (RUSSIA(1999)) in December 1999, which still included the article, maintaining the foreign shareholding limit of 49% on company capital. Thus the Agreement between Russia and European Union had not progressed as originally agreed by 31 December 1999, the date of the thesis submission.

9.2 Model for entry of CEECs to the European single insurance market

9.2.1 Essential points

9.2.1.1 Consideration of the realities of the associated countries

As analysed in the previous section, the purpose of the requirements provided for by the Europe Agreements and the key measures suggested in the White Paper is to clarify the minimum requirements for entry into the European Union's internal market, not to propose to CEECs appropriate measures that take into account their market conditions. For example, since the EU insurance directives do not reflect particular conditions in the CEECs, some provisions are not suitable for their market developments, at least in the case of some of the CEECs. For example, current solvency margin requirements under the relatively high risk environments in some of the CEECs seem to be an insufficient early warning measure. The prohibition of systematic prior approval of insurance products and tariffs as laid down in the EU third directives are not appropriate for at least the initial stage of the transitional economies.

Indeed, the White Paper emphasises:

"The particular difficulty faced by the CEECs and not shared by existing Member States is the transition to a market economy." (see COMMISSION OF THE EUROPEAN COMMUNITIES (1995a) White Paper p.29.)

For the CEECs, two goals have to be achieved at the same time: harmonisation with the EU system and establishment of a sound and robust insurance system based on free market mechanisms. Suitable policy arrangements for European integration that take into account the current social, economic and legislative situations in the CEECs are essential to the development of their insurance markets.

9.2.1.2 A comprehensive programme for Europe integration

The measures prescribed in the Europe Agreements and the White Paper are not comprehensive with regard to preparation of a robust insurance system. For example, essential legislation for insurance business, such as winding up regulations and contract law, is not covered by the EU insurance directives. Provisions for some of the supervisory items included in the directives are not sufficient as regards prudential control of the insurance market.

Thus, each of the CEECs has to prepare its own the policies to create a sound insurance system in conformity with that of the European Union. However, this is a particularly difficult task for the CEECs, with their limited experience in market-oriented insurance systems and the EU's insurance system. Thus a comprehensive programme for establishing a robust insurance system, that takes into account the requirements and guidelines laid down in the Europe Agreements and the White Paper will be of great benefit to such markets.

9.2.1.3 Practical guidance for ensuring that insurance legislation is effective

The Europe Agreements and the White Paper do not cover concrete practical measures for ensuring that the insurance legislation of the CEECs functions properly. The White Paper argues:

"The main challenge for the associated countries in taking over internal market legislation lies not in the approximation of their legal texts, but in adapting their administrative machinery and their societies to the conditions necessary to make the legislation work." (see COMMISSION OF THE EUROPEAN COMMUNITIES (1995a) White Paper p.23.)

It is essential that the associated countries receive clear, concrete and practical guidance in order to make legislation work in their countries.

9.2.2 Specific measures for establishing a sound insurance market

9.2.2.1 General introduction

As explained above, the Europe Agreements, the White Paper and EU insurance directives are texts that present the minimum harmonisation required to achieve a single EU insurance market. However, what is essential for the economies in transition is that they create a sound national insurance system (whose market conditions are different to those of the EU countries), in harmony with the EU system.

Thus this section examines the essential measures for the CEECs to follow in order to achieve an appropriate insurance market reform. The basis of the model proposed here is that presented in Chapter 7 and 8, *i.e.* the model for three-level development aimed at achieving a developed insurance market. Since the internal market of the European Union is unique in character, *i.e.* a single market based on home country control, this section focuses on the particular arrangements that are indispensable for adapting the model discussed in the previous chapter.

Since the EU first and third insurance directives represent the core of the EU internal insurance market, this section covers the appropriate measures for complying with these directives.

9.2.2.2 Particular points to consider

In order to comply with the EU directives, the following aspects must be particularly taken into account.

(1) The balance between liberalisation and prudential regulations

Strengthening of the regulation and supervision framework in parallel with the cautious introduction of liberalisation measures is essential for improving the efficiency of the insurance market. Insurance sector stability is only achieved when prudential standards are met and when markets operate competitively, professionally and transparently in an international environment. Liberalisation without attendant prudential regulations and supervisory measures only leads to chaotic market situations. Indeed, implementation of the EU directives without taking into account the balanced development of prudential regulations and liberalisation measures will have a negative impact on the insurance system. The CEECs do not have to comply with all the provisions of the EU first, second and third directives consecutively. Most of the prudential regulations laid down in the third directives are best be complied with at the initial stage of the transitional period. Liberalisation measures should best be introduced once the regulatory and supervisory system has been well established.

(2) Gradual development policy

EU Member countries have taken more than thirty years to reach their current level of integration, *i.e.* a single license based on home country control. In particular about twenty years separated the first and the third non-life directive. The co-ordination procedure has taken a considerable amount of time. In other words, the EU internal insurance market is a system established as a result of an enormous amount of discussion and negotiation and thus considerable interaction among the EU member states.

The CEECs should take this fact into consideration when complying with the EU insurance directives. They should prepare an appropriate timetable with regard to their economic, social and political conditions. Hasty approximation and implementation of the EU insurance directives without due consideration for the market realities, would damage the whole insurance regulatory system.

(3) Co-ordination with EU supervisory authorities

A firm foundation for achieving an EU single market is close co-operation between European Union insurance supervisors. For this reason, the system of information exchange must be established with the supervisors of the European Union member countries. Indeed, the first, second and third EU insurance directives have numerous provisions related to co-ordination and co-operation among EU member states. For example, the provisions prescribed in the EU first insurance directives on this matter cover such issues as: a general co-operation clause (art.13 (non-life), art.15 (life)), authorisation of branches (art.11-3 (non-life and life)), solvency of the whole business verified by the main office (art.14 (non-life), art.16 (life)), information exchange for exercising supervision (art.19-2 (non-life) art.23 (life)), companies in trouble (art.20 (non-life), art.24 (life)), withdrawal of authorisation (art.22 (non-life), art. 26 (life)), second branches in the European Union (art.26-28 (non-life), art.30,31 (life)).

A sound insurance system backed by close co-operation with other EU member states is also a prerequisite for mutual recognition. The essence of the functional home country control is mutual recognition among member countries.

9.2.3 Relationship between the model and EU integration process

The author places the process of the CEECs into the European Union internal market in the context of the model that the author proposed in the previous chapters. In order to effect a single EU insurance market, the CEECs should take four steps in accordance with their market environments, i.e., the CEECs should take one step further in order to join the European Union.

The appropriate measures explained in the first, second and third level of development in the previous chapter are in principle, the same as the general policies for CEECs integrating with the EU internal insurance market. Thus, the reform model for the European Union applicants in these stages (first, second and third level) will note only those particular arrangements required for integration with the EU internal market, most of which are prescribed in the EU first insurance directives.

The fourth level of development covers those measures required uniquely of CEECs. These special arrangements are necessary to comply with the EU third insurance directives and establish a single EU insurance market. Relations between the model of this thesis and the guidelines of the White Paper are shown in the table 9-3 in the next page.

Table 9-3
Relation between the model and the guidelines stated in the White Paper

The Model	The White Paper	EU Insurance Directives
First Level	Stage I	First non-life directive First life directive Accounts directive
Second Level		
Third Level		Second non-life directive Second life directive
Fourth Level	Stage II	Third non-life directive Third life directive

9.2.3.1 The first and second levels (Stage I described in the White Paper)

During Stage I, as described in the White Paper, CEECs must comply with the EU first insurance directives (non-life and life) and EU insurance accounts directive. As mentioned above, the initial stage of market reform, the establishment of a sound insurance system is the first priority. Thus, in addition to the EU first insurance directives and EU insurance accounts directive, the CEECs should comply with EU motor liability directives and the articles concerning prudential regulations laid down in the third EU directives. Moreover, CEECs should implement all the measures stated in the first and second level of the insurance supervisory system, as described in the previous chapter. Since the EU first insurance directives are the core of the internal market, their general nature and their particular importance for CEECs in the process of compliance are described below.

(1) General nature of the EU first insurance directives

The main objective of the EU first insurance directives is to co-ordinate EU member state provisions relating to:

- the taking up of the business of direct insurance;
- the carrying out of direct insurance.

The White Paper clarifies that the purpose of these directives was to make it possible for insurance companies in one EU member state to carry out their business in another member state according to the conditions of the host country with a minimum of red tape (see COMMISSION OF THE EUROPEAN COMMUNITIES

(1995a) White Paper p.295.)

With this aim, harmonisation was introduced in the following areas:

- conditions for admission
- conditions for operation
- conditions for withdrawal of authorisation
- rules relating to branches established within the European Union whose head offices are outside the EU.

(2) Compliance by the CEECs with the EU first insurance directives

General provisions

The EU first insurance directives extend supervision to all insurance activities. In the non-life sector, a list of classes was established to cover the whole non-life sector (art.1 (non-life)). This classification of risks in the different fields of insurance is needed in order to determine those activities subject to compulsory authorisation and to way down the amount of the minimum guarantee fund for each class of insurance. The EU first insurance directives also establish the kinds of insurance, operations and institutions not covered by the directives (art.2,3,4 (non-life and life)).

Conditions of admission

The EU first insurance directives specify all the classes of insurance to which they apply and which are subject to official authorisation, and also define the conditions for the granting of such authorisation.

A license to carry out direct life and non-life insurance activities, shall be granted to an insurance company by the competent authorities of the EU member state in which the risk is situated or where its head office is established (art.6, 7 (non-life and life)).

The legal forms an insurance undertaking may adopt are listed by each EU member state (art.8 (non-life and life)) on the basis of mutual recognition. An insurance company is obliged to limit its business activities to insurance and operations directly arising therefrom, to the exclusion of all other commercial business (art.8 (non-life and life). In addition, no insurance company may simultaneously carry out life insurance and non-life business operations (art.13 (life)).

The EU first insurance directives do not prevent EU member states from introducing fit and proper control of directors and managers and prior approval of tariffs and products (art.8 (non-life and life). The CEECs should from the beginning introduce fit and proper control of directors and managers as well as supervision of shareholders of insurance companies as laid down in the EU third insurance directives (the EU third directives, art.8, 15 (non-life) art.7,14 (life)). Prior approval of tariffs and products is also an essential control measure at the initial stage of the transition, although it was not prescribed in the EU insurance directives.

The EU first insurance directives prescribe that in principle, an EU member state must grant permission to establish operations if all requirements of the relevant procedure are met. Authorisation can not be subject to the economic situation of the domestic market, nor an insurer lodging a deposit or providing any security (art.6, 8 (non-life and life)). Precise reasons must be given for rejection of an application for authorisation. Member states shall have the right to apply to the courts (art.12 (non-life and life)).

In the event of authorisation of branches and agencies within the European Union (art.10,11 (non-life and life)), the host country shall communicate with the home country before granting a license (art.11(3) (non-life and life)).

Conditions of exercise of business

With regard to the conditions of exercise of business in the European Union, the EU first insurance directives state that the supervisory authority in the home country shall verify the state of solvency of the company with respect to its entire business (art.14 (non-life) and art.16 (life)). The EU first insurance directives also prescribe that insurance companies must possess solvency margin and minimum guarantee funds (art.16 and 17 (non-life), art.18,19,20 (life). The solvency margin requirements applied in CEECs should take into account the particular conditions in their markets, and as mentioned in the previous chapter certain modification may be necessary.

The EU first directives also specify that technical reserves and corresponding assets be controlled by each EU member state (art.15 (non-life), art.17 (life)). They do not state any common rules for calculation of technical reserves or for evaluation of assets, although strict rules for currency matching and localisation of assets are stipulated (art.15 (non-life), art.17 (life)). These provisions are not sufficiently detailed for CEECs. A better solution is to comply with the corresponding articles in the EU third insurance directives.

Prohibition of any rules concerning selection of free assets (assets in excess of those representing technical reserves) is specified by the EU first directives (art.18 (non-life), art.21 (life)). During the initial stage of the transition however, the assets are more volatile and sometimes difficult to evaluate. The free asset could be an element to deteriorate the whole balance sheet. Thus it is natural that the CEECs apply some rules on these assets as well as the assets corresponding to the technical provisions. In other words, this provision in the EU directives does not have to be complied with during the first and second level of development.

The EU first directives prescribe that home country supervisors shall require annual accounts, and supervisory returns together with statistical documents from insurance companies. Host supervisors shall require supervisory returns together with statistical documents from insurance companies (art.19 (non-life), art.23 (life)). The CEECs should carefully prepare the forms and measures for collecting such information. Conditions are defined for intervention and withdrawal of authorisation in the case of insurance companies in trouble (art.20 and 22 (non-life), art.24 and 26 (life)).

Branches from outside the European Union

This section prescribes rules applicable to branches established within the European Union but whose head offices are outside the EU. The CEECs should carefully arrange their regulations so that branches from outside the European Union are not discriminated against in favour of the branches from within the European Union. It is important that CEECs follow the rules of MFN of GATS and the non-discrimination provision of the OECD code. These differentiations will be permitted only after the CEECs become members of the European Union.

9.2.3.2 The third level

This is the final stage before establishment of mature insurance market except in the case of countries seeking membership of the European Union. After establishing a functional insurance system during the first and second level, the countries should undertake measures to ensure that the system functions effectively. Their policies should focus on gradual liberalisation of the market in parallel with strict prudential regulations. Detailed third level policy measures are described in the previous chapter.

This is also the essential step toward a single European market. The European Union took nearly twenty years to comply with the first directives and the third directives. Co-ordination and co-operation during that period was the basis for the EU single insurance market. Thus CEECs should carefully arrange their third level policies, so that their markets smoothly integrate with the EU single market.

9.2.3.3 The fourth level

In order to achieve an EU single market, countries should take further measures than those specified in the third level. These fourth level measures mostly correspond to the Stage II prescribed in the White Paper, *i.e.* implementation of the EU third life and non-life insurance directives. These are intended to introduce a single passport within EU insurance markets and allow insurance companies to freely decide whether to sell their insurance products through an existing establishment in another member state or directly. They prescribe that countries abolish prior control of products and tariffs.

The eventual development of a single passport in the insurance field is a result of trust and co-operation between the supervisory authorities established under the first, second and third level. The White Paper states:

> *It (a single passport) pre-supposes a higher degree of market integration and closer relationships, de facto and de jure, between supervisory authorities within the context of supra-national co-operation. The main elements of stage II approximation (the fourth level) comprise the measures establishing procedures for closer co-operation between supervisory authorities, the introduction of a single licence, deregulatory measures liberalising the control of products and tariffs and measures laying down minimum rules for the investment of technical provisions.* (see COMMISSION OF THE EUROPEAN COMMUNITIES (1995a) White Paper p.300.)

Countries should prepare prudential regulations for protecting policyholders and market integrity according to the single market.

(1) The EU third insurance directives

Definition, scope and taking up of the business of insurance

This section of the EU third insurance directives calls for the abolition of monopolies (art.3 (non-life)). This requirement has significant impact on those CEECs which still have monopolies in respect of certain classes of insurance.

The EU third insurance directives introduce a system of single authorisation under which companies will no longer have to seek authorisation from each EU member state in which they wish to conduct business. The authorisation provided by their home member sates will be valid for the entire European Union, whether business is conducted through a branch or via the provision of cross-border services and whether the risks are large risks or mass risks (art.5 (non-life), art.4 (life)). The financial supervision of all such business will be the sole responsibility of the home member state regulator (art.9 (non-life), art.8 (life)). Financial supervision is, moreover, to be exercised in accordance with the law of the home country. The authority in the host country has to rely on this being carried out, and has to accept the situation on the principle of mutual recognition even if its own law differs from that of the home country.

Home country authorities are also given extended powers to carry out on-the-spot controls of branches situated in other EU states (art.10 (non-life), art.9 (life).

The most significant change in the system of authorisation is the prohibition of prior approval of tariffs and products (art.6-3, art.29 and art.39 (non-life), art.5-3, art.29

and art.39 (life)), since this requirement is regarded as inconsistent with the freedom to provide services in the single market. This change requires supervisors to reinforce financial supervision and the other measures of controlling insurance companies in order to ensure the sound financial condition of insurance companies. The EU third insurance directives also require controls that ensure the suitability of managers, directors and shareholders (art.8 and art.15 (non-life), art7 and art.14 (life)). However, as mentioned above this measure is best introduced at the first level, not the fourth.

Harmonisation of the conditions governing the business of insurance

The introduction of a single authorisation system and home country control with a view to creating a high level of protection for the consumer necessitates harmonisation and reinforcement of EU member state rules on supervision. As for the CEECs, establishment of strong legislation and supervisory authorities will be their first priority during the initial stage of transition. Therefore, except for those supervisory measures that correspond with the creation of a single market, the points for reinforcing supervision should be introduced in the first level and not the fourth. Such provisions are: supervisory powers of authorities (art.11 (non-life), art.10 (life)), professional secrecy (art.16 (non-life), art.15 (life)), and control of technical provisions and assets (from art.17 to art.23 (non-life), from art.18 to art.24 (life)).

On the other hand, provisions relating to the single market, particularly the provisions on extension of home member state control should be complied with at the fourth level. Those provisions are home country powers of EU-wide financial supervision (art.9 (non-life), art.8 (life)) and on-the-spot supervision of branches situated in other EU states (art.10 (non-life), art.9 (life)).

Provisions relating to right of establishment and the freedom to provide services

This section describes the administrative procedure for authorisation and notification of the establishment of a branch and cross-border services in other EU member states and thus the essential measures for conducting insurance business in the EU single market. These measures need to be considerably simplified. With regard to the establishment of a branch in other EU member countries, an EU insurance company should be able to obtain authorisation within five months where it satisfies the stipulated requirements (art.32 (non-life and life)).

With regard to the freedom to provide services, a company must notify the authorities in its home country if it intends to conduct cross-border business for the first time in other EU member countries (art.34 (non-life and life)). The home country authorities must provide certificates directly to the host authorities within one month confirming the suitability of the cross-border business by that company. The company should be able to commence business on the date on which the host country receives the certificates (art.35 (non-life and life)).

This procedure ensures that the authorisation to conduct business in other EU member states is given within a limited period by the home country and not by the host country.

However, this does not mean by any means that the authority in the host country need no longer concern itself with the activities of other EU companies on its territory. The law of the host country shall still apply to their activities (art.40 (non-life and life)) and thus the role of the host country authorities remains as vigilant as ever.

Transitional provisions

If necessary, the transitional provisions in the EU third insurance directives should also be applied to the CEECs, in particular, those concerning prior approval of products and tariffs and control of technical provisions, as applied by some EU member states. As explained above, insurance supervisory authorities should implement all the essential measures described in the first, second and third level. This can not be achieved without experience and knowledge and thus may take considerable time. Therefore, CEECs should consider retaining at least the control of products, tariffs and technical provisions for some time following implementation of the EU third insurance directives in order to ascertain that single market implementation is helping to develop their market without causing undue confusion.

(2) Particular points to consider

Responsibilities of the host country

Even after implementation of the EU third directives, insurance authorities in the host country shall still maintain considerable responsibility for policyholder protection on its territory.

Although authorisation of insurance activities and financial control within the European Union is carried out by the home country (the country of origin), the EU third directives call for the strong powers of control by the authorities of the host country (the country of activities). Host country authorities may intervene in the activities conducted on its territory by companies whose head offices are situated in other EU countries, and may even prevent them from commencing new activities where necessary under its legal provisions and where the host country has introduced prescribed procedures.

Indeed, in the name of "the general good", the authorities of host countries still maintain considerable powers of intervention in the activities on its territory. This means that even under the single market and the principle of home country control, insurance authorities should take responsibility for the protection of all policyholders on its territory.

The strong supervisory system of each country balanced with the single market

In many cases, the provisions in the directives are not sufficient in respect of prudential control of each country's market. A strong legal base and supervisory system in each country is always essential under a single market.

Indeed, the preamble of the EU third insurance directives clearly states that "certain provisions define minimum standards." The CEECs should take into account that the establishment of a sound EU single market needs higher prudential consideration than that specified by the EU directives.

Of course, the necessity of laying down stricter supervisory measures with the aim of improving consumer protection needs to be balanced against the necessity to ensure co-ordinated operation of the insurance single market with as few regulatory, competitive and other barriers as possible remaining.

Tax collection

Since the tax system has not yet been harmonised within the European Union, every insurance contract shall be subject exclusively to the indirect taxes on insurance premiums in the host country. The CEECs should establish appropriate measures for ensuring tax revenues from cross-border insurance transactions until the eventual harmonisation of tax systems.

Evolution of the European Union

The European Union is not static but dynamically evolving. The requirements for European internal markets are being changed by the development of the European Union itself. The CEECs should keep abreast of the latest development of the European Union with regard to the insurance field, such as modification of solvency margin regulations; and discussions on further harmonisation of the regulations concerning intermediaries and winding up. The official interpretation of "the general good" also has considerable influence on the regulatory systems of the CEECs.

All these issues will not be adopted as binding instruments soon. However, once adopted, they will have a strong impact on the insurance system in the European Union and the CEECs. Since CEECs have not participated in the discussion and negotiation process of these latest developments, they need to make all the more effort to regularly obtain information on these issues.

CHAPTER 10: CO-OPERATION WITH FOREIGN ORGANISATIONS - EFFECTIVE WAYS OF IMPLEMENTING THE REFORM PLAN

As examined above, a well-planned scheme that takes into account market conditions is essential for the reform of economies in transition. In order to effectively implement such schemes, one particularly important element must be considered.

This is close co-operation with foreign organisations such as governments in other countries and international organisations, because learning from the experiences of developed markets is the most efficient way to achieve a system that will be compatible with them. Foreign organisations provide a variety of training programmes as well as useful information on legislation and supervision. For example, since the CEECs have already been given a framework of the future system by the European Union, co-operation with EU member states is particularly important for them.

However, such co-operation usually fails to function properly or achieve expected results. In respect of the development of insurance systems in economies in transition, this problem is equally serious as the fact that economies in transition have yet to establish proper models or guidelines for the reform of their insurance markets. Thus, in this chapter, the author analyses the deficiencies of programmes for co-operation with foreign institutions as faced by the governments of economies in transitions and proposes measures to improve the situation.

10.1 Problems involving co-operation with foreign organisations

The obstacles to functional co-operation programmes with foreign organisations originate on both sides, *i.e.* in the authorities in economies in transition themselves and in the organisations providing co-operation programmes. Following an analysis of the general problems arising on both sides, situations specific to CEECs are examined below.

10.1.1 Economies in transition

10.1.1.1 Lack of initiative

A fundamental and often observed obstacle to the use of the co-operation programmes provided by foreign organisations is a lack of initiative on the part of the countries receiving these programmes. Economies in transition often do not prepare specific requests of the co-operation programmes on their legislative reform or staff training schemes. In such situations, the foreign organisations willing to provide co-operation programmes are unable to grasp the real needs of economies in transition and thus are unable to prepare effective programmes. For this reason, co-operation programmes often fail to be organised systematically. The issues examined are often too general or too detailed and the programme fail to attain the results expected.

Such situations often lead to economies in transition simply copying a system of a developed insurance market without reflecting on the particular conditions of their own markets, and thus establishing an unsuitable system.

10.1.1.2 Lack of comprehensive information on co-operation programmes

Economies in transition do not always keep in close contact with those foreign organisations that could provide them with co-operation programmes. There exists no organisation to co-ordinate the various kinds of co-operation programmes offered by different institutions. This situation prevents economies in transition from obtaining a comprehensive view of such programmes. As a result, they tend to receive uncoordinated co-operation programmes from various foreign organisations.

In addition, there is no regular communication between the authorities of economies in transition. This means that they lose the opportunity to learn from each other's experience on how best to take advantage of using co-operation programmes.

10.1.2 Countries providing co-operation programmes

The problem facing foreign organisations which provide co-operation programmes for economies in transition is that they often fail to understand the particular situation of economies in transition. Since they do not fully grasp the real needs of those countries, they are inclined to suggest the insurance system to which they belong and therefore know best. In many cases, this is not the most suitable system for economies in transition. The system suggested often fail to correspond to the market conditions in economies in transition.

10.1.3 CEECs

In general the CEECs have received better organised co-operation programmes than other economies in transition, since they already have a given framework for reform, *i.e.* an insurance system compatible with that of the European Union, and have an established assistance system such as the PHARE programme. Once the Accession Partnership takes shape and membership negotiations begin, EU assistance programmes will be directly linked with the goal of the reform, *i.e.* the establishment of the EU internal market.

But the co-operation programme prepared by the European Union is in general bureaucratic, inflexible and involves a time-consuming application procedure, thus often failing to correspond to the urgent needs of CEECs.

Moreover, insurance is often not given sufficiently high priority in requests from CEECs' governments. The scope and amount of support is much smaller than for other areas, such as banking.

10.2 Measures for effective use of co-operation programmes

10.2.1 Strong initiative on the part of the transitional countries

Insurance authorities in economies in transition should recognise that co-operation with foreign organisations is essential to their organisations. The department of the insurance authority dealing with this matter should keep in close contact with such other sections as legislation, supervision and personnel so that the co-operation programme may reflect the needs of the organisation as a whole.

Insurance authorities should prepare a concrete plan for co-operation programmes from foreign organisations that are based on their particular needs. They can then send their proposals and select the programme or foreign organisation which best corresponds with their requirements.

A prerequisite for good organisation of a co-operation programme is close contact with foreign organisations. In this respect, it is worthwhile to actively participate in international meetings of supervisors. A contact established with foreign insurance authorities at a multi-lateral forum can often be the start of a bi-lateral co-operation programme. Organising international meetings in one's own country is also helpful in developing a closer relationship with the authorities from other countries.

With regard to a co-operation programme for CEECs, relations with the EU Commission are particularly important in order to keep abreast of the EU insurance legislation development and obtain official support from an assistance programme such as PHARE. The EU Commission will also provide assistance through TAIEX (the Technical Assistance Information Exchange Office) which helps provide CEECs with information, advice or assistance on the EU internal market. With regard to specific issues concerning insurance regulations and supervision, EU member states possess more knowledge and experience than the EU Commission. Thus CEECs should also keep in close bilateral contact with EU member states. Exchange of information between the CEECs is also effective in the development of an insurance system for each country in this region. In view of this, certain countries should take the initiative in organising a discussion forum.

10.2.2 Understanding the basic schemes of foreign co-operation

As examined above, lack of comprehensive information on the co-operation programmes offered by foreign organisations is an obstacle to the effective use of those programmes. Therefore this section examines the chief organisations providing co-operation programmes, their nature and measures for using them.

10.2.2.1 Government organisations

Some governments in developed markets have their own co-operation programmes to assist in the reform of economies in transition. The insurance authorities of some developed countries provide co-operation programmes for economies in transition. Since the supervisors of those markets have a broad expertise of insurance regulations and supervision, their support can be practical and effective. For example, the authorities in some developed markets accept personnel from economies in transition on trainee placements. However, the insurance authorities in most developed markets have an already well established staff and do not have the extra capacity needed for co-operation programmes. Work on co-operation programmes is additional to their routine responsibilities and in such cases economies in transition can not request assistance that exceeds their capacities.

10.2.2.2 The private sector

Organisations from the private sector such as associations of insurance companies or large reinsurance companies actively co-operate with the insurance authorities of economies in transition. They usually possess high technical expertise and practical insurance business skills and are willing to share their knowledge. Insurance authorities should make good use of what the private sector has to offer, but without imposing their own business interests. In this respect, insurance supervisors may ask for co-operation in reinforcing their technical knowledge of such concepts as technical provisions, assets and reinsurance contract, as opposed to subjects directly related to the interests of the foreign private sector such as licensing or liberalisation of markets.

10.2.2.3 OECD

The OECD Insurance Committee provides co-operation programmes for supervisors and regulators in economies in transition by organising workshops on collaboration with experts from OECD member states. The workshops are not aimed at supplying economies in transition with a single standard but rather with a range of possibilities and appropriate advice. The workshops usually take the form of a discussion forum between experts from OECD member states and those from either a specific country or from a group of countries with economies in transition.

Since the OECD Insurance Committee has a broad range of high quality information on insurance supervision and regulation, economies in transition may request information in this area from the OECD.

10.2.2.4 WTO

Although WTO itself does not organise co-operation programmes for economies in transition, GATS (General Agreement for Trade in Services), an annex to the Agreement establishing the WTO, is first the world-wide established set of rules on trade in services. The purpose and priorities of the GATS directly reflect the belief of governments in the largest possible degree of liberalisation and deregulation and in fair market rules and consumer protection. This should ensure service-suppliers greater freedom to choose their mode of supply and style of operations and thus encourage technical and managerial innovation, price competitiveness and high quality service. In other words, the GATS provides the framework for liberalisation of international trade in services. Though they are not directly related to any particular co-operation programmes, the concepts of GATS play a key role in the liberalisation of insurance systems in economies in transition. Concerning cross border services provisions in GATS, please refer to section 8.3.2.1 - cross border services provisions.

10.2.2.5 IAIS

The goal of the IAIS (International Association of Insurance Supervisors), is co-operation that ensures improved supervision of the insurance industry at the domestic as well the international level in order to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. It develops practical standards for supervision of insurance and provides regional training programmes for insurance supervisors and regulators in emerging markets.

Economies in transition are encouraged to positively participate in the activities of IAIS, since it benefits such countries to comply with appropriate standards of insurance regulation and supervision. In addition, the training programmes organised by the IAIS provide a good opportunity to learn the principles and practical measures of insurance supervision.

The IAIS supervisory principles and GATS may play supplementary roles in creating stable and efficient markets. It follows from analysis of the above models that the prudential regulations prescribed by the IAIS principles should be complied with before introducing the liberalisation measures laid down by GATS.

Since one of the fundamental problems facing the insurance sector is the lack of any single organisation capable of fully understanding the needs of economies in transitions with regard to assistance, or co-ordinating the co-operation programmes of various organisations, the IAIS may play a key role in reinforcing co-ordination. Due to its broad membership (about ninety countries) and its unique international role in insurance supervision, the IAIS is in an ideal position to be a central intermediary between organisations which provide co-operation programmes and the users of such programmes. The IAIS can ensure that the co-operation programmes provided by various institutions are complementary and not duplicated.

CHAPTER 11: POLAND'S INSURANCE MARKET UP TO EARLY 1990'S AND THE FIRST STEPS TOWARD A MARKET ORIENTED SYSTEM

The following two chapters comprehensively analyse Poland's transitional insurance market. The present chapter reviews the Polish insurance market, from its beginnings to early 1990's. The next chapter analyses the Polish insurance market's reform toward the European Union and argues the effectiveness of the theory and models discussed so far. The reasons for selecting Poland from among CEECs are:

- Poland is by far the largest insurance market among the ten CEECs that have signed the Europe Agreements and thus the most appropriate to represent the insurance markets in this region. In 1996, total insurance premium in Poland amounted to USD 3,041 million, a sum slightly less than the total premiums of the other nine CEECs.

- Poland is also one of the most developed CEEC insurance markets (see Chapter 7 and Tables 7-5). Thus, it should prove instructive for less developed economies in transition to review Poland's market development.

This chapter firstly analyses the Polish insurance market's development from its earliest beginnings. In particular, closely reviewed is the insurance system during the communist regime, as it was the starting point from which the sector moved toward a market-oriented reform in 1990. Secondly, it considers the positive effects and limitations of that first reform in 1990 toward a market-oriented system. Finally, it analyses the problems encountered by the insurance market in the initial period of reform, with particular emphasis on the causes of the same.

11.1 The pre-communist insurance system (1803-1944)

11.1.1 The beginnings of Poland's insurance system (1803- 1919)

Recent developments in Polish insurance have been considerably influenced by the country's long insurance tradition from the past. As Dmochowski (1981) pointed out, during the so-called Partition Period, when Poland was under Prussian control, a royal decree in 1803 established a public-law insurance office for south Prussia (Region of Warsaw and Poznan) to provide compulsory fire insurance for urban buildings. This has been recognised as the first Polish insurance company in history. In 1816, this Prussian system of a locally administered mutual association was also applied in that part of Poland controlled by Russia. Since that time, this type of insurer continued to develop in Poland. In 1860, the mutual company Florianka was established and operated successfully in Cracow, the capital city of Austrian controlled Poland. In time, several independent Polish-owned companies and mutuals were established. For example, the Warsaw Fire Insurance Company, founded in 1870, became well known in Europe through its reinsurance activities.

11.1.2 The insurance system after the First World War and during the Second World War (1919-1944)

After the restoration of an independent Poland, the country's insurance market was open and remarkably developed. Rogers (1988) pointed out that between 1919 and 1938 the number of insurance operators in Poland increased from 2 public-law offices, 8 mutuals and 11 stock companies to 16 public-law offices 38 mutuals and 72 private companies. In 1920 the public-law insurance office in Poznan, successor to the oldest insurance office on Polish territory established the professional reinsurance company Warta.

Between the end of the First World War and 1929, the insurance market in Poland developed steadily, recovering from the damage and difficult economic situation created by the war. Between 1930 and 1934 however, the world economic crisis was to drastically slow development of this market. The last few years before the Second World War were characterised by a slow recovery from this economic crisis and a reorganisation of the insurance industry. The role of public-law insurers grew in importance and thus in 1937 – for the first time in history – the market share of public-law insurers reached 50% of gross premiums. Foreign-owned private companies also developed and their share in gross premium had reached 38 % by 1937. In 1937, 70% of stock companies' total premium income was being reinsured abroad.

The Second World War again partitioned the Polish insurance market. Germany invaded the larger part of the Polish territory and except for PZUW (General Institute for Mutual Insurance), all Polish insurance companies were forced to halt operations. In the Soviet occupied territory, all Polish insurance companies were excluded and insurance business was exclusively controlled by the Soviet insurance administration Gosstrakh.

11.2 The insurance system during the communist regime (1944-1989)

The communist system enforced on Poland after the Second World War led to considerable changes in the insurance market structure. The history of the Polish insurance system during this period can be divided into the following periods:

1944-1947: the rebuilding of Polish insurance companies and their commencement of operations within the new communist framework

1947-1958: the process of full nationalisation of the insurance industry.

1958-1984: stabilisation and gradual obsolescence of the communist insurance system.

1984-1989: the system's gradual evolution towards a market–oriented mechanism.

(see detail in Dmochowski(1981) and Kowalewski (1988))

11.2.1 The insurance system between 1944-1984

The process of introducing command economy policies was carried out progressively. In 1947, all stock and mutual companies were dissolved except for PZUW, which thereafter monopolised all insurance classes. At the same time, a 1947 law made Warta the only professional reinsurance company in Poland. For practical purposes, we may say that an insurance monopoly was established at this time. In 1952, the mutual company PZUW was renamed PZU and transformed into a specialised branch of the government dealing with insurance services, operating as a legalised monopoly.

Economic reforms in 1958 introduced some degree of decentralisation, providing greater autonomy for state enterprises and a new regulatory framework was introduced for the insurance sector.

The 1958 insurance act:

- transformed the PZU from an entity that by nature was an administrative arm of the state into a state-owned insurance enterprise;

strengthened public control of insurance activities through re-establishment of the Insurance Council, vested with decision-making powers;

reduced the number of obligatory insurance lines to five (although in practice this number was later gradually expanded by subsequent government decrees)

introduced the principle of freedom with respect to the voluntary insurance of non-state units of the national economy, at the same time limiting administrative regulation of the scope of insurance cover in the state sector.

11.2.2 The 1984 Insurance Law

11.2.2.1 General nature

Following the example of the Soviet Union, from the early 1980's Poland's communist rulers began discussions on reforming the command economy system. That trend was also to have considerable impact on the Polish insurance system. The September 20 1984 Law on property and personal insurance reflected this reform's objectives. The scope and detail of the new law was more extensive than that of 1958. Nevertheless it failed to meet the requirements of a transforming economy, i.e. it was burdened with the same drawbacks that characterised the regulatory framework of former decades.

The 1984 Law in particular:

at least theoretically de-monopolised the insurance sector, permitting the establishment of other state-owned insurers, co-operative insurers in the form of joint stock companies;

confirmed that the state was not responsible for an insurer's liabilities but also that an insurer was not responsible for the liabilities of the state;

for the first time since the war established proper principles for premium calculation;

extended the Insurance Council's role and provided it with far greater powers. Formerly an advisory board, it could now exercise supervisory and even executive functions to protect the interests of policyholders;

controversially extended the catalogue of compulsory insurance, including the fixed assets of state-owned enterprises. Compulsory insurance arose as soon as a specific insurance object came into existence. Although the parties to compulsory insurance, as in the case of voluntary insurance, were the insurer and insured, their rights were governed by statutory and administrative law rather than by contractual agreement. Premiums, like taxes, were collected through orders to pay. (see Chapter 3.1.2 "Limited product choice and semi-automatic insurance cover" and Roger (1988) for further discussion on compulsory insurance).

11.2.2.2 Insurance products

The classes and premium of insurance offered by PZU in 1986 are presented in Tables 11-1 and 11-2.

(1) Compulsory insurance

The 1984 insurance law required compulsory insurance for the following categories of property:

- agricultural insurance for buildings, contents, crops, livestock, and farmers liability;

- traffic insurance for automobiles;

- fixed assets of state enterprises;

- legal liability for nuclear plants.

Table 11-1 Insurance premium by class 1986 (in millions PLN)

Type of Insurance	State	Private	Total	Total(%)
Compulsory insurance				
Buildings and Agriculture	7,024	28,167	35,191	21.8
Traffic	4,328	26,597	30,925	19.2
Fixed Assets	13,976	-	13,976	8.7
Total Compulsory Insurance	25,328	54,764	80,092	49.7
Voluntary insurance				
Property	25,375	7,478	33,453	20.8
Accident	472	11,642	12,114	7.5
Life	-	35,495	35,495	22.0
Total Voluntary Insurance	25,847	54,615	81,062	50.3
Total - Compulsory and Voluntary	51,175	109,379	161,154	100.0

Data source: PZU 1986 Annual Report

Table 11-2 Classification of Insurance Products in Poland 1986

Compulsory
Agricultural
- Buildings (fire and other perils)
- Contents (fire and other perils)
- Crops (hail and flood)
- Livestock
- Farmers Liability

Traffic
- Automobile Physical Damage
- Automobile Accident
- Automobile Liability

State Enterprises
- Fixed Assets

Nuclear Plant Legal Liability (1986)

Voluntary Property and Casualty
Dwellings and Household Property
General Property of State and Non-socialised Enterprises
Plate Glass
Burglary
Supplemental Livestock
Supplemental Crop
Supplemental Traffic
Legal Liability
Transportation
Watercraft and Aircraft Hull
Baggage

Voluntary Personal
Accident
- Individual and Group
- Group Employment
- Juvenile
- Special Event

Life
- Individual and Group
- Juvenile
- Group Family

Annuity
- Deferred
- Immediate

Data source: PZU 1986 Annual Report

Agricultural insurance

Farmers' buildings had to be insured to their full value against loss by fire, hurricane flood, and other disasters. Contents of private farms also had to be insured.

Crops, vegetables and livestock were also insured against hail, fire and disease-related forced slaughter. Farmers liability insurance applied to all members of a family and any persons employed on a farm. The total premium in 1986 was 35,191 million zloty, amounting to 21.8% of Poland's total insurance premium.

Traffic insurance

Compulsory insurance of automobiles against physical damage, automobile accident and automobile liability were included in the traffic insurance category. This category's total premium in 1986 was 30,925 million zloty, constituting 19.2% of the country's total insurance premium.

Fixed assets of state enterprises

In the 1984 insurance law reform, fixed assets of state enterprises were included under compulsory insurance. This category was composed of buildings, machinery, equipment, and all permanent structures of state enterprises. The total premium was 13,976 million zloty, amounting to 8.7% of Poland's total premium.

(2) Voluntary insurance

The 1984 insurance law laid down the framework of voluntary insurance. Specific details were left to the discretion of PZU. Even in the case of voluntary insurance, certain forms could be purchased voluntarily by a state enterprise but had to accord with any directive issued by a higher authority. Thus in practice, enterprises were forced to purchase this coverage.

Property insurance

Property insurance mainly comprised the insurance of households and household property and any property of state enterprises that was not covered by compulsory insurance. This insurance category amounted to 33,453 million zloties in 1986, 20.8 % of Poland's total premium.

Accident insurance

Accident insurance, covering losses caused by unforeseeable accident, amounted to 7.5% of the country's total premium.

Life insurance

Life insurance was composed of two types of products: individual life and group family life. In 1983, premium income from group family insurance amounted to approximately 94% of total life premiums. Almost all employees of state-owned enterprises were covered. In 1985, approximately 15 million persons were covered by this insurance. The total life insurance premium amounted to 22.0% of all insurance premiums in 1986.

11.2.2.3 Distribution of insurance products

In the 1980's about half of the Polish market's premium came from compulsory insurance, where no marketing was required. The other half of the premium derived from voluntary insurance, where marketing played an important role. For those products, it was common for state enterprises to negotiate and purchase insurance products directly from local branches of the PZU. Their custom amounted to about one third of the PZU's voluntary insurance business. The remainder, about two thirds of voluntary insurance business or almost one third of the PZU's total premium income, derived from the private sector. Agents handled the majority of those transactions. The PZU was entitled by law to conclude insurance contracts through the medium of agents and any person interested in such work was able to become an agent, i.e. no special professional training was required.

11.2.2.4 The PZU's financial statements

The 1984 Law declared the PZU a self-financing organisation. This meant that the state was not responsible for the insurer's liabilities but also that the insurer was not liable for expenses not related to its business. Previously, any surplus of the PZU was transferred to the state budget. Thus, insurance premiums practically constituted a tax. To ensure the principle of self-financing, the 1984 law laid down the method for calculating premiums in order for these to cover all PZU costs.

The 1984 Law stipulated that the PZU was required to establish the following seven funds:

(1) A statutory fund that was to reflect the value of fixed and current assets.

(2) Technical reserves that were to cover future liabilities resulting from insurance activities. In practice, these consisted of provisions for life and annuities insurance. Unearned premium provisions and loss provisions did not exist mainly because insurance transactions were reported on a cash basis (see 3.1.3 "Accounting systems in command economies").

(3) A reserve fund, designed to cover balance sheet losses and created from the balance sheet surplus, amounting to the sum envisaged by the technical plans of insurance and also from interest earned on the investments of this fund. The amount of this reserve fund was equal to one average annual premium income, calculated over the previous three years. These reserves were similar to the equalisation reserves under the insurance systems of market economies.

(4) A loss prevention fund was designed to finance loss prevention activities and was created from the premium's deductions and any business surplus.

(5) A development fund was to cover the insurer's business development and investment costs. This fund provided the company's management with various business improvement opportunities.

(6) A fund for awards and (7) an institutional fund were used to cover such company employee benefits as bonuses, housing and other welfare. All the funds were located on the central banks' accounts or in the securities issued by the State.

11.3 The 1990 insurance law and insurance market at that time

After the fall of the communist regime in Poland in 1989, the Polish authorities took a decisive step toward a market-oriented economy. The insurance law of 1990 was epoch-making in Poland's insurance history as it initiated and spurred a market reform based on the European Union's insurance framework. The chief elements of this law derived from the EU's first generation insurance directives. However, the limitations and deficiencies of the 1990 law became evident within a few years of its implementation.

The market's condition during the initial period of its reform in the early 1990's was characterised by a continuation of PZU's monopoly, the slow growth of the insurance market, limited product choice and limited investment opportunities.

11.3.1 The 1990 insurance law: The first reform toward a market oriented insurance system

11.3.1.1 The introduction of insurance concepts compatible to those of EU countries

An insurance concept compatible to that of European Union countries was introduced in Poland in 1990. The financial statements of the communist regime in Poland were fundamentally different from those of EU countries. The PZU's accounting was on a cash basis and the company maintained seven special funds, bearing no comparison with the insurance system in EU countries. Alongside a reform of the accounting system, the 1990 law introduced the application of the same insurance terminology as that used by market economies, such as assets, technical reserves and capital (Chapter 5 of the 1990 insurance law). In addition, the insurance product classification laid down by the 1990 law (Annex to the 1990 insurance law) was also guided by the EU's first generation insurance directives (Table 11-3). Thus, the 1990 law ensured that the Polish insurance market was compatible to EU countries in terms of insurance terminology and general concepts.

11.3.1.2 The creation of a prudential insurance supervisory system

The 1990 law also introduced a prudential supervisory system based on that of EU countries. The 1990 law laid down requirements for obtaining a license, including a minimum amount of capital, a business plan, fit and proper management and general product terms (Chapter 3 of the 1990 insurance law). An on-going supervisory system, involving control of solvency margins, minimum guarantee funds, technical

Table 11-3 Classification of Insurance Products in Poland 1990

Class I - Life Insurance

1. Life insurance
2. Dowry insurance, children's maintenance insurance
3. Life insurance linked with investment fund
4. Pension insurance
5. Accident and sickness insurance, if these supplement insurance referred to in groups 1-4

Class II - Other Personal Insurance and Property Insurance

1. Accident insurance, including accident at work and occupational disease insurance:
   - 1.1 single performance
   - 1.2 repeated performance
   - 1.3 combined performances
   - 1.4 carriage of persons
2. Sickness insurance
   - 2.1 single performance
   - 2.2 repeated performance
   - 2.3 combined performances
3. 'Casco' insurance of land vehicles, with the exception of rail vehicles, covering damages to:
   - 3.1 motor vehicles
   - 3.2 non-propelled land vehicles
4. 'Casco' insurance of rail vehicles, covering any damages thereto
5. 'Casco' insurance of aircraft covering damages thereto
6. Insurance of marine and inland navigation covering damages to:
   - 6.1 sea-going vessels
   - 6.2 inland waterways vessels
7. Goods-in-transit insurance covering damage to goods while being transported, irrespective of the means of transport used
8. Damage caused by calamities covering material damage not included in groups 3-7, caused by:
   - 8.1 fire
   - 8.2 explosion
   - 8.3 storm
   - 8.4 other calamities
   - 8.5 nuclear energy
   - 8.6 landslides or bounces
9. Insurance against other kinds of material damage (if not included in group 3, 4, 5, 6 or 7) caused by hail or frost and by other causes (e.g. theft), if these causes are not included in group 8
10. Civil liability of any kind, resulting from possession and use of self-propelled land vehicles, including liability of the carrier
11. Civil liability of any kind, resulting from possession and use of aircraft, including liability of the carrier

12. Civil liability for sea and inland navigation, resulting from possession and use of inland waterways vessels or sea-going vessels, including liability of the carrier
13. Civil liability (general civil liability) not included in groups 10-12
14. Credits, including:
    14.1 general insolvency
    14.2 export credits
    14.3 repayments of instalments
    14.4 loans secured by mortgage
    14.5 agricultural loans
15. Guarantee:
    15.1 direct guarantee
    15.2 indirect guarantee
16. Various financial risks, including:
    16.1 occupational risk
    16.2 insufficient income
    16.3 bad weather conditions
    16.4 loss of profit
    16.5 regular general expenses
    16.6 unexpected commercial expenses
    16.7 loss of market value
    16.8 loss of regular income source
    16.9 indirect commercial losses apart from aforementioned
    16.10 other financial losses
17. Legal protection
18. Assistance granted on behalf of persons encountering difficulties while travelling or when away from their place of residence

Data: Annex to the 1990 Polish Insurance Law reserves and asset investment, was also introduced at this time (Chapter 5 of the 1990 insurance law). An insurance guarantee fund for some compulsory insurance (automobile third party liability and farmers' civil liability) was created to compensate policyholders where they were unable to receive indemnification. In addition, a policyholder protection fund was established. This fund paid claims to policyholders where an insurer became insolvent (Article 51 to 57 of the 1990 insurance law). The non-contractual quasi-taxation system of compulsory automobile third party liability insurance was replaced by contractual insurance (Article 3 and 4 of the 1990 insurance law).

11.3.1.3 The introduction of competition

To some extent, the 1984 law permitted the entry of new companies to the market. However, in practice only two co-operatives (Polisa and Westa) were established between 1984 and 1990. Any real competition was yet to be implemented. The 1990 law stipulated licensing procedures and allowed entry to new entities regardless of their nationality once such applicants satisfied certain requirements. By the end of 1991, 24 insurance companies had been licensed, of which six were foreign companies. The 1990 law introduced competition in the market for the first time since the Second World War.

11.3.1.4 PZU's reform

The 1990 law limited the forms of insurance companies only to joint stock companies and mutual insurance companies (Article 11 of the 1990 insurance law). It did not allow insurance companies to simultaneously conduct life insurance and non-life insurance business (Article 10-2 of the 1990 insurance law). Thus the state monopoly PZU was transformed into a joint stock company owned by the state and divided into the PZU Life company and PZU that operated solely non-life insurance business.

11.3.2 Weaknesses in the regulatory system

Although the 1990 law initiated market-oriented mechanisms in Polish insurance, some major problems arose in implementing effective market reform.

The fundamental difficulty was a lack of implementation power and expertise in the supervisory authority and insufficient reform of PZU. These are analysed more in the following section "11.4 Failures encountered in the initial period of Polish insurance market reform".

11.3.3 The market situation in early 1990's

At the beginning of the 1990's, the Polish economy was in a difficult situation. Between 1990 and 1992, GDP growth was minus 11.6%, minus 7.0% and 2.6%. In 1990, the inflation rate was more than 600%. Such difficult economic conditions had a direct influence on Poland's insurance market.

11.3.3.1 PZU dominance

During the initial period of market reform in 1990-1992, PZU (and Warta in non-life) continued to maintain its monopoly position. In 1991 and 1992, PZU's market share in life insurance was 94.5% and 97.6% respectively. In 1990, 1991 and 1992, the total market share of PZU and Warta in non-life insurance was 97.2%, 84.3%, and 80.5 % respectively (see Table 11-4).

Foreign insurance companies were slow to enter this market. Until 1992, only six foreign insurance companies (AGF, Amplico {AIG} and Commercial Union

Table11-4(1) Life Insurance: Market Share by Company- based on gross written premium 1991-1998 (in PLN)

Insurance company	1991	1992	1993	1994	1995	1996	1997	1998
1. AGF Ubezpieczenia ycie S.A.	0.011%	0.165%	0.332%	0.412%	0.382%	0.319%	0.329%	0.371%
2. TU Allianz BG Polska ycie S.A.	-	-	-	-	-	-	0.000%	0.165%
3. STUn Alte Leipziger Hestia S.A.	-	-	-	-	-	-	0.006%	0.177%
4. PAPTUn iR Amplico Life S.A.	0.000%	0.058%	0.394%	2.011%	4.629%	7.474%	8.983%	9.267%
5. KU Filar- ycie S.A.	-	0.000%	0.004%	0.017%	0.054%	0.087%	0.072%	0.027%
6. Cardif Polska S.A.	-	-	-	-	-	-	-	0.000%
7. TU iR Cigna Stu ycie S.A.	-	-	-	-	-	0.000%	0.000%	0.010%
8. Commercial Union Polska - TUn ycie S.A.	0.000%	0.001%	0.439%	2.844%	6.453%	11.596%	15.880%	17.951%
9. TU Compensa ycie S.A.	-	-	-	-	-	-	0.000%	0.009%
10. Garda Life S.A.	-	-	-	-	-	-	0.000%	0.006%
11. Gerling Polska TU na ycie S.A.	-	-	-	-	-	-	0.006%	0.066%
12. BTUiR Heros Life S.A.	-	-	-	0.005%	0.676%	0.893%	0.382%	0.413%
13. TU Inter-Fortuna ycie S.A.	-	-	-	-	-	-	0.001%	0.009%
14. TU PBK- ycie S.A.	-	-	-	-	-	0.0	0.007%	0.048%
15. TUn Nationale-Nederlanden Polska S.A.	-	-	-	0.000%	0.465%	2.019%	4.592%	6.686%
16. TU iE Petrus S.A.	-	-	-	0.000%	0.002%	0.008%	0.011%	0.016%
17. TUn ycie Polisa- ycie S.A.	-	-	-	0.000%	0.042%	0.303%	0.216%	0.290%
18. ZUiR Polonia- ycie S.A.	-	-	-	0.008%	0.059%	0.048%	0.050%	0.072%
19. PZU na ycie S.A.	94.615%	97.628%	98.832%	94.703%	87.227%	76.992%	68.980%	63.636%
20. TUn Warta Vita S.A.	-	-	-	-	0.012%	0.175%	0.402%	0.510%
21. ZU Westa Life S.A.*	5.374%	2.148%	-	-	-	-	-	-
22. Winterthur ycie S.A.	-	-	0.000%	0.000%	0.000%	0.004%	0.024%	0.158%
23. Zurich Handlowy TU na ycie S.A.	-	-	-	-	-	-	-	0.024%
24. TUW Rejent Life	-	-	-	-	0.000%	0.082%	0.059%	0.091%
Total life	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

* company has failed
"0" means no premiums collected
"-" means lack of license

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Table 11-4(2) Non-life insurance: Market Share by Company- based on gross written premium 1990-1998 (in PLN)

Insurance company	1990	1991	1992	1993	1994	1995	1996	1997	1998
1. AGF Ubezpieczenia S.A.	-	0.072%	0.419%	0.837%	0.684%	0.554%	0.633%	0.611%	0.692%
2. TUwRiG Agropolisa S.A.	-	-	-	-	-	-	-	0.062%	0.289%
3. TU Allianz BG Polska S.A.	-	-	-	-	-	-	-	0.083%	0.479%
4. AIG Polska TU S.A.	-	0.043%	0.212%	0.368%	0.372%	0.528%	0.547%	0.584%	0.591%
5. Atu TU S.A.	0.236%	0.270%	0.501%	0.668%	0.567%	0.500%	0.788%	1.493%	1.669%
6. TUiR Cigna Stu S.A.	-	-	-	-	0.000%	0.045%	0.262%	0.557%	0.517%
7. Commercial Union TU - Ogólnych S.A.	-	0.000%	0.000%	0.001%	0.001%	0.001%	0.005%	0.168%	0.233%
8. TU Compensa S.A.	-	0.163%	0.911%	1.550%	1.353%	1.087%	1.500%	1.520%	1.899%
9. Daewoo TU S.A.	-	0.320%	0.669%	1.540%	1.553%	1.787%	1.297%	1.126%	1.933%
10. PTU Energo-asekuracja S.A.	-	-	-	-	0.000%	0.197%	0.735%	1.183%	1.200%
11. TU Europa S.A.	-	-	-	-	0.000%	0.203%	0.365%	0.157%	0.134%
12. TU Fenix S.A.*	-	0.017%	0.228%	0.484%	1.109%	1.748%	0.804%	0.000%	0.000%
13. KU Filar S.A.	-	-	0.013%	0.131%	0.368%	0.584%	0.856%	0.817%	0.853%
14. TU Gryf S.A.*	-	0.127%	0.606%	1.656%	2.711%	2.928%	-	-	-
15. TUiR Gwarant S.A.	-	-	-	0.000%	0.000%	0.116%	0.296%	0.414%	0.437%
16. BTUiR Heros S.A.	-	-	0.004%	0.425%	0.701%	0.778%	0.810%	0.731%	0.657%
17. STU Hestia Insurance S.A.	-	0.074%	1.113%	2.138%	2.749%	2.500%	3.285%	2.880%	3.829%
18. ZU Hestja S.A.*	-	0.022%	0.211%	0.694%	1.167%	1.402%	0.329%	-	-
19. TU Inter-Fortuna S.A.	-	0.000%	0.009%	0.133%	0.298%	0.384%	0.407%	0.395%	0.693%
20. KUKE S.A.	-	0.001%	0.002%	0.006%	0.037%	0.088%	0.096%	0.102%	0.160%
21. TUiR Partner S.A.	-	-	-	-	-	-	0.015%	0.131%	0.205%
22. TU PBK S.A.	-	-	-	-	-	0.001%	0.293%	1.536%	1.322%
23. TUR Polisa S.A.	0.040%	0.906%	1.941%	2.671%	3.346%	3.299%	3.675%	4.001%	4.105%
24. ZUiR Polonia S.A.	-	0.409%	1.501%	2.109%	2.295%	2.598%	2.928%	2.948%	2.694%
25. PZU S.A.	79.088%	68.448%	64.715%	65.653%	60.771%	60.241%	65.084%	62.683%	58.884%
26. TU Samopomoc S.A.	-	1.169%	0.874%	0.729%	0.600%	0.619%	0.723%	1.180%	1.332%
27. TUiR Warta S.A.	18.199%	15.843%	15.780%	18.105%	19.176%	17.548%	13.986%	12.672%	13.176%
28. ZU Westa S.A.*	2.437%	12.115%	10.272%	-	-	-	-	-	-
29. Winterthur S.A.	-	-	-	-	0.000%	0.001%	0.027%	0.392%	0.567%
30. Zurich Handlowy TU S.A.	-	-	-	-	-	-	-	-	0.027%
31. TUW Cuprum	-	-	-	-	0.000%	0.138%	0.111%	0.084%	0.076%
32. TUW SKOK	-	-	-	-	-	0.000%	0.000%	0.000%	0.026%
33. TUW TUW	-	0.000%	0.018%	0.104%	0.141%	0.127%	0.133%	0.155%	0.169%
34. TUW Wielkopolska	-	-	-	-	-	-	0.000%	0.062%	0.085%
35. PTR S.A.	-	-	-	-	-	-	0.009%	1.272%	1.067%
Total non-life	100%	100%	100%	100%	100%	100%	100%	100%	100%

* company has failed
"0" means no premiums collected
"-" means lack of license

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

established a life and non-life insurance company separately) operated in Poland. In 1992, the market share of foreign companies was only 0.2% for life insurance and 0.6% for non-life insurance (see Tables 11-5 and 11-6). Since economic recovery was not yet a certainty during this period, foreign insurers were cautious about launching business in Poland. With the exception of Westa, Polish companies (i.e., companies with majority Polish capital) other than the former monopolies failed to gain a strong market presence in this period. Westa recorded rapid growth until its bankruptcy in 1993. Westa's operations also showed up the weaknesses of the Polish market during the initial reform period. These are analysed in the following section "11.4 Failures encountered in the initial period of Polish insurance market reform".

11.3.3.2 Slow premium growth

The insurance market showed slow growth in the beginning of the 1990's. Until 1992, real premium growth (after deducting the inflation factor) was negative (-23.8% in 1991 and –1.9% in 1992) (see Figure 11-1).

11.3.3.3 Life insurance market

In 1990, the life insurance market was much less developed than non-life. On average the premium level of life insurance and non-life insurance in OECD countries was about equal. In the Polish insurance market however, life insurance companies accounted for only 8% of the total premium in 1990 (see Figure 11-2). Under the communist regime, life insurance did not play the important role, as a social security system played a role of life insurance to a large extent. In addition, hyperinflation in 1989 and 1990 i.e., 500 % to 650% per year, made individual, long-term life insurance almost worthless and the real value of nominal insurance sums

Table 11-5 Number of Insurance Companies 1991–1998

Aggregation Type	1991	1992	1993	1994	1995	1996	1997	1998
Life insurance	**5**	**6**	**6**	**10**	**13**	**15**	**21**	**24**
- with domestic capital	2	2	1	4	7	9	10	11
- with a majority of foreign capital	3	4	5	6	6	6	11	13
Non-life insurance	**19**	**21**	**22**	**26**	**27**	**30**	**30**	**31**
- with domestic capital	16	18	18	21	22	21	20	19
- with a majority of foreign capital	3	3	4	5	5	9	10	12

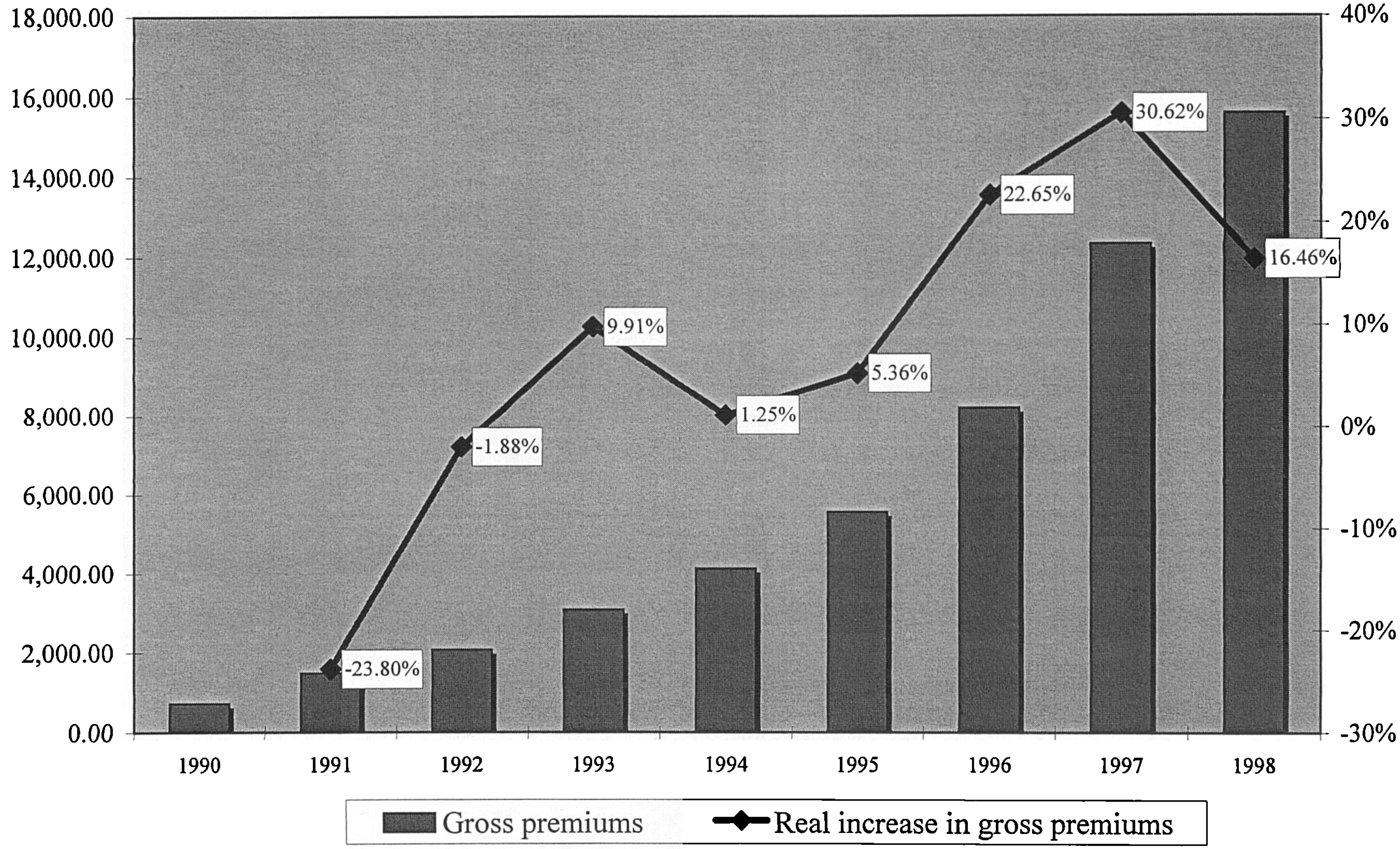
Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Table 11-6 Share of the Insurance Market Held by Foreign Companies - based on gross premiums 1991-1998 (in millions PLN)

	1991	1992	1993	1994	1995	1996	1997	1998
Life Insurance premiums taken by foreign companies	0.02	1.22	10.36	67.86	221.92	600.00	1,217.20	1,515.38
Total gross premiums for life insurance	208.14	541.93	887.07	1,284.37	1,851.93	2,791.02	4,072.50	5,378.35
Market Share	**0.01%**	**0.22%**	**1.17%**	**5.28%**	**11.98%**	**21.50%**	**29.89%**	**28.18%**
Non-Life Insurance premiums taken by foreign companies	1.47	9.72	26.62	30.25	59.05	137.70	625.20	1071.22
Total gross premiums for non-life insurance	1275.34	1539.67	2208.51	2862.35	3731.38	5419.76	8250.73	10206.92
Market Share	**0.12%**	**0.63%**	**1.21%**	**1.06%**	**1.58%**	**2.54%**	**7.58%**	**10.50%**

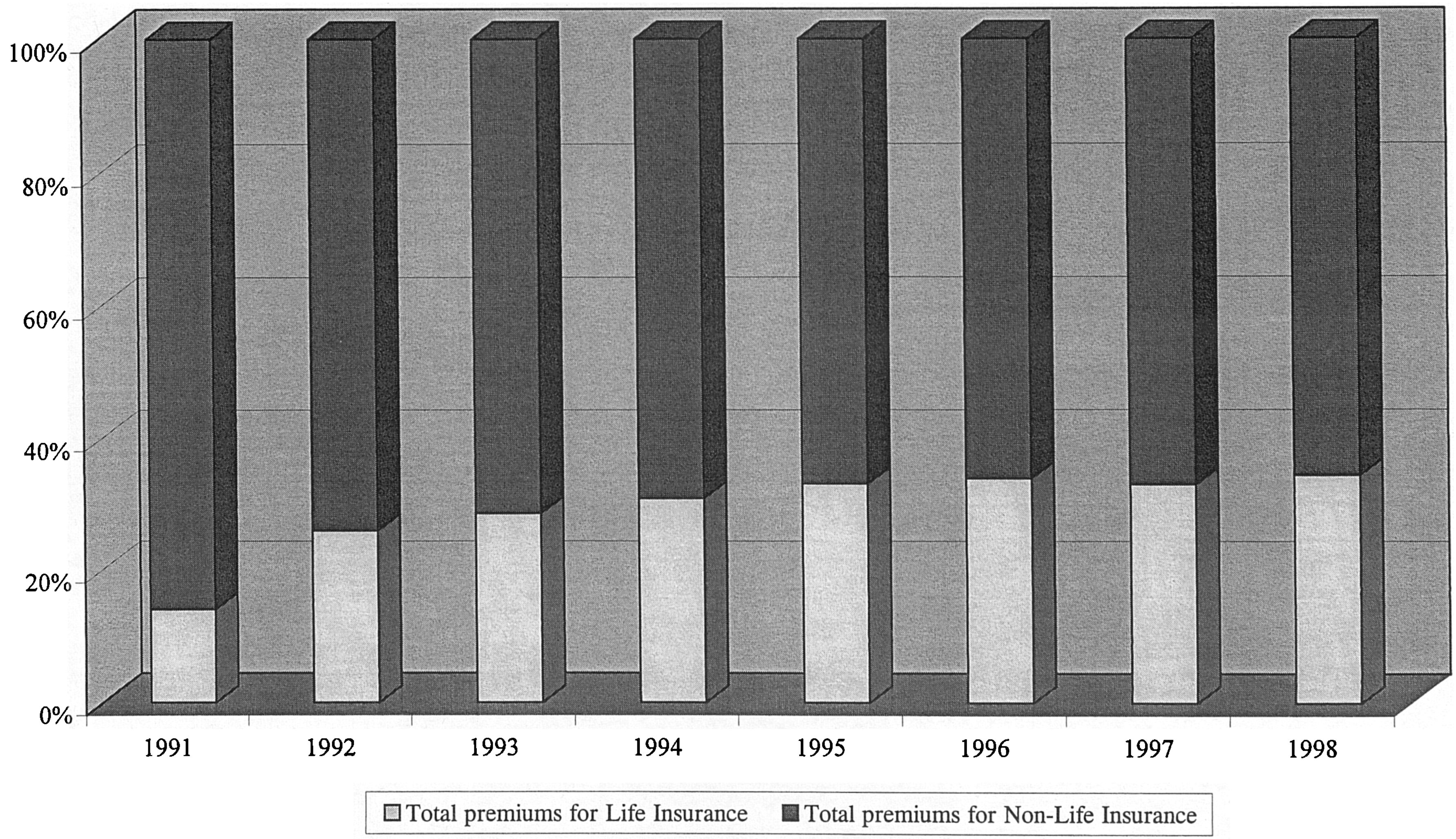
Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Figure11-1 Nominal Value in Million PLN and Real Increase of Total Gross Insurance Premiums



Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Figure 11-2 Proportion of Life to Non-Life Insurance - by total premiums 1991-1998



Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

dropped to one thousandth and less. This fact discouraged consumers from purchasing long-term life insurance policies. Insurance companies were, for their own part, reluctant to sell long-term life insurance policies, since safe, long-term investment opportunities that protected policyholders against high inflation were not to be found during this period. Thus no life insurance product linked to investment funds was sold in this period. Yet at the same time, people were particularly interested in protection against the uncertainties of the future. Thus, there were remarkably increased sales of short-term group contracts. Life insurance on a group basis with a one-year contract proved to be a popular product, since this was largely immune to the depreciation of insurance coverage through high inflation. The more than 10-fold increase in life insurance premium volume from 1990 to 1992 (57.1 million zloties in 1990 to 580.0 million zloties in 1992) was mainly due to the increased sales of such life insurance products. In 1994, group insurance accounted for almost all PZU life insurance policies written.

11.3.3.4 Non life insurance market

Between 1990 and 1992, the number of non life insurance companies increased rapidly. In 1990, only five companies (PZU, Warta, Westa, Atu and Polisa) were in operation on the Polish market. In 1992, this number increased to 21(see Table 11-5). Although the market was still dominated by PZU, whose market share in 1992 was 65%, other companies steadily increased their sales volumes (see Tables 11-4(2)). However, the rapid growth of Westa in 1990-1992 and its bankruptcy in 1993 had a negative effect on the development of Poland's insurance market. In particular, people lost confidence in insurance companies.

Compulsory insurance still played an important role and in 1991, its market share in the entire insurance classes was 42%, although this was lower than during the communist regime. Automobile related insurance products constituted by far the largest class. Third party liability automobile insurance accounted for approximately 90% of compulsory insurance. Casco (vehicle damage) insurance represented 32% of voluntary insurance. Thus in 1991, total automobile related insurance provided 56% of the non-life sector's premium. In 1991, insurance related to farmers represented a much smaller share of total insurance volume than it had in the late 1980's, under the communist regime.

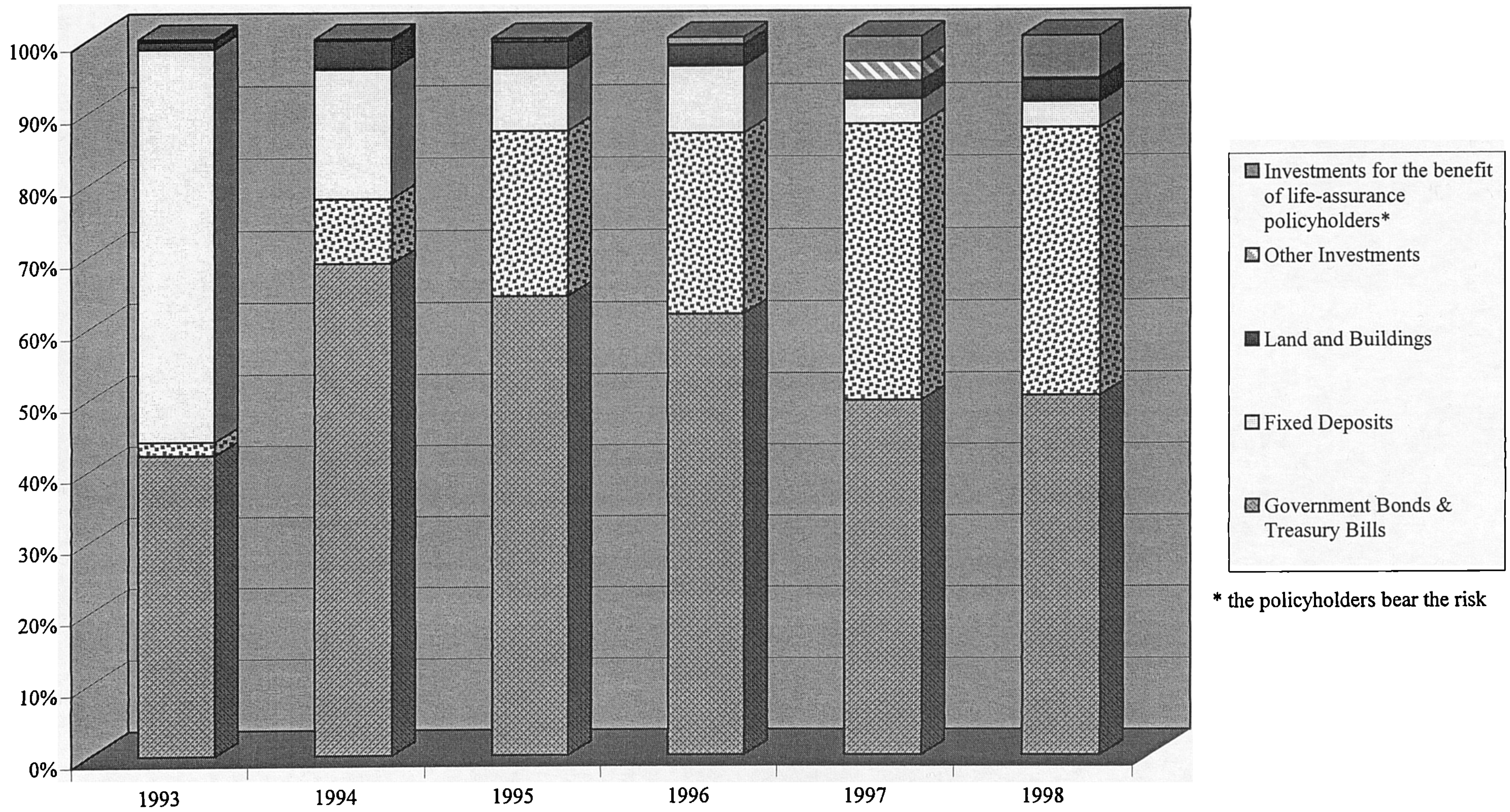
11.3.3.5 Limited investment opportunities

In 1990, investment regulation in Poland followed to some extent the EU insurance directives (Chapter 8 of the 1990 insurance law). It stipulated diversity and dispersion of investments. With regard to assets corresponding to technical provisions, the law laid down the kinds of investment and the maximum percentage that insurance companies were permitted to invest. In 1990 the Polish insurance law required the insurer to invest assets corresponding to technical provisions within Poland.

As investment in shares, real estate and other investments were still surrounded by considerable uncertainty in Poland in the early 1990's, insurance companies invested most of their assets in bank deposits, government bonds and treasury bills (see Figures 11-3 and 11-4).

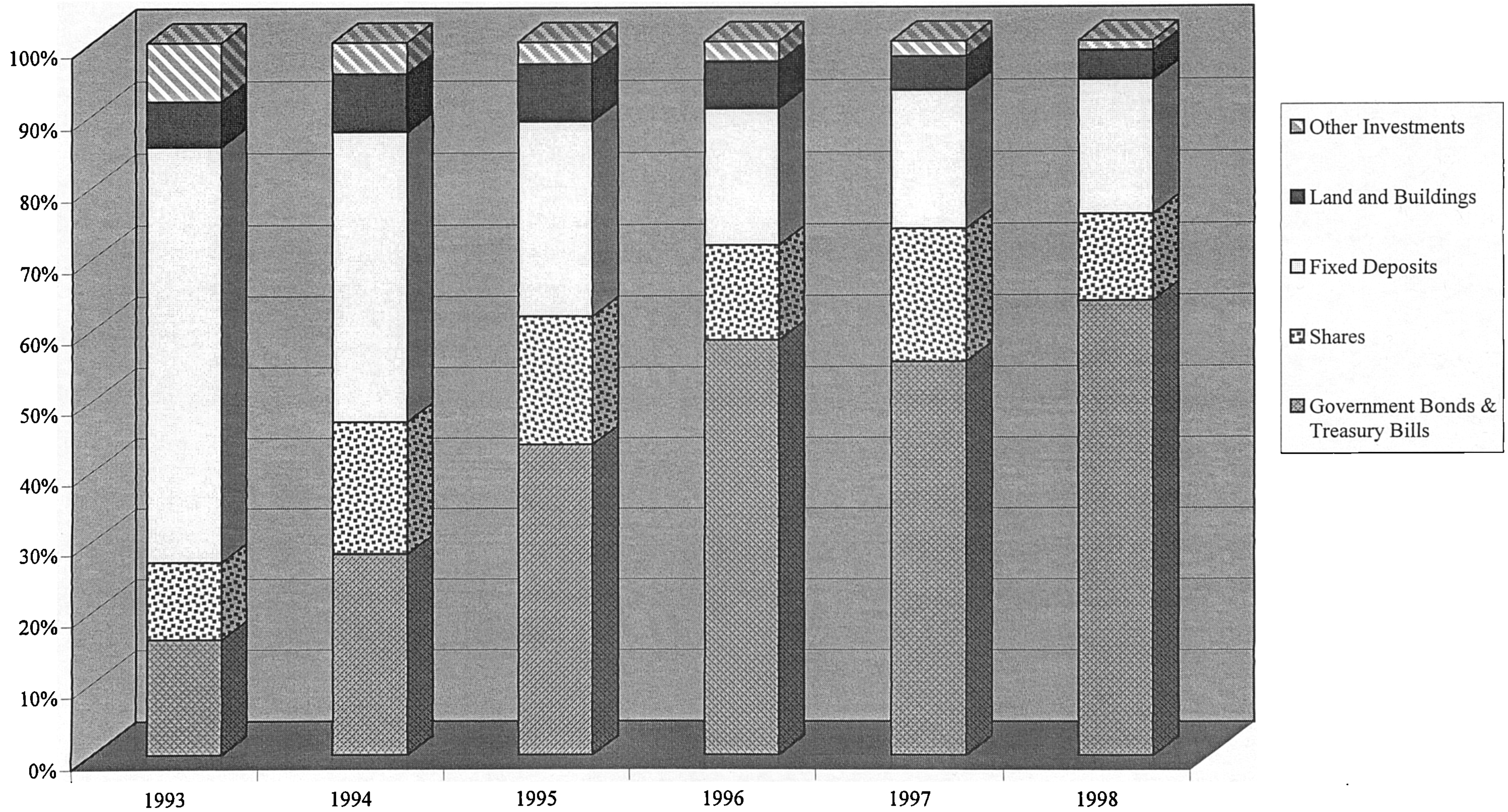
In 1992 and 1993, 66% and 57% respectively of total assets were invested in bank deposits. Bank deposits did not earn a high yield but provided high liquidity and relatively safe investment.

Figure 11-3 Types of investment made by Life Insurance Companies 1993-1998



Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Figure11-4 Types of investment by Non-Life Insurance Companies 1993-1998



Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Life insurance companies invested more in government bonds and treasury bills than non-life insurance companies. In 1993, 42% of the assets of life insurance companies and 16% of those of non-life insurance companies were invested in these. Since the yields of some government bonds were inflation linked, this provided relatively safe investment opportunities, in particular for life insurance companies.

In this same period, the stock exchange was still at an early stage of development. It opened in Warsaw in 1991 and in the first year, fewer than 20 Polish companies were listed. In 1993, life insurance companies invested 11% of their assets, while non-life companies invested only 2% of their assets on the stock market.

In the early 1990's, the real-estate market in Poland was underdeveloped and hindered by regulations and confusing property titles. For this reason, most insurance companies did not consider real estate as a good investment but rather as indispensable property for their business operations. (Additional tables and graphs with regard to the Polish insurance market can be found in the appendix.)

11.4 Failures encountered in the initial period of the Polish insurance market reform

Reform of the insurance markets in former communist countries is an unprecedented challenge. In the first few years of market reform, five major insurance companies went bankrupt. These bankruptcies resulted in the loss of a considerable number of policyholders and consequently, a loss of confidence in the insurance market, a factor that has significantly retarded this market's reform. These failures should be carefully reviewed, in order to avoid similar mistakes and to establish sound insurance policies for Poland in the future.

11.4.1 Difficult market conditions during the initial market reform

In 1990, following the communist regime, the Polish insurance sector was beset by difficult conditions that were not conducive to establishing a sound insurance market based on a market economy.

In the late 1980's and the beginning of the 1990's, the Polish economy fell into a deep recession, due to political and economic confusion and transition, creating a difficult environment to carry out insurance reform.

In that period, a market economy based infrastructure, including a legal framework, accounting systems, the basic statistics indispensable to insurance business, insurance expertise, in short all those aspects essential to a sound insurance system, were yet to be established. In addition, institutional governance was still a new concept and thus insurance companies had yet to establish effective internal controls and management systems. Moreover, the market was devoid of any healthy competition, since the state monopoly was still firmly in place and new entries found conditions extremely difficult. The state monopoly frequently failed to be guided by proper market-oriented mechanisms, a factor that seriously hindered the development of a sound insurance market. At that time, the insurance system had no strong supervisory authority or effective insurance regulation corresponding to those required by a market-oriented economy. Such an environment made the establishment of a sound insurance system in Poland in the beginning of the 1990's extremely difficult.

11.4.2 Measures adopted by Polish authorities

In 1990, the Polish government adopted a rigid macro-economic policy and implemented drastic economic reform. A reform of the legal system was also carried out in parallel with economic reform. However, no distinct reform policy was adopted with regard to the insurance system. The Ministry of Finance, the insurance regulatory body, employed a British insurance expert supported by the ABI (Association of British Insurers) to set up an insurance system. The introduction of the new insurance law was greatly appreciated, as it was the first such law in a former communist country to be based on the system of a market-oriented economy. However, it did suffer some criticism, since it failed to address Poland's market situation at that time. It did not take into account the specific market conditions of economies in transition, but simply copied EU insurance directives. The law did not clearly stipulate the supervisor's power of intervention vis-à-vis insurers. The government did not pay enough attention to the importance of establishing a strong insurance supervisory authority. It depended excessively on market discipline and consumers being responsible for their own decisions.

The weakness of the insurance regulatory and supervisory system could be observed in several areas:

Although laid down by the 1990 law, licensing controls were not implemented effectively due to a lack of experience and supporting mechanisms in the supervisory authority. In the beginning of the 1990's, the authority granted a license to several incapable insurers, causing serious problems later. The supervisor did not have the authority to examine insurance policies during on-site inspections, nor did it have any power to correct under-priced products. In addition, the law failed to lay down clearly penalties against illegal activities. The supervisor therefore faced difficulties in implementing the law, although it covered important provisions for prudential regulation.

Supervision was performed by a small group of junior officials with limited experience from the Ministry of Finance, who at the same time had to prepare amendments to the insurance law and several insurance related ordinances.

The 1990 law did not satisfactorily cover those areas indispensable to insurance supervision. No clear guidance was laid down for the calculation of technical provisions. No controls of insurance intermediaries were put into place and it failed to sufficiently cover remedial procedures or winding up measures. Moreover, still to be developed were preconditions for insurance market mechanisms, such as an insurance accounting system, a claim database and disclosure of essential financial information. The internal monitoring systems in insurance companies often failed to function properly.

11.4.3 Mismatch between policies implemented and the model for market reform

In the initial period of the market reform, five major insurance companies (Westa (life and non-life), Hestja, Gryf and Fenix) went bankrupt. Except for the state-run companies, i.e. PZU and Warta, Westa life and Westa non-life were the largest insurance companies, with a market share of 12% in non-life insurance and 5% in life insurance in 1991. Before going bankrupt, Gryf, Fenix and Hestja were also among Poland's largest non-life companies other than PZU and Warta.

The bankruptcies occurred due to the lack of a sound insurance regulatory and supervisory policy or model and an effective body to implement the same. In the beginning of the 1990's, there was no established reform model for the insurance market. Thus, Poland simply copied EU insurance directives and the insurance systems of EU countries. The Polish authority laid too much emphasis on the market mechanism and underestimated the importance of creating a sound insurance regulatory and supervisory system. The insurance policy implemented did not correspond to the needs of market reform. This resulted in market instability and consequently caused several major bankruptcies (see Table 11-7).

Since the preconditions for a sound insurance market, such as economic stability, a general legal system, a basic insurance infrastructure and insurance expertise cannot be created immediately, reform of any insurance system should be gradual and progressive.

The reform model stresses the importance of creating a basic infrastructure for the insurance system. In particular, the establishment of effective insurance regulation and a well-organised body to implement prudential supervision are essentials for an insurance market in the early stages of reform. In reality all five bankrupt companies committed serious breaches of the insurance law, but at the time, there was no institutional mechanism to monitor insurance companies. The supervisory system did not function sufficiently and so was unable to intervene early enough so as to correct their inappropriate or illegal activities. Details of five bankrupt company cases are given in Table 11-8, which describes dates and causes of bankruptcy and the infringement of insurance regulation by companies. The information in Table 11-8 was provided to the author by the State Office for Insurance Supervision, Poland, in August in 1999. Market reform was also urgently needed in order to avoid the state-owned former monopoly taking advantage of its state-maintained stability and quasi-monopolistic market presence. In Poland, the market situation provoked insurance companies to compete for customers by offering under-priced products and this often resulted in their experiencing financial troubles. A policy of insurance market liberalisation should only be implemented once a basic market infrastructure has been established.

Table 11-7

Mismatch between policies implemented and the model for market reform (Initial stage of the market reform)

	Model	**Policy implemented (Real situation)**
Goal and reality	Establishment of an effective system	Weak system dependent on market mechanism. Copying an insurance system in developed economies
Market infrastructure	Creation of essential market infrastructure • Legislation • Accounting standards • Reporting system • Insurance professionals • A reliable database	Basic market infrastructure was not set • No insurance accounting standards • No effective reporting system • Very limited trained insurance professionals • No reliable database
Insurance authority	Creation of a strong insurance regulatory body	Weak insurance regulatory body
Regulatory measures	Establishment of effective prudential supervisory and regulatory measures • Strict licensing system • Proper on-going supervision • Remedial actors and sanctions	No effective prudential supervisory and regulatory measures • Weak licensing system • Not functional on-going supervision • Not effective remedial actors and sanctions
Institutional governance	Arrangement of proper institutional governance	Institutional governance not developed
State monopoly	Swift and thorough reform of the state monopoly	No material reform on the state monopoly
Result	Bankruptcies of five major insurance companies	

Table 11-8

Causes of insurance company bankruptcies in Poland

Items/Company name	Date of bankruptcy declared	Causes of bankruptcy	Infringement of insurance regulation
Westa-Life S.A. in Łódź	6 February 1993	Poor organisation of it's operations. Insurance policies with an investment fund (high guaranteed rate of return). Investments with a high level of risk. An expanded network of organisational establishments increasing the company's fixed costs. Too little equity of the company (share and reserve capital) in comparison with the volume of operations conducted. The company's take-over of the life policies portfolio of "Westa" S.A. in Łódź (inadequate premiums to cover the company's guaranteed liabilities). The company's major shareholder was "Westa" S.A. in Łódź, which also suffered financial problems (limited capability of increasing its capital).	Non compliance with technical provisions requirements. Conducting business operations other than insurance; also insurance operations that did not conform to the Finance Minister's concession. Conducting an investment policy that did not conform to the Insurance Law. Not satisfying the solvency margin requirement.
Westa S.A. in Łódź	15 March 1993	The company's organisation and management (lack of insurance know-how, copying the experience of the former monopoly). The management personnel failed to fulfil the condition of fit and proper.	Conducting business operations without the Finance Minister's concession (active re-insurance). Conducting business operations other than insurance.

Westa S.A. in Łódź (cont.)		Investments with a high level of risk. The insuring of loans raised by entities not having credit standing and the granting of guarantees to such entities. An expanded network of organisational establishments increasing the company's fixed costs. Inadequate insurance premium tariffs and premium rates. Too little equity of the company (share and reserve capital) in comparison with the volume of operations conducted. The dominant shareholder took decisions that came within the authority of the management board.	Not complying with technical provisions requirements. A deficit of assets that cover technical provisions. Conducting an investment policy that did not conform to the principle of security and liquidity. Not satisfying the solvency margin requirement.
Gryf S.A. in Bydgoszcz	5 March 1996	The company's organisation and management (lack of insurance know-how, copying the experience of the former monopoly). The management personnel failed to fulfil the condition of fit and proper. Financial dealings with the company's shareholders and dependent entities, infringing the insurance company's interests. Inadequate insurance premium tariffs and premium rates.	Not complying with technical provisions requirements. Conducting an investment policy that infringed the Insurance Law. A deficit of assets that cover technical provisions. Not satisfying the solvency margin requirement.

Gryf S.A. in Bydgoszcz (cont.)		Too little equity of the company (share and reserve capital) in comparison with the volume of operations conducted, share capital not paid. The paying out of high dividends to shareholders. An aggressive marketing policy (high commissions for insurance intermediaries). An expanded network of organisational establishments increasing the company's fixed costs. A concentration of investments in an entity dependent on the company's shareholders, at a time when it was in serious financial straits.	
Hestja S.A. in Poznań	4 September 1996	The company's organisation and management (lack of insurance know-how). The management personnel failed to fulfil the condition of fit and proper. Investments with a high level of risk. Failure to carry out its short-term solvency plan. Share capital paid inadequate for the volume of business conducted. Sharp rise in sales without capital support ensured.	Not complying with technical provisions requirements. A deficit of assets that cover technical provisions. Not satisfying the solvency margin requirement.

Fenix S.A. in Katowice	24 March 1997	The management personnel failed to fulfil the condition of fit and proper. Unprofitable investment policy. The granting of guarantees to business entities without credit standing. Unfavourable agreements with insurance intermediaries. Sharp rise in sales without capital support ensured. High costs of services provided by entities connected with its shareholders.	A deficit of assets that cover technical provisions. Not satisfying the solvency margin requirement. Conducting insurance operations that did not conform to the concession held.

Source: Provided to the author by the State Office for Insurance Supervision, Poland in August 1999. Unpublished.

CHAPTER 12: POLAND'S INSURANCE MARKET REFORM TOWARD THE EUROPEAN UNION

Following the previous chapter's analysis of the Polish insurance market up to early 1990's, this chapter analyses Poland's insurance market reform toward the European Union.

This chapter firstly reviews the market's development from the early 1990's in terms of general economic conditions, development of foreign insurance companies, growth in the premium volume and diversification of investments. Secondly it proposes guidelines on complying with the EU insurance regulatory system, following Ellis's analysis (1994) and classification. The author points out that the major tasks facing Poland in its endeavours to enter the EU single insurance market are:

organisation of a single license mechanism based on home-country control;

reinforcement of the country's co-operation with EU member states.

12.1 Insurance market development from the early 1990's

12.1.1 General economic conditions

The Polish economy has been steadily growing since 1992. Between 1992 and 1994, the GDP increased annually 3-5% and 5-7% between 1995 and 1998. The inflation rate has constantly decreased - from 43% in 1992 to 10% in 1998. The insurance market has developed in parallel with the growth of the economy. At the same time, five major insurance companies went bankrupt in the initial period of the market reform, due to mismanagement and a weak supervisory system.

12.1.2 Rapid development of foreign insurance companies and the former monopoly's reduced dominance

Although PZU has yet to be privatised, its market share of both life and non-life insurance has been constantly decreasing. In the case of life insurance, its market share has decreased from 97.6% in 1992 to 63.6% in 1998 (see Table 11-4(1)). In the same period, its share in the non-life sector fell from 64.7% to 58.9% (see Table 11-4(2)). This decrease is mainly due to the development of foreign insurance companies. Between 1992 and 1998, the market share of foreign insurers increased from 0.2% to 28.2% in life insurance and from 0.6% to 10.5% in non-life insurance (see Table 11-6). Foreign insurance companies in the life insurance sector have increased in number significantly since 1997 and in the non-life insurance sector since 1996 (see Table 11-5). In 1998, foreign capital amounted to 32% of the total capital of insurance companies in Poland. In 1998, 55 insurance companies were conducting business in Poland, of which 25 were foreign insurance companies. Insurance companies with majority Polish capital also have been steadily growing, in particular in the non-life insurance market (see Table 11-4(2)).

12.1.3 Rapid growth in the insurance premium volume

Since 1993, the real increase in insurance premium (after adjusting for inflation) has been constantly positive and real growth has been accelerating since 1996 (see Figures 11-1), maintaining a rate of more than 15%. Life insurance has expanded faster than non life insurance. In 1990, life insurance constituted 8% of the total insurance premium, while in 1998 it amounted to 34% (see Figure 11-2). Life insurance linked with investment funds has spurred the growth of the life insurance premium. In the beginning of the 90's, customers had little confidence in long-term life insurance products, due to losses in the value of such products after the hyperinflation of 1989 and 1990. However, thanks to the economic stability and constant growth since 1992, consumers have again turned to these products, particularly those linked to investment funds. These products were developed by foreign insurance companies. The rapid increase in sales of such products has resulted in the growth of their presence in the market.

With regard to non-life insurance products, the growth in motor insurance (third party liability and Casco) has been exceptional. The premium level increased twenty-fold between 1990 and 1998. This class's market share, which stood at 55.8% of total non-life insurance in 1991, had increased in 1998 to 69.5%. This was not only due to the rapid increase in the number of automobiles but also to an increase in the tariff level, particularly from 1996. PZU has annually raised the tariff of third party automobile insurance more than 30% since 1996. On the other hand, the share of other compulsory insurance classes (mainly relating to farmers) has been constantly falling.

12.1.4 Diversification of investments

The nature of investment policies conducted by insurance companies has also changed drastically during the 1990's. Initially in early 1990's, insurance companies invested mainly in bank deposits, government bonds and treasury bills. There was not much difference between the investment policy of life insurance and non-life insurance companies in that period. The reason was that the market offered few if any opportunities for safe, long-term investment, a factor that prevented the development of long-term life insurance products. Since the mid-1990's however, the financial market has developed significantly. The government issued long-term bonds such as 10-year government bonds. The insurance authority permitted insurance companies a certain degree of investment abroad. These changes in the financial and regulatory environment allowed insurance companies to diversify and disperse their investments in the search for higher yields within their risk-taking capacities. Life insurance companies developed new types of products linked with investment return. Thus, by 1998, there was an observable difference in the type of investment conducted by life and non-life insurance companies. The life insurance companies invested only limited amounts in bank deposits (3.8% of total investment) but a considerable amount in shares (39.3%). Non-life insurance companies invested more heavily in bank deposits (18.6%) and less in shares (12.1%). (see Figures 11-3 and 11-4). (Additional tables and graphs with regard to the Polish insurance market can be found in the appendix.)

12.2 Guidelines on complying with the EU insurance regulatory system

12.2.1 Overview

As discussed in the previous chapter, there was some disparity between the insurance policy implemented and the model needed for market reform in the early 1990's in Poland, resulting in market instability and causing several major bankruptcies. Thus, as the author has pointed out, the importance of drawing up an effective reform model that takes into account the market situation and the need to establish a strong implementing body should be stressed. The Polish insurance market has followed the model presented in Chapter 7 and 8 since 1995, thanks to which it becomes much more stable and sound.

In order to satisfy EU membership requirements, applicant countries should accomplish the following tasks:

comply with EU insurance company law (EU insurance directives) establish a strong supervisory body equivalent to those of EU member countries;

conduct market reform in order to make the market compatible with those of EU member counties.

In line with the analysis by Professor Ellis (1994) of essential conditions for entering the single European market, the author points out those tasks still to be undertaken in order for the Polish authority to comply with EU insurance company law.

Poland's insurance authorities should conduct the following in order to enter the EU internal insurance market:

- arrange a single license and a home country control mechanism

- reinforce co-operation with the supervisory authorities of EU countries

12.2.2 Approach to the EU single market: Compliance with the EU's insurance company law

The insurance law of EU member states that underpins the Single Market can be broken down into the following three constituent parts (see Ellis (1994)):

(1) Insurance company law

(2) The law relating to insurance intermediaries

(3) Insurance contract law

Ellis (1994) pointed out that insurance company law including prudential regulation dealt with access to national markets and in fact for all practical purposes, the EU's insurance law could be taken to mean its insurance company law. The Polish authority has taken exactly this approach. The Polish Ministry of Finance has decided to draft an Insurance Code in order to create a legal framework for insurance compatible with that of the EU member states. This Insurance Code will be composed of insurance business law (insurance company law), insurance intermediary law and insurance contract law, which covers compulsory insurance regulation. The provisions relating to European Union integration will be included in the insurance business law.

Although all the three insurance laws are crucial to the establishment of a sound insurance system, it is reasonable to focus on EU insurance company law in analysing the measures required to integrate Poland into the European Union.

12.2.3 EU Commission's request for Poland's entry to the EU single market

The EU commission pointed out that Poland (as well as other applicants for EU membership) should satisfy the following points:

Compliance with EU insurance company law (in particular, the first and third EU insurance directives);

Establishment of a strong supervisory body equivalent to those of EU member states;

Reform of the former state monopoly.

Thus the author firstly examines the current level of compliance with EU insurance company law and discusses issues still outstanding before Poland can enter the EU's single insurance market;

Next, the author analyses the State Office for Insurance Supervision - the body responsible for implementing insurance supervision;

Finally, closely reviewed is the stage at which reform of the former state monopoly presently stands.

12.2.4 Compliance with EU insurance company law

12.2.4.1 The 1995 Polish insurance law

As mentioned earlier, it soon became obvious that the 1990 insurance law did not correspond to market reform requirements. Therefore, on June 8th 1995, the Polish Parliament adopted an insurance law amending the previous insurance law of 1990. The amended insurance law not only changed many existing regulations but also introduced new provisions. The main provisions of these amendments, which came into force on October 22nd 1995, are as follows:

The creation of a State Office for Insurance Supervision (SOIS);

The introduction of stricter regulations governing the financial policies of insurance companies;

The introduction of higher capital requirements for insurers;

The introduction of licensing and qualification requirements for insurance intermediaries (agents and brokers);

The establishment of the Insurance Guarantee Fund;

The creation of the Insurance Ombudsman.

The introduction of examination requirements for actuaries

In addition, the following major insurance ordinances issued by the Minister of Finance came into force:

Ordinance of December 29th 1994, on the specific principles governing an insurer's accounting rules (which covers the definitions of technical provisions);

Ordinance of September 17th 1995, regarding the method for calculating the amount of solvency margin and the minimum amount of guarantee capital for each group of insurance and reinsurance;

Ordinance of March 22nd 1996, specifying cases that permit the conclusion of insurance contracts with an insurer not in possession of a license to conduct insurance activities in Poland;

Ordinance of April 19th 1996, on the regulation of actuaries

12.2.4.2 Compliance with EU insurance company law

The essential condition for an EU single market is compliance with EU insurance company law. This law covers several EU directives in the field of non-life insurance (the first non-life insurance establishment directive of 1973, the second non-life insurance establishment directive of 1973, the co-insurance services directive of 1978, the tourist assistance business directive of 1984, the credit and surety directive of 1984, the legal expenses insurance directive of 1987, the freedom of non-life insurance services directive of 1988, the freedom of motor insurance services directive of 1990, the insurance companies accounts directive of 1991 and the non-life insurance framework directive of 1992). The three most important are:

The first non-life insurance establishment directive of 1973 (EU first non-life insurance directive)

The freedom of non-life insurance services directive of 1988 (EU second non-life insurance directive)

The non-life insurance framework directive of 1992 (EU third non-life insurance directive)

EU insurance company law includes the following three directives with regard to life insurance:

The life insurance establishment directive of 1979 (EU first life insurance directive)

The freedom of life assurance services directive of 1990 (EU second life insurance directive)

The life framework directive of 1992 (EU third life insurance directive)

The author discusses Poland's compliance with EU insurance company law and points out those issues that should be covered in Polish insurance law in order to ensure entry to the EU single market.

The following regulatory issues must be complied with in order to enter the EU single market (see Ellis (1994)):

- Starting up a new insurance company;

- Reporting responsibilities of an insurance company's management; the monitoring and remedial powers of regulatory authorities;

- Entry to a host member state by an EU based insurance company either (i) by opening or (ii) without opening a branch office;

- Conditions for market access by non-EU based insurance companies;

- Transfers of portfolios;

- Winding up insurance companies.

(1) Starting up a new insurance company

The first non-life and life insurance directives state several license requirements with which EU member countries should comply. The third non-life and life insurance directives state conditions, with which EU member countries should comply in order to achieve a single license system (see Chapter 9: CEEC's integration into the EU insurance market).

The Polish insurance law complies with the licensing conditions prescribed in EU first insurance directives. However, the concept for an EU single license {EU third directive, art. 5 (non-life), art. 4 (life)} has yet to be prepared.

(2) The reporting responsibilities of management; the monitoring and remedial powers of regulatory authorities;

The main aim of the EU insurance company law is to protect policyholders within the EU by ensuring that authorised insurers do not fall into financial difficulties. Thus, the financial requirements and the monitoring and remedial powers of regulatory authorities constitute the core of EU insurance company law. EU insurance company law stipulates the following: reporting to the regulatory authority, spot-checks in host member states, accounts and information requirements, powers of insurance regulators, composite insurance undertakings, technical reserve requirements, solvency margin requirements, minimum guarantee fund requirements, requirements with regard to assets, currency matching (life insurance), monitoring of financial requirements by the insurance regulatory authority, the remedial powers of regulatory authorities, confidential information and professional secrecy (see Ellis (1994)).

The 1995 Polish insurance law complies with the above mentioned provisions concerning prudential supervision except for some of the investment rules and the provisions relating to a single license and the home country control principle.

Regarding investment regulation in Poland, some provisions are actually incompatible with EU directives. An insurance company in Poland is allowed to invest abroad only up to 5% of assets corresponding to technical provisions. At the same time, the currency matching principle has yet to be introduced.

The provisions relating to the EU single market, such as home country powers of EU-wide financial supervision {the EU third directive's art. 9 (non-life) and art. 8 (life)} and spot supervisory inspections of branches opened in other EU states {EU third directive, art. 10 (non-life) and art. 9 (life)}, have yet to be included in the Polish insurance law.

(3) Entry to a host member state by an EU based insurance company either (i) by opening or (ii) without opening a branch office;

In the EU internal market, an insurance company authorised to operate insurance business is permitted to carry on insurance business in any other EU member states, either by opening a branch office (freedom of establishment) or by providing cross-border services without opening branch offices (freedom to provide services). The EU second and third insurance directives state in a comprehensive manner the conditions and procedures governing this.

The Polish insurance law has yet to introduce any provisions concerning freedom of establishment and freedom to provide services as stipulated by the EU insurance directives.

(4) Conditions governing market access by non-EU based insurance companies

The EU first life and non-life directives prescribe rules applicable to branch offices established within the European Union where the insurance company's main offices are outside the EU. The Polish insurance law was revised in December 1998 to permit foreign insurance companies to open branch offices in Poland. These provisions include the prudential rules prescribed in the EU first directives. However, they make no distinction between branches whose main offices are situated within the EU and outside the EU.

(5) Transfers of portfolios

The EU third life and non-life directives introduce rules for transfer of portfolios within the EU territory. The Polish law only prescribes conditions for portfolio transfer within Poland, between Polish insurance companies and has yet to prescribe rules for transfer of portfolios within the EU.

(6) Winding up of insurance companies

The EU Commission has proposed a winding-up directive that deals with forms of winding up, maintenance of special asset registers and the priorities of creditors. The proposed directive has yet to be adopted, even after more than two decades of discussion.

The Polish insurance law prescribes rules to govern the winding up of Polish insurance companies. However, it makes no provision for eventual compliance with the EU draft directives on winding up insurance companies.

12.2.5 Establishment of a strong supervisory body

The 1995 amendments to the Insurance Law enabled the establishment of a State Office for Insurance Supervision (SOIS), to control and supervise insurance operations in Poland. Its aim is to protect the interests of policyholders and to prevent situations in which an insurance company would be unable to pay policyholders due benefit.

The SOIS commenced operations on February 1 1996. The Prime Minister appoints the SOIS president. Composed of five departments (legal, supervision, inspection, statistics and research and intermediaries) and one Director General's office, the SOIS employs 90 staff, 70% of which are university graduates. The SOIS has provided its employees with various training programs, organised by the Director General's office. The supervisory functions are divided between the Ministry of Finance and the SOIS. The Ministry of Finance maintains authorisation powers (issuing and revoking the license of insurance companies, approving insurance companies' statutes) and the power of determining insurance legislation, whereas all other functions related to insurance supervision, including authorisation for insurance brokers, have been taken over by the SOIS. Thus, from the moment of obtaining their licenses, insurers come under SOIS supervision.

The SOIS may demand explanations and information concerning the insurer and its financial situation and may order an insurer to submit the data requested. The SOIS may also at any time conduct on-site inspections.

SOIS insurance supervision activities include inspections of the legal and financial aspects of insurance companies. Where an insurance company's activities are contrary to the law or where any activity threatens the insurance company's solvency, the SOIS may:

issue directions aimed at eliminating the inaccuracies and adjusting the insurance company's activity to comply with the provisions of the law;

impose financial penalties on insurance company employees up to an amount equal to their three-month gross income;

impose fines on an insurance company up to 0.5% of its gross premium collected in the previous year;

contact the competent body of an insurance company with a motion to deprive a board member or a proxy of his post;

contact the competent body of an insurance company with motion to suspend board members until an issue has been investigated or to remove them from their posts;

demand from an insurance company's management that an extraordinary general meeting be convened, with the issues in question included on the agenda;

appoint a representative to the general shareholders' assembly in the above mentioned cases, who is authorised to speak on the issues included on the agenda as well as on any other issues not on the agenda;

Where an insurance company's own funds fall below the required solvency margin, the SOIS may request the company to present a proposal for its financial recovery. Should an insurer's own funds fall to a level lower than the required guarantee fund, the company must immediately notify the SOIS and present a short-term solvency plan for approval. The SOIS may fix a deadline for the insurance company to draft a plan, order any adjustment of the same or request for it to be redrafted.

If the plan presented does not provide any guarantee that financial solvency will be restored or where the plan has not been sent to the SOIS for approval, an office of the state administrator may be appointed for the insurer. The office of the state administrator takes over the right to make decisions on all matters that are normally reserved for the insurer in the insurance law and in the statutes. The office of the state administrator prepares and co-ordinates a short-term financial solvency plan with the SOIS. It is obliged to keep the SOIS informed about the implementation of the short-term solvency plan at least every three months.

On the recommendation of the SOIS, the Ministry of Finance may revoke the insurance license for one or more groups of insurance or one or more kinds of insurance.

Liquidation of an insurance company may be voluntary or compulsory. If a situation arises that may lead to the process of liquidation, the insurer is obliged to immediately notify the Ministry of Finance. The Ministry of Finance may appoint an official receiver, required to provide the insurance company with all necessary information about the process of liquidation.

In the case of compulsory liquidation, the SOIS appoints the receiver. Once the impending liquidation of an insurance company has been published or ordered, no new insurance contracts may be concluded, existing contracts may not be prolonged nor may insurance coverage be increased.

Since the 1995 amendments to the Insurance Law, the legal power of insurance supervision is comparable to that of other supervisory authorities in the European Union. Although it is a newly established supervisory authority, the SOIS is well structured and its staff is well trained. Thus, it may be said that in terms of implementing insurance supervision, Poland is ready to join the European Union.

12.2.6 Reform of the former state monopoly

12.2.6.1 Overview

The reform of the former state monopoly, PZU is by far the most important task in the reform of Poland's insurance market since the beginning of 1990. Even though its market share is constantly decreasing, PZU still maintains a dominant position, with a 64% market share in life and 59% market share in non-life in 1998. The reform of PZU was initiated by the 1990 insurance law, which required PZU's transformation to a join stock company and its division into PZU Life and PZU which was to deal with only non-life business. However, as the companies are still state-owned and continue to dominate the market, the reform had little real impact.

In the early 1990's, there was a plan to privatise (non-life) PZU and divide it into two after an increase in the company's capital to cover prudential reserves. However, the plan was cancelled following the change in government after the election of October 1993. Since then, every new government considered a reform of PZU, but this never took shape until 1999. In March 1999, the Polish government finally approved a process for privatising PZU. Pursuant to this privatisation plan, 30% of the company is to be sold in 1999 to a strategic investor. There are almost 2.6 million shares to be purchased, and there may not be more than three purchasers. According to information issued by the Minister of the State Treasury, Emil Wasacz, the second stage of privatisation will involve selling the rest of PZU's shares by the end of 2001. Moreover, 15% of PZU's shares will be offered to those persons eligible to acquire shares free of charge according to the provisions of Polish law, and 5% will be retained by the State Treasury as a reserve for the State's privatisation needs.

12.2.6.2 PZU's current market status

It has been said that over the past 7 years, PZU has suffered from serious capital shortages. In 1998, the shortage in the company's own funds exceeded 1 billion PLN (285 million USD). In the middle of January 1999, the State Treasury supplied PZU with Bank Handlowy bonds. Thanks to this operation, the company's share capital was increased by 852 million PLN (243 million USD). It is believed that the interest from the Polish Bank's Privatisation Fund will yield more than 70 million dollars. In spite of the aforementioned capital shortages, the latest financial description of PZU (as of 1997) presents the company as being worth approximately 3 billion PLN (857 million USD). According to financial experts, the real value of PZU should be estimated by taking into account its position on the Polish insurance market.

12.2.6.3 Privatisation procedure

Four stages are planned for completion of the whole privatisation procedure:

(1) Invitation to negotiation

The first stage consists of the invitation to negotiation. This was announced in the Polish newspaper "Rzeczpospolita" on 10 May 1999. According to the invitation, there were 2.590.569 registered share series, representing 30% of PZU's share capital.

(2) Initial proposal

The entities that received the memorandum of information have been requested to deliver an initial proposal regarding their purchase of PZU shares. The deadline for delivering the initial proposal was June 21 1999. The Ministry of the State Treasury is not considering these initial proposals as binding. They have been treated as a statement that the investors are generally interested in purchasing shares.

(3) "Short list" and final decision

Many companies expressed their intention to purchase PZU's shares. The list of interested companies has not been disclosed, although it is well known that for example: AXA, Allianz and Eureko wished to participate in further negotiations. It is known that the American Insurance Group was also interested in acquiring PZU's shares. However, they have subsequently decided not to enter into further negotiations. Therefore, after due consideration, the so-called "short list" of investors with whom further negotiations would be undertaken was presented by the end of July. The list, officially presented by the Minister of the State Treasury, contains only three remaining investors, i.e. AXA, Swiss Re together with Winterthur, and Eureko.

The "short list" investors were allowed to take part in a due diligence of PZU. After obtaining relevant information, the investors presented their so-called "binding offers" by August 18 1999. On 22 September 1999 the Minister of the State Treasury chose Eureko as the investor to PZU.

12.2.6.4 PZU reform and entry to the EU single market

As pointed out by the European Commission, PZU's reform is crucial to the reform of the Polish market and a precondition for Poland to enter the EU single market. In terms of the competition policy, it is inappropriate that the state owned company dominates in the market. The first step of the privatisation of PZU, i.e. selling its shares to a strategic investor, Eureko, will be completed by the end of 1999. It will definitely help to make Polish insurance more competitive and market oriented. The Polish market is moving toward the sound insurance system compatible to that in EU member countries.

12.2.7 Future tasks for Poland to enter the EU single insurance market

As analysed above, the Polish insurance market has generally made good progress towards entry to the EU single insurance market. At the same time, the author points out some issues that have yet to be concluded. The Polish authority should fulfil the following two main tasks in order to ensure entry to the EU single insurance market:

12.2.7.1 Organisation of a single license mechanism based on home country control

The Polish insurance authorities have yet to lay down any provisions concerning the EU single license mechanism based on home country control. These provisions include not only those related to freedom of establishment and freedom to provide services but also those concerning license control, financial supervision, market access by branches of non-EU insurers and portfolio transfer.

While it is true that most of the provisions can not be put into force before entry to the European Union, they can be added to the law, stating the date of their implementation as the date of entry to the European Union. Taking into account the recent rapid progress of the Polish insurance system and envisaging entry to the European Union in the near future, the Polish insurance authorities should prepare these provisions without delay.

12.2.7.2 Reinforcement of co-operation with EU countries

Close co-operation with the insurance supervisory authorities in EU member states is essential to implementing a single license mechanism. The White Paper (COMMISSION OF THE EUROPEAN COMMUNITIES (1995s)) pointed out that a single passport pre-supposes a higher degree of market integration and de facto and de jure closer relationships between supervisory authorities. In this respect, the State Office for Insurance Supervision - SOIS's initiative in organising meetings of pan-European insurance regulators/supervisors in 1997,1998 and 1999 was highly appreciated. The SOIS also actively participates in International Association of Insurance Supervisors (IAIS) meetings, which also ensures SOIS involvement in international insurance supervisory matters. The Polish insurance authorities should continue this effort and reinforce their co-operation with the supervisory authorities of EU member countries. This co-operation will also enable Poland's insurance authorities to keep abreast of the dynamically evolving developments in the European Union.

CHAPTER 13: CONCLUSION

13.1 Conclusion

The insurance markets of economies in transition are unique in character as a result of the former command system. In analysis of those markets, many tasks have yet to be carried out. The fundamental problem in these countries is the lack of information, statistics, analysis and guidelines to ensure them sound insurance systems. The consequence of this has been the failure of the insurance system, causing a considerable number of insurance companies in economies in transition to experience financial difficulties. Without adequate information and proper analysis of their market, economies in transition have often undertaken a policy that fails to correspond to market conditions. They often simply copy a developed country's insurance system or introduce one that severely limits powers of intervention.

The information, statistics, analysis and models for reforming the insurance markets of economies in transition provided and proposed in this thesis emphasise those measures that correspond to market development and consider the proper order to introduce those measures. The author established original key statistics and information that had never previously been prepared.

The thesis particularly emphasises the importance to economies in transition of prudential regulations and the basic infrastructure for their implementation at the initial stage. Such liberalisation measures as abolition of product and tariffs control and cross-border insurance transactions should be introduced once a legislative and supervisory system has been established. This order should not be reversed. Once proper regulations have been established, deregulation measures may contribute to market efficiency. Many economies in transition have repeated similar errors by not following this order. Without regulations and supervision, a market is simply uncontrolled and chaotic.

Countries seeking EU membership need particular arrangements in order to achieve a single license based on home country control. The thesis proposes specific guidelines for CEECs integrating into EU single markets. It emphasises a step-by-step approach to achieve this goal, since even current EU member states took more than 30 years to establish the EU internal market. The CEECs should first establish a minimum harmonisation of their prudential regulations with those of EU countries in order to achieve mutual recognition of insurance systems with EU countries, thus facilitating to their integration in the EU internal market.

In implementing their models, economies in transition should make effective use of the co-operation programmes conducted by foreign organisations. However, since there is no organisation that fully understands the assistance needs of the economies in transition or co-ordinates the co-operation programmes of various organisations, no co-operation programme is likely to achieve the expected result. The author suggested that due to its unique position in the area of insurance supervision the IAIS should play a key role in the co-ordination of the various kinds of co-operation programmes. Finally the Poland insurance market, the largest insurance market and one of the most developed insurance systems in CEECs was comprehensively reviewed. The author analysed how the Poland market had developed and pointed out future tasks for Poland to enter the EU single insurance market.

13.2 Areas for future research

This thesis proposes the model applicable to economies in transition in general on the basis of the analysis of the data and information collected from the CEECs. In addition, the author proposes a specific model for insurance reform in CEECs, which are all pursuing integration into the European single market. In particular, the author examines thoroughly the applicability of the model to the Polish insurance market, the largest insurance market in CEECs applying for the European Union.

The starting point for insurance markets in economies in transition is a state controlled insurance system; the goal is a market oriented insurance system where demand and supply are decided by market mechanisms. This basic characteristic of the insurance system in economies in transition could be more widely applied, i.e. not only to CEECs but also to some Asian countries such as China, Vietnam, India and African countries. Of course, among economies in transition, the characteristics specific to CEECs should exist because of the background, namely, the command economy in the European context.

Therefore, further research objectives are to analyse insurance markets in other economies in transition than CEECs, find differences and test the applicability of the model proposed in this thesis. Where necessary, the model should be modified in order to establish the model applicable to economies in transition globally.

APPENDIX 1: QUESTIONNAIRES TO CENTRAL AND EASTERN EUROPEAN COUNTRIES ON INSURANCE REGULATION AND SUPERVISION

Introduction to the questionnaires

I Introduction

The author prepared two questionnaires on insurance systems in economies in transition. The author drafted the first one and sent by the OECD secretariat after adding a few questions. The second one covered, in addition to the questions in first questionnaire, author's drafted questions concerning the actual experiences of insurance supervisors and a questionnaire originally prepared by the European commission.

Since the second questionnaire covered all the questions of the first, only the second questionnaire is attached to this thesis.

The second questionnaire was composed of the following three parts.

1. The updated first questionnaire (Question I)

2. The updated EU questionnaire (Question II)

   This part was originally prepared by the EU Commission in July 1995. This updated questionnaire aimed at obtaining information on the recent developments in the Central and Eastern European Countries in respect of their integration to the European Union.

3. A questionnaire concerning the actual experiences of insurance supervisors

This part focused on questions of actual supervisory practice and experience. It consisted of two sections. The first section requested information on the current situation with regard to regulations and supervisory practices based on experience. The second section enquired about treatment of troubled insurance companies.

II *Findings and analysis*

The findings and analysis of the replies to the questionnaires are categorised into three parts and are to be found in the main body of the thesis presented below.

1. Data and statistics

   The main data and statistics for current insurance markets in economies in transition are described and analysed in section 2 of Chapter 3 in the main body of the thesis.

2. The current insurance system of each country

   The main characteristics of the current insurance system of each economy in transition are analysed from three aspects, *i.e.* historical background, current situation and prospects, in Chapter 4, in the main body of the thesis.

3. Regulatory and supervisory system

   The regulatory and supervisory system in economies in transition is analysed in Chapter 5 in the main body of the thesis. The author classifies the main regulatory and supervisory issues into fourteen categories and analyses each item comprehensively, comparing the situation of individual economies in transition.

On the basis of the above-mentioned findings and analysis, the author classifies economies in transition into three groups, according to the development of their insurance system, and this is presented in section 1 of Chapter 7 in the main body of the thesis. In addition to the findings and analysis mentioned above this classification is the basis for the models of policy measures for insurance regulations and supervision in economies in transition as presented in section 2 of Chapter 7, Chapter 8 and 9 of the main body of the thesis.

Questionnaires

I Updating your reply to the OECD questionnaire (drafted by the author in collaboration with the OECD secretariat)

Could you please reply (if you have not yet responded) or update your reply to the OECD questionnaire for the conference in Warsaw this April (see attached questionnaire), following below guidelines.

1. Basic information on insurance market

"1 number of insurance companies" and "2 number of employees" of insurance companies of (page 1,2):

Please provide the most recent data.

"3 Volume of Direct Premium written", "4 investments by direct insurance companies" (page 2):

Please provide the data in 1996

2. Basic Information on the insurance supervision (page 3 to page 6):

Please reply (if you have not yet responded) or update your reply according to the modifications to your insurance regulations or supervisory system, if any.

3. Supplementary questions to some relevant items

Please reply the following supplementary questions.

(1) Are specific classes of business defined in the insurance law?

(2) Is operating authority of insurers limited to defined classes of business?

(3) Do insurers report premiums and losses by class of business, or disaggregated according to any other specific categories (e.g., territory, size, occupation, nature of business)?

(4) Are there definitions of the data required?

II Updating your reply to the EU questionnaire

Since the EU integration issue is one of the most important items for discussion in the meeting, could you please reply (if you have not yet responded) or update your reply to the European Commission "Questionnaire on information requested for the preparation of the opinion on the application for membership of the European Union"(see attached) prepared last year, following below guidelines :

1. Question 5 and Question 6

Please include the data 1994, 1995 and 1996 (most recent data)

2. The other questions

Please reply (if you have not yet responded) or update your reply according to the modifications to your insurance regulations or supervisory system, if any.

III Supervisory and regulatory issues

Please describe your experience, current main challenges and tasks in respect of insurance regulation and supervision for each discussion item. Since the purpose of the meeting is to share experience and determine the best measure through frank discussion, could you please carefully prepare for your analysis on the basis of your actual practice and experience, and not only the written articles of legislation. With regard to each of the following 6 items, *i.e.*

(1) licensing;

(2) control of technical provisions;

(3) control of assets;

(4) insurance accounting and reporting system to the supervisory authority;

(5) reinsurance;

(6) statistics and data for the calculation of technical provisions and tariffs;

Could you please describe the points below with 1-2 pages on each item separately:

1. Current situation (brief description of the regulations and supervisory practice)

- regulations
- supervisory practice (how do you supervise the issue in practice)

If the regulations have already been described in another part of the responses (for example, the response to the OECD questionnaire), please only describe your supervisory practice.

2. Experience and tasks

Your experience on the actual supervisory practice. What is the most difficult aspect of supervising the issue? What kind of practical problems and tasks do (did) you face in respect of regulations and supervisory activities with regard to this issue?

3. Prospects

How do you plan to change or modify the regulations and supervisory practice, if any?

IV Treatment of a troubled insurance company

Since treatment of a troubled insurance company is one of the main subjects to be discussed, could you please reply the following questions:

1. Do you practice on-the-spot inspections by yourself, by appointed auditors or you do not practice on-the-spot inspections?

2. During last three years (1994,1995,1996) how many companies were withdrawn its licenses and how many policyholders suffered damage each year (1994,1995,1996)?

3. How many companies had another kind of sanction (could you please state precisely what kind) in the last three years and how many were put under possible recovery s or other safeguarding measures (could you please state precisely which kind)?

4. What is the normal procedure for finding a troubled company?

Are there EDP (Electronic Data Procedure)-based (or other) early warning systems in place (e.g. analysing and comparing company results with aggregated market results) or being developed?

5. What are the main causes for troubles (please explain in detail)?

6. What are the remedial procedures for a troubled company? Please distinguish

between possible preventive measures such as recovery s and sanctioning procedures.

7. What are the most difficult tasks for treating a troubled company (please explain in detail)?

8. What is the procedure for bankruptcy and liquidation of an insurance company?

9. Does your country apply any measures to protect policyholders in the case of liquidation of an insurance company? (If yes), how do they function?

V Any relevant information

Please send by mail any supplementary information preferably in English (in not, in French or in Russian) that you consider to be relevant. For example;

1. Insurance law and decrees;
2. Annual report prepared by the Supervisory Authority or by the Insurance Association
3. Any other publication or reports concerning the insurance supervision or market in your country.

(Attachments)

1	OECD questionnaire	6 pages
2	EU questionnaire	2 pages
Total		8 pages

INSURANCE IN ECONOMIES IN TRANSITION

QUESTIONNAIRE

(Prepared by the author and the OECD Secretariat for the Second East-West Conference on Insurance Systems in Economies in Transition in Warsaw in April 1997)

I. Basic information on Insurance Market

1. Number of Insurance Companies

* The figures should include all insurance companies, whether supervised or not, excluding any social security system.

** Composite Insurance Companies means legal entities which concurrently place both life and non-life business.

*** Reinsurance Specialist Companies means legal entities which exclusively underwrite reinsurance.

**** State-Owned Companies means companies whose majority (50% or more) of the controlling powers belongs to the state.

***** National Private Companies means in this context companies whose majority (50% or more) of the controlling powers belongs to national entities excluding State-Owned Companies.

******Foreign-Controlled Companies means companies whose majority (50%) or more) of the controlling powers does not belong to national entities; branches and agencies of foreign companies should be excluded from this category.

*******Estimated data is welcome if exact figures are not available.

********It is important to complete the questionnaire using the following symbols where appropriate:

(i) "0" where the answer is zero,

(ii) "N/A" where the required information is not available and cannot be estimated.

	State-Owned Companies 1	National Private Companies 2	Foreign-Controlled Companies 3	Branches and agencies of foreign companies 4	All companies (=1+2+3+4) 5
Life					
Non-life					
Composite					
Reinsurance					
TOTAL					

2. Number of employees of Insurance Companies

* The figure should indicate the number of staff employed (full-time or part-time) by insurance companies. Brokers, agents and staff employed by brokers or agents should be excluded.

** Estimated data is welcome if exact figures are not available.

3. Volume of Direct Premiums Written

* Please provide the data as of the end of 1996.

** Please provide the data in US$ terms based on the average foreign exchange rate during the year 1996.

*** Please do not include reinsurance premiums.

**** Life and Non-Life categories should follow the definitions used in national law. However, the premiums for accident and sickness insurance underwritten by life companies should be included in non-life figures.

*****Estimated data is welcome if exact figures are not available.

(1) Direct Premiums Written of Non-Life Insurance

(2) Direct Premiums Written of Non-Life Insurance

(3) Market Shares of State-Owned Companies in above (1)

(4) Market Shares of State-Owned Companies in above (2)

4. Investments by Direct Insurance Companies

* Please provide the outstanding figures as of the end of 1996.

** Please provide the data in US$ terms as of the end of 1996.

*** Please do not include investments by Reinsurance Specialist Companies.

**** The breakdown into "Domestic" and "Foreign" should be based on investment destination, i.e., investments in your country and investments abroad.

	1. LIFE Amount placed	2. NON-LIFE Amount placed	TOTAL Amount placed
Real Estate			
Shares			
Bonds			
Loans			
Other investments			
Total			

II. Basic Information on the Insurance Supervision

1. Organisational Structure of Insurance Supervisory Body

(1) Please indicate the name (translated into English) of the insurance supervisory body. If there is more than one body, please explain the role of each body and answer below (2) and (3) respectively.

(2) How many people work for the insurance supervisory body?

(3) How is the insurance supervisory body financed?

2. Licensing

(1) Please describe the main licensing requirements of insurance companies (legal form, minimum initial capital with the name of the currency used, documents required etc.) and the licensing procedure.

(2) Does your country apply any economic needs test, whereby applications might be rejected because of the excessive number of already existing insurance companies?

(3) How does your country deal with foreign insurance companies' application for license and operation?

(i) Are foreign insurance companies allowed to establish wholly-owned subsidiaries? If yes, please describe the main licensing requirements.

(ii) Are joint ventures between foreign shareholders and national shareholders allowed? If yes, please describe the possible maximum limit of foreign participation in these joint ventures.

(iii) Are foreign insurance companies allowed to operate in your country as branches? If yes, please describe the main requirements.

3. Financial soundness

(1) Has your country adopted (or does it intend to adopt) specific insurance accounting principles? If yes, please describe them. Are the accounting method and the content of accounting documents harmonised?

(2) Has your country adopted (or does it intend to adopt) any provisions concerning technical provisions ? If yes, please describe them and explain the adequacy of technical provisions can be monitored by actuaries, auditors and the supervisory body.

(3) What kind of accounting documents do insurance companies submit to the supervisory body and with which periodicity?

(4) Has your country adopted (or does it intend to adopt) solvency requirements for insurance companies? If yes, please describe them.

(5) In your country, are the business situation and financial soundness of insurance companies audited by external auditors on a periodical basis? Does the supervisory conduct on site inspections? If yes, please give details.

4. Policy Conditions and Premium Rates

(1) Does your country supervise policy conditions and premium rates? If yes, please specify which classes of insurance products and premium rates are supervised and describe the modalities of this supervision.

(2) Does the insurance supervisory body monitor claims data such as loss frequency

and loss severity so that they can be adequately reflected in premium rates? If yes, please describe the way claims data is monitored.

(3) Can claims data such as loss frequency and loss severity be shared among insurance companies so that adequate premium rates can be calculated on a broader statistical basis? If yes, please describe who collects these data and for which classes of insurance?

5. Distribution

(1) What kind of intermediaries (employees of insurance companies, insurance agents, insurance brokers etc.) operate in your country? Please indicate their respective market shares in insurance distribution.

(2) Are there any provisions in your country's insurance legislation concerning intermediaries (registration, qualification, disclosure requirements regarding legal status of intermediaries, their relationship with insurance companies etc., financial guarantees or professional liability insurance in case of brokers etc.) ? If yes, please describe them.

(3) Are foreign intermediaries allowed to operate in your country? If yes, please describe in which classes of business they are particularly active (reinsurance, marine, aviation, transport, commercial risk etc.).

6. Investment

(1) Are there any provisions in your country's insurance legislation concerning the evaluation method of investments (historic valuation, market valuation etc.)? If yes, please describe them.

(2) Are there any provisions in your country's insurance legislation concerning investments by insurance companies (principles of investment, list of admitted investments, maximum limit for each category of investments, localisation requirements, currency matching requirements etc.)? If yes, please describe them and explain how the observance of these provisions by insurance companies can be monitored by auditors and the supervisory body?

(3) Does your country allow portfolio investments abroad by insurance companies? If yes, please describe the regulations (maximum limit of foreign investments etc.).

7. Compulsory insurance

(1) Are there in your country any compulsory classes of insurance? If yes, please indicate which classes of insurance are compulsory and explain the reason for that.

(2) What percentage of total premiums written in your country does each compulsory class of insurance account for?

(3) Are compulsory classes of insurance subject to specific regulations (monopolistic provisions by state-owned insurance companies, supervision of policy conditions and premium rates, legal obligation of insurance companies to insure these risks etc.)? If yes, please describe them.

8. Reinsurance

(1) Does your country regulate or supervise reinsurance? If yes, please describe the modalities of this regulation supervision.

(2) Does your country apply any domestic retention requirements? If yes, please describe them.

(3) Does your country allow cross-border transactions of reinsurance (reinsurance cover by reinsurance companies outside of your country which are not licensed by your country)?

9. Winding-up

(1) Does your country apply any measures to protect policyholders' interests before an insurance company goes bankrupt? If yes, please describe. In particular, is the organisation of portfolio transfers by the supervisory body common or feasible before the actual bankruptcy of an insolvent company?

(2) Is there in your country any guarantee fund, i.e., for motor insurance, to prevent policyholders from losses in case the company goes bankrupt?

(3) Does your country apply any measures to protect policyholders' interests in the liquidation procedure of bankrupt insurance companies?

10. Others

(1) Are there any tax incentives for the purchase of life insurance products in your country? If yes, please describe them.

(2) How are public and/or private pensions financed in your country? Are they integrally funded through a pay-as-you-go system, or are they partly financed on a funded basis? In the second case, please describe the funded pension's system in your country (managing institutions, possible of role of insurance companies etc.). Are there any expected changes in this respect, due notably to the aging

population of your country?

(3) Are there associations of insurance industry in your country? If yes, please describe them and explain what kind of role they play?

(4) Is statistical data collection organised on a systematic basis? If yes, please explain who centralised statistical data (insurers' association, supervisory body etc.)

(5) Are there any provisions in your country's legislation concerning cross-sectoral investments (creation of banking subsidiaries of insurance companies, insurance subsidiaries of banking institutions etc.)? If any, please describe them.

(6) Please explain the privatisation schedule of state-owned insurance companies if any.

EU Questionnaire

Information requested for the preparation of the opinion on the application for membership of the European Union

D. Insurance services

General Questions

1. What are the plans and timetables for legal and practical implementation of White Paper Stage I measures? What is envisaged with regard to White Paper Stage II measures - timetable, expected developments?

2. What is the current situation with regard to right of establishment and cross-border supplies of services in your country for EU insurance companies? Which conditions apply?

3. Are foreign insurance companies, once authorised, treated in every respect as a national undertaking?

4. Is there a legal monopoly in one or more insurance branches (e.g. motor insurance)?

5. What is the number of insurance institutions operating in your country?:

   (a) Domestic

   (b) Non-domestic EU (i) subsidiaries and (ii) branches

   (c) Non-domestic non-EU (i) subsidiaries and (ii) branches

   Changes in (a) to (c) since 1990

6. Concentration of the market (of premiums held by largest 5, 10, 15 and 20 undertakings broken down by life and non-life companies), including whether they are:

   (a) Domestic

   (b) Non-domestic EU

   (c) Non-domestic non-EU

   Changes in (a) to (c) since 1990.

Legal Framework

Condition of admission

7. Which conditions are required of new insurance companies by national law before taking up the business of direct insurance (financial guarantees, prior authorisation, legal form, needs test, limit itself to insurance, schemes of operations, control of shareholders)?

Condition of operation

8. What is the set-up of the financial supervisory authorities in insurance? Who supervises the insurance company's business overall, its state of solvency and its technical provisions and the assets covering them (Please indicate name and address)? Does the supervisory authority publish an annual report? Could you provide the Commission with a copy or a summary of the report in one of the EU languages? What are its powers of intervention in case of insolvency, abuses of authorisation?

9. Which annual accounting prudential and statistical information is the insurance undertaking required to give to the supervisory authority in respect of its business? Which rules apply to insurance companies with regard to the format of balance sheet, net or gross presentation, acquisition costs (profit and loss accounts), valuation of investments (historical vs. current value), unrealised investment gains? What specific rules apply to the publication of annual accounts?

10. What powers does the supervisory authority possess in order to require supplementary periodical information? Carry out on the spot verification? Ensure that managers and directors act in a fit and proper way?

11. What are the rules concerning the establishment of technical provisions? How many actuaries are employed by the supervisory authority, and are life/non-life companies obliged to employ actuaries?

12. What is the definition of solvency margin? What are the solvency margins broken down by non-life and life insurers companies operating in your market?

13. What are the rules on the minimum Guarantee Fund?

14. Which insurances are compulsory? What are the specific legal provisions relating to that insurance to be fulfilled by insurance company?

15. What are the requirements imposed by national law as regards prior approval of premia or policy conditions for non-compulsory or compulsory insurance?

Third Country Branches or Agencies

16. What are the principles and conditions for authorisation of an undertaking whose

head office is outside the EU?

Specialisation

17. Are there any insurance classes (e.g. credit insurance) for which a specialisation requirement exists to the exclusion of other classes, meaning that an insurance company offering that class of insurance can only operate in this area to the exclusion of others?

APPENDIX 2: INSURANCE MARKET AND REGULATORY SYSTEM IN SEVERAL ECONOMIES IN TRANSITION

The analyses of insurance market and regulatory system in economies in transition, which are not included in Chapter 4 of the main document, are described here. The countries covered in this appendix are Albania, Belarus, Bulgaria, Croatia, Estonia, Latvia, Lithuania, Romania and Ukraine.

1 Albania

1.1 A brief history of the insurance market

Insurance is still a fledgling market in Albania, with limited free-market experience. Prior to 1991, insurance operations consisted of cargo and hull coverage for Albanian flag vessels as well as some agriculture and livestock. No other classes of insurance existed, while the only reinsurance relationships concerned ceding of cargo activity.

These operations were conducted by a public institution, the "Savings and Insurance Institute" whose main activity was administering the population's savings deposits.

The socio-economic changes that took place in Albania at the beginning of the nineties revealed the relative lack of preparation on the part of the local insurance sector for the new concepts and practices of a market economy.

The existing insurance elements, being part of a centralised economy that included compulsory features, could not entirely satisfy the demands of a growing market.

In July 1991, the Albanian Parliament approved a law that established the Insurance Institute of Albania (INSIG) which divided its activities and became both a savings bank and an insurance company. This was the first step toward the modernisation of the insurance industry in Albania.

The main provision of this law is that insurance and reinsurance activities in Albania are carried out by INSIG. INSIG acts as a joint-stock company with 100 per cent of its shares owned by the state, but is independent in the performance of its economic and financial operations. Its relations with the state consist in the payment of due taxes.

INSIG has its own managing bodies, namely an administrative council and a board of directors. The authority of these bodies is stipulated by its legal status, as approved by the Minister of Finance.

This law also stipulates that the Minister of Finance constitutes the supervision authority in Albania. Since its establishment in 1991, INSIG has always regarded its activities, including its performance as a company, as an important aspect of market development and consolidation.

Any business involving the Albanian insurance market requires keeping a close eye on the performance, activities and achievements of INSIG.

Representing the Albanian insurance market has proved a difficult task for a newly established company. In a relatively short period of time, INSIG has done much to fulfil the economic and legal demands of the new market. Its operations have greatly contributed to:

- creating an insurance mentality, by providing a wide range of services that cover practically the whole territory, and offering more than 30 insurance products. This has resulted in increasing the share of non-compulsory insurance;

- laying the foundations of a free market. Aware of its responsibility as sole operator in the market, INSIG has assisted in compiling the legal acts for insurance operations, the chief one of these being the Law on Insurance and Reinsurance activities.

  INSIG activities have included close co-operation with foreign markets. This has served to provide these with a realistic view of the Albanian political situation and economic potential and thus establish relations of mutual confidence with insurance and reinsurance companies. Relations achieved with foreign markets are regarded as a major success as well as a major investment opportunity for the Albanian insurance market.

  The hiring of qualified personnel and their training in insurance business (more than 450 staff nation-wide) constitutes a sound basis for other companies wishing to join the Albanian market.

1.2 The Current Situation

At present there exists only the single company (INSIG), whose premium volume stood at US $13.4 mil in 1996. This company operates only in the field of non-life insurance. The total sum of investments by the company was US $ 31 mil in 1996.

The legal framework has changed during the last five years.

The most important statutes governing the insurance business in Albania are:

- Law no. 7506, dated 31.07.1991 "Concerning the Insurance Institute of Albania". This chiefly stipulates that insurance and reinsurance activities in Albania are conducted by INSIG (Insurance Institute of Albania), a state-owned company under the supervision of the Minister of Finance.

- Law no. 7641, dated 1.12.1992 "Concerning the Compulsory Insurance of Motor Vehicle Users against Third Party Liability". This law, which came into force on 1.01.1993, provides for compulsory insurance against third party claims. In content it is quite similar to the corresponding laws in other European countries. The law has undergone minor changes that were proposed by the insurance industry.

- The Albanian Civil Code, dated 1.11.1994. Articles 1113 to 1168 of the Civil Code deal with insurance activities, divided into: "General Provisions", "Property Insurance", "Life Insurance" and "Other Provisions".

- Other legal acts of the Government and the Minister of Finance which relate to several aspects of INSIG operations.

- Law no. 8081, dated 7.03.1996, "Concerning Insurance and Reinsurance Activities in the Republic of Albania". The objective of this law is "to define the principles and general rules governing insurance enterprises and particularly those that deal with:

    a. direct life and non-life insurance,

    b. reinsurance,

    c. state supervision of insurance companies and other legal entities that undertake insurance and/or reinsurance activities.

Even though it has been approved, application of this law will still need several legal acts to be issued by the Government and the Ministry of Finance. These acts should in practice open up the market by defining the rules for licensing and controlling insurance companies, etc. A joint commission is presently working to create these acts, but these have yet to be finalised. However it is foreseen that this legal framework will be completed in the near future.

Some important provisions of this law are:

Direct insurance activities may be carried out by domestic companies. Foreign companies may only carry out such activities through their establishment on Albanian territory.

A company's activity shall be limited to insurance operations exclusively. It will not be permitted to carry out any other commercial activities.

Life companies are separated from non-life.

Premium rates are defined by insurance companies themselves, except in the case of compulsory liability and property insurance, where rates are established by law.

Any domestic or foreign company shall need an official authorisation, prior to entering into any direct insurance transactions. This authorisation is issued by the Insurance Supervisory Body, in accordance with the stipulations of this law. The criteria for such authorisation are:

- the company's financial and technical means
- the fidelity and technical qualifications of the company's officers
- the distribution of the company's capital.

Insurance and/or reinsurance companies will be required to possess an initial capital of 30 mil leks (approx. $300,000).

Total foreign participation in any domestic company may not account for more than 40 per cent of its capital or voting rights at its general assembly.

The law also provides for the privatisation of INSIG. This shall take place by first evaluating INSIG's assets and legally transforming it into a stock company 100 per cent owned by the state, followed by a gradual reduction in the state's participation.

2 *Belarus*

2.1 The current situation

As of January 1st 1997, the insurance market in the Republic of Belarus included 56 insurance companies, legal entities, 54 of which conducted both life insurance business and other types of insurance and 2 of which were involved in exclusively life insurance business.

In the Republic of Belarus, there are no specialised reinsurance companies involved exclusively in reinsurance business.

In four insurance companies, the controlling interest (over 50%) is owned by state-owned companies such as: Belnevstragh, Promtransinvest, Belkasko and Gomyi. 100 % of Belgosstragh's shares are state owned, while the remaining 52 companies are domestic, privately owned insurance companies. There are no insurance companies controlled by foreign capital in Belarus.

The insurance companies involved exclusively in life insurance business employ 21 full-time staff, while insurance enterprises involved in other types of insurance business, including life insurance, employ 5,740 persons. The above data does not include the number of insurance brokers.

2.2 Legislative development

Organisational structure of the insurance business supervision system

In the Republic of Belarus, state supervision of insurance business is carried out by the Insurance Activity Supervisory Committee at the Ministry of Finance.

This Committee is composed of 72 persons, 38 of which operate within the central agency and 35 of which work in the Committee's regional branches.

The Committee is financed from the state budget.

Licensing

Insurance companies applying for a license must meet the following requirements:

State-owned insurance companies, joint stock insurance companies, limited liability companies and additional liability companies established for the purpose of conducting insurance business and other activities as defined in the Law of the Republic of Belarus "Concerning Insurance Business" must have a statutory fund, a reserve fund and reserves for a total amount of not less than USD 333,000 and in case of a specially established reinsurance business - not less than USD 100,000 in cash. Such insurance enterprises must be duly registered by the Insurance Activity Supervisory Committee at the Ministry of Finance of the Republic of Belarus.

In the case of insurance and reinsurance transactions carried out in foreign currencies, an insurance enterprise must establish a relevant fund in the said currency amounting to not less than USD 33,3,000, and a reinsurance enterprise - respectively not less than USD 100,000.

In compliance with article 43 of the Law of the Republic of Belarus "Concerning Insurance Business" and in accordance with the Decision on procedures relating to the granting of licenses to insurance companies, reinsurance companies and insurance brokers, a separate license must be granted for each type of voluntary and obligatory insurance. A separate license is also granted for reinsurance business, on condition that the underwriter is involved exclusively in reinsurance business.

Licenses are granted upon applications submitted by insurance enterprises, reinsurance enterprises or insurance brokers. Applications must be properly prepared and include the following attached documents:

- an insurance operations development plan;
- the rules or conditions governing the insurance or reinsurance business;
- samples of documents to be used in underwriting insurance policies;
- a business plan, including the estimated profit and loss account, the reinsurance coverage programme or information on any other guarantees securing the liabilities;
- a copy of the transfer order, confirming that the relevant license fee has been duly paid.

According to the legal regulations of the Republic of Belarus, foreign insurance companies may not be established within the territory of the Republic. The same applies to subsidiaries, representative offices and affiliated companies. Only joint insurance companies with foreign capital that represents a maximum 49 % of the original capital may be established.

Financial Stability

The guidelines for financial reporting are defined in article 14 of the Law of the Republic of Belarus "On Accounting and Financial Reporting" (No. 3321-XII, adopted on October 18th 1994). These are uniform guidelines for all sectors of the national economy and include: full representation of all business operations conducted during a given accounting period; proper reference linking incomes and expenditures to particular accounting periods; current expenditures broken down into production (operating cost) and investments; analytical data that must comply with synthetic data; the business operations policy adopted must correspond to the valuation included in the records; all entries in the annual balance-sheet and other forms of the annual reporting system must be confirmed by the data resulting from stock-taking. There are no specific rules regarding a financial reporting system for insurance business. Financial reporting reflects all the ratios, based upon main accounting documents.

Insurance companies must, on a quarterly basis, provide the Insurance Activity Supervisory Committee at the Ministry of Finance with the following information: a balance-sheet, a profit and loss account and a list of basic ratios for their financial and business operations. Once a year, the annual accounting report is attached as an appendix to the balance-sheet.

In the Republic of Belarus, the requirements relating to the financial standing of insurance companies have already been approved and are included in the Law on insurance business. In compliance with article 6 of the Law, those underwriters that possess the statutory fund, reserves and a reserve fund amounting at least USD

33,300 may become legal entities. Furthermore, article 36 of the Law requires underwriters to maintain a proper balance between assets and insurance liabilities and the supreme supervision body determines the method for defining and measuring this proportion.

The financial reports of all insurance companies operating in the Republic of Belarus must be published once a year, following an audit of their accounts by an independent chartered auditor. Moreover, at the request of an insurance company's owners, an independent external audit of the accounts may be carried out.

Once every two years, the Insurance Activity Supervisory Committee at the Ministry of Finance conducts on-site inspections of insurance companies. For the purpose of these inspections, the Committee draws up a timetable and a detailed list of issues to be examined.

Terms and Conditions of Insurance Policies and the Insurance Tariffs

The terms and conditions of insurance policies, along with their premiums are controlled by the Insurance Activity Supervisory Committee at the Ministry of Finance. This control of insurance products corresponds with the procedure for granting licenses to underwrite insurance policies. At the same time, the Committee ensures compliance with the legal regulations concerning insurance business. The Committee has at its disposal sufficient information on the liabilities covered by insurance, divided according to type. The structure and scope of this information is presented in the obligatory statistical reports that are drawn up every quarter.

Insurance companies share information concerning the volume and level of their losses due to accidents.

Distribution

According to article 8 of the Law "On Insurance Business" of the Republic of Belarus, insurance agents and brokers are entitled to conclude and execute insurance policies. The institution of insurance broker is relatively new and still underdeveloped, and underwriters collect approximately 50% of annual premiums through their insurance agents.

The Insurance Activity Supervisory Committee has elaborated on regulations regarding insurance brokers. Its paper defines their functions, tasks, scope of activities, rights, obligations and liability, as well as licensing procedures and supervision of insurance brokers.

Foreign insurance companies are not permitted to underwrite insurance policies within the territory of the Republic of Belarus.

Investments

According to article 19 of the Law "On Accounting and Financial Reporting", financial expenses must be reflected in accounting records and financial reports, in amounts that constitute the equivalent of actual expenses incurred by an investor. In cases of fixed-income securities and fixed redemption dates, differences between actual expenses and nominal value are calculated on an increased profit or loss account on a regular (monthly) basis.

Investment operations of insurance companies are regulated by the normative acts of the Council of Ministers of the Republic of Belarus, where the sources, terms and conditions, nature and range of investments are duly defined. During on-site inspections of insurance companies and on receiving accounting reports, supervisors check whether investment procedure requirements have been met. Chartered auditors are also permitted to control the methods and procedures of the investment process.

Up to 20 % of an insurance enterprise's total reserves may be invested outside the country.

Compulsory Insurance

At present, there is no compulsory insurance, apart from the obligatory state insurance for certain categories of employee. Such insurance is financed from the state budget.

Operations connected with this obligatory national insurance are carried out by the state-owned insurance company “Byelgosstrah”.

Reinsurance

The reinsurance operations of insurance companies are regulated by Article 14 of the Law of the Republic of Belarus "On Insurance Business”.

According to the Law "On Corporate Income Tax”, premiums transferred by foreign insurance and reinsurance companies are entered in accounts as the original cost of insurance services (*i.e.* are not subject to income tax), provided that the reinsurance policies are concluded in compliance with the procedure laid down by the state organ of supervision.

Reinsurance transactions are possible on the basis of reinsurance agreements, whether concluded with domestic reinsurance companies or foreign underwriters.

Termination of Operations

The Republic of Belarus at present has no normative act protecting the interests of policyholders against the bankruptcy or winding-up of an insurance enterprise. Current legal regulations do not allow the establishment of a guarantee fund to cover possible losses incurred by policyholders in the event of an insurance enterprise's bankruptcy.

Other Issues

According to an executive regulation adopted by the Council of Ministers of the Republic of Belarus, no income tax is due on premiums for voluntary life insurance and additional retirement pensions, calculated in the cost of manufacture (works, services), where these do not exceed 4% of salary expenditures and are paid on the basis of concluded voluntary life insurance policies, or 8 % of salary expenditures paid on the basis of retirement insurance policies.

The current legal regulations of the Republic of Belarus do not provide for the privatisation of state-owned insurance companies.

3 Bulgaria

3.1 A brief history of the insurance market

The entire Bulgarian insurance industry was nationalised after World War II. On June 27th 1946, the Darshaven Zastrachovatelen Institut Act (DZI) was passed and until 1960, DZI operated as the sole insurer on the market. These decades of operation were marked by the establishment of compulsory insurance in key industries. Thus almost all state, co-operative business and household assets were covered.

In 1961, another state insurance company was formed, namely Bulstrad. Its activities covered reinsurance operations and marine insurance as well as overseas insurance transactions and those involving foreign currency. The monopoly of these two companies lasted until 1990, when political changes brought pressure for de-monopolisation of the insurance industry.

3.2 The current situation

There are presently about 120 companies with insurance as their main registered commercial activity, but only 25 actually offer effective insurance products and services. In 1995, there were 14 insurance companies operating on the insurance market and one specialised reinsurance company. In two of these companies, the state has a controlling number of shares, three companies are controlled by foreign legal entities or individuals and the remaining companies are domestically owned.

During the period when compulsory insurance was predominant in Bulgaria, over 80% of insurance contracts were concluded directly between the insurance companies and insured parties. At present, voluntary insurance is predominant and over 90% of insurance is sold through independent intermediaries.

3.3 Legislative development

The business operations of insurance companies in Bulgaria are regulated by the Insurance Act which was passed on October 11th 1996 and came into force on January 1st 1997. This law specifies the minimum capital requirement levels for the various insurance sectors:

- non-life insurance companies - of the minimum LVL300m required at the time of submitting a licence application, LVL 200m to be in real capital;

- life insurance companies - LVL200m at the time of applying for a licence.

Companies already in operation had to register capital of at least LVL80m when applying for a licence pursuant to the Act. This requires that by the year 2000, the companies deposit the remaining part of the required capital in three instalments.

No individual shareholder or corporate shareholder may possess, personally or through third parties, more than 5% of the shares in an insurance company. This restriction does not apply to foreign entrepreneurs, the state or holding companies.

Insurance companies may invest their reserves only in Bulgaria, in government securities, deposit them in a bank, or invest up to 25% in real estate. Up to 5% may be invested in locally issued bonds and up to 10% in shares of listed companies. Any investment of reserves abroad is to be authorised by the Ministry of Finance.

Under the provisions of the Act, an Insurance Supervisory Office was created, subordinated to the Ministry of Finance.

Amendments to the 1996 Insurance Act came into force in January 1997. These included three main amendments:

- A 10-fold increase in the minimum capital requirement, *i.e.* a life and accident insurer will need a minimum capital of LVL2bn and a property insurer will need LVL3bn to register. Reinsurers will need LVL4bn. The companies are to register or re-register by December 31st 1997 and deposit the minimum capital in full by March 31st 1998. At least half the capital must be in cash and the remainder in government securities.

- Foreign insurers have been able to open subsidiaries in Bulgaria or enter joint ventures with local insurers since March 1998. The branches of foreign insurers are subject to the same restrictions as those applied to Bulgarian insurers.

- Supervision in Bulgaria is to be carried out by the National Council on Insurance (subordinate to the Council of Ministers). The Insurance Supervision Office is subject to the NCI and will fulfil rather more technical functions in the control and verification of licence applications, mergers, transfers of portfolios between insurance companies, etc. Final decisions and issue of licences will be made by the NCI and will not be subject to appeal. Renewed application will not be permitted for six months.

Acquisition of stakes in insurance companies of over 5% will require NCI approval. Stakes of over 1% will require owners to demonstrate their financial status and account for the sources of their funds. Insurers are to set aside 2% of their pre-tax profits for a Preventive Measures Fund, and 30% of this fund will be directed to helping the Interior Ministry improve its stolen vehicle tracking operations. Insurance companies are taxed under the Commercial Code. An Anticipated Profit Tax of up to 40% has to be paid in advance.

Darshaven Zastrachovatelen Institut (DZI), Sofia is to be restructured into a joint stock company registered under the Commercial Code, with a share capital of LVL50bn.

4 Croatia

4.1 A brief history of the insurance market

Profound changes were initiated In the Republic of Croatia in the spring of 1990, following the country's first free elections. In 1989, certain changes already took place in the development of the insurance system, when insurance companies were permitted to take the legal form of joint stock companies and conduct business according to market principles. New regulations were implemented in the years following.

4.2 The current situation

By 1995, there were 14 companies operating on the insurance market, along with one specialised reinsurance company. In two of these companies, the state has a controlling number of shares, three others are controlled by foreign legal entities and individuals and the remainder are domestically owned.

In the first quarter of 1997, four new insurers were licensed, bringing the number of active insurance companies up to 19. A further 2 companies have since submitted licence applications.

4.3 Legislative development

After the Republic of Croatia pronounced its independence and sovereignty in October of 1991, business operations of insurance companies were regulated on the following basis:

- property and personal insurance is voluntary, with the exception of compulsory insurance that may be introduced under the Law against the risks to third parties or their property, as well as other mandatory insurance against risks which represent a general danger;

- both property and persons are to be covered by insurance companies whose permanent place of business is in the Republic of Croatia, except where the government proscribes which domestic property and persons, and under which conditions, may be insured or co-insured with a foreign insurer;

- insurance companies must comply with the principle of domestic retention and only then may they cede part of the risks abroad;
- insurance companies are classified as follows: joint stock, public, mutuals, captives and mixed.

Insurance activities in Croatia are regulated by the Insurance Law of January 27th, 1994. This law governs inter alia:

- Requirements for insurance activity
- Licensing procedures
- Technical reserves
- Solvency
- Accounting and audits
- State supervision and regulation
- Penalties for infringement
- Mergers and dissolution of insurance companies
- Confidentiality
- Compulsory insurance.

Amendments to the 1994 Insurance Law were passed in the first quarter of 1997. The main changes were:

- minimum capital was raised to HRK 4m (US $ 667,000) for one line of non-life insurance; HRK 8m for life insurance; HRK 12m for reinsurance and more than one line of non-life.

- Foreign ownership was permitted, along with mixed foreign-domestic ventures, but in the latter case the maximum permitted shareholding by any one person or entity is 15%, unless the insurance supervisor agrees to a higher limit.

- The supervisor may refuse an application for a licence if capital is insufficient to cover potential losses; if the proposed general manager has insufficient qualifications or experience; if it is considered that the company will not be capable of making decisions in its own or the insured best interests; or if the company is not considered viable.

- Company presidents and board members must be approved by the Minister of the Economy.

- At least one third of profits must be allocated to safety funds and security funds must at all times be sufficient to cover liabilities. Assets must be invested with regard to maintaining adequate permanent liquidity. Non-specified investment categories are subject to approval by the insurance supervisor.

- Insurance companies with common interests may establish insurance and reinsurance pools.

- More detailed procedures governing the winding up of insurers were introduced, covering compulsory dissolution, merger and receivership. Mathematical life reserves were given the status of special funds in receivership.

- Motor claimants on insolvent insurers are in future to receive payments directly from the Croatian Insurance Bureau's guarantee fund.

The amendments to the Insurance Law established that calculation of technical reserves is to be regulated by a general enactment that accords with the criteria for allocation of premiums to technical reserves, as laid down by the Supervisory Directorate for Insurance companies. Insurance and reinsurance companies are obliged to comply with the provisions of the amended Law within a period of two years.

No special insurance accounting principles have been adopted to date, but accounting regulations have been introduced by which profit and loss accounts and balance sheets are prepared in accordance with the respective Insurance Accounting Directive published by the European Union.

5 Estonia

5.1 A brief history of the insurance market

The monopolistic insurance system dating from the period of the Soviet regime in the Baltic countries was maintained up to the nineties. Before then, all insurance transactions were controlled and conducted directly by the Ministry of Finance of the Soviet Union. After the disintegration of the USSR, Estonia like all other former Soviet republics, had to devise insurance legislation and regulations of its own. Much of the work was done with the assistance of foreign experts. While drafting the present Insurance Law, many principles were borrowed from foreign legislation as well as from EU Directives.

Before 1991, the sole insurer in Estonia was the Estonian State Insurance, which was later reorganised into a state-owned joint-stock company, Eesti Kindlustus (the Estonian Insurance Company). This company inherited low-priced policies from its predecessor and was left with serious problems, calling in life insurance reserves held by the Soviet State Insurance's Head Office. The company was privatised on June 19th 1996. The best offer was made by the company Hoiupanga Elukindlustuse AS (Saving Bank Life-Insurance Ltd.).

5.2 The current situation

The first private insurance companies began operating in late 1991. At the beginning, the newly formed companies were mostly composite, writing both life and non-life business. But since enactment of the Insurance Law at the end of 1992, which thereafter permitted no composite companies, the insurers have been forced to establish separate life and non-life insurance companies.

In 1996, there were 24 insurance companies in Estonia, of which 16 were engaged in non-life insurance and 8 in life insurance. The actual number of companies active in the market was smaller, with 16 non-life and 7 life companies conducting business in Estonia.

Table next page shows the breakdown of insurance companies in Estonian in the period between 1992 and 1996.

Breakdown of insurance companies in the Estonian market (Non-life & Life/Life companies)					
	1992	1993	1994	1995	1996
State companies	1/1	2/1	2/1	2/1	0/0
Private domestic companies	8/2	10/2	11/2	12/3	14/4
Joint ventures	5/2	6/2	6/2	9/3	9/3
Others –Traffic Insurance Foundation	1	1	1	1	1
Total	**15/5**	**19/5**	**19/5**	**24/7**	**24/7**

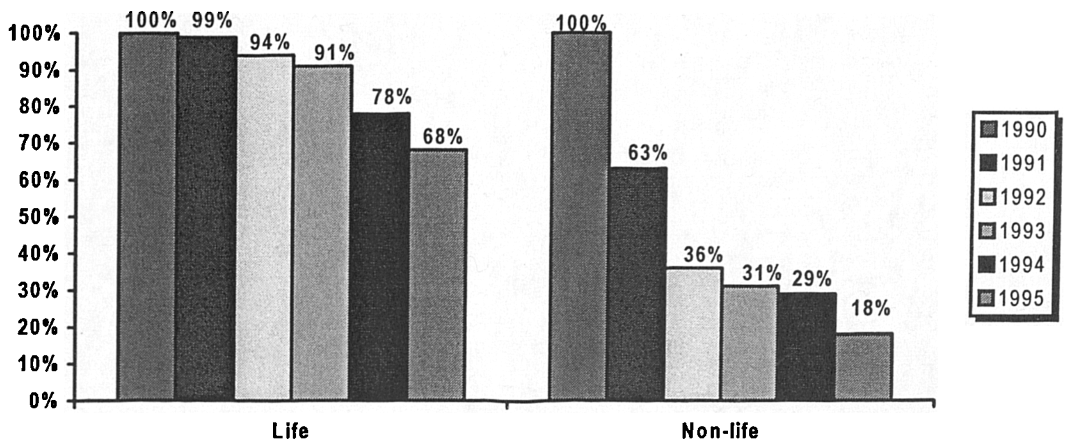
Source: EISA

With regard to the different types of non-life insurance business, the current market situation may be characterised by a concentration by private insurance companies on insuring the property of corporate bodies far more than that of individuals. This fact also becomes evident from a comparison of premiums collected and claims paid out for voluntary insurance of commercial and private property. Corporate property insurance takes second position (16.8%) after motor TPL with respect to premium volume. Third place is taken by land vehicle damage insurance (16.5%) and this is followed by individual property insurance, with only 6.4%.

The market shares of insurance companies tend to be equally divided, both as a whole and in almost all lines of business. A reason for this can be seen in the strengthening of competition, as a result of which many companies have broadened their product range. At the same time, a consequence of stronger competition and the adverse effect on the financial situation of insurance companies is a continuous decrease in premium rates within all major business lines (except motor TPL insurance, where rates are established by the state and are therefore not affected by competition), especially in commercial property insurance.

The position of the former state monopoly insurer, currently the Estonian Insurance Company, is diminishing from year to year both in life and non-life insurance business. The figure below presents this trend.

Market share of Estonian Insurance Company (former state monopoly)



5.3 Legislative development

Insurance activities in Estonia are regulated by a series of insurance laws:

- the Insurance Law - passed on November 18th 1992, amended on February 15th 1995 and on March 13th 1996;
- the Motor TPL Insurance Law - passed on June 4th 1992, revised on April 27th 1995 and amended on November 14th 1996;
- Statutes of the Estonian Insurance Supervisory Authority - passed on December 23rd 1992;
- Statutes of the Traffic Insurance Foundation - passed on November 3rd 1992;
- the Commercial Code - enacted February 15th 1995;

- and other normative acts adopted by the Government, the Ministry of Finance, the Insurance Supervisory Authority and Traffic Insurance Foundation in line with the above laws.

The Insurance Law stipulates:

- basic insurance-related concepts;
- requirements for conducting and terminating insurance contracts;
- the solvency margin, as well as the institution and dissolution of an insurance company
- the final section of the law governs insurance supervision.

EU directives have been used as a model for basic rules in preparing the legal acts governing the Estonian insurance market.

In accordance with the Insurance Law, the Estonian Insurance Supervisory Authority was set up on January 1st 1993 to ensure a stable insurance market and to exert control over the activities of all insurance enterprises.

Licence

Insurance enterprises may write insurance business only on the basis of the respective licence. A licence is issued separately for each line of business, while the following conditions must be met:

- A company shall be entered in the relevant business register, according to the requirements of the legislation in force (Insurance Law 1992, Commercial Law 1995);

- A company shall follow the minimum capitalisation requirements as promulgated by the Insurance Law. Also, share capital must correspond to the company's business plan;

- A company shall present financial and business plans that shall constitute the basis for its future operations. Plans shall exist both in technical areas (business plan), as well as in other related areas;

- The board of directors shall have the necessary qualifications. Obligations shall be divided between the members of the board, and company employees shall have the necessary qualifications.

On issuing a licence, the State assumes responsibility for a company's behaviour, *i.e.* a company must be capable of performing its duties towards policyholders and insured parties. Proceeding from this, the Supervisory Authority shall assure that an insurer is capable of continuous existence. The right to suspend or revoke a license is promulgated in the Insurance Law, but one of the most important duties of the Supervisory Authority is to avoid and eliminate causes for crises. According to the Insurance Law, the Supervisory Authority shall be required to ensure, through the reporting and supervision system, that an insurer does not endanger its future, whether by its actions or lack of action, by violating the business plan in force or in any other way.

The Supervisory Authority does not itself issue or revoke licences. This is the responsibility of the Licensing Commission, subordinate to the Ministry of Finance and headed by the Minister. The Director and Deputy Director of the Supervisory Authority participate in the work of this Commission. All relevant materials, together with an application for license are submitted to the Supervisory Authority, that forms an opinion on whether or not to issue a licence. The votes of the Supervisory Authority are crucial to the final decision of the Commission. If the Supervisory Authority discovers some facts about the insurance company through its supervisory activities that would be sufficient to justify suspending or revoking the licence, it shall turn the respective materials over to the Commission.

Technical provisions

Proceeding from the Insurance Law and the Accounting Law for Insurance Companies, financial supervision also includes control over adherence to the rules for the formation of technical provisions. The Supervisory Authority can and shall control the accuracy and correctness of calculation methods for technical provisions, and also adherence to these methods throughout the insurance company's existence. In 1994, the Instructions for the Formation of Technical Provisions came into force and these Instructions have been the basis for all insurers for drafting their own rules, which are duly submitted to the Supervisory Authority for approval. In 1997, the Supervisory Authority amended these Instructions and these amendments are soon to come into force.

Assets

Supervision of the assets of insurance companies is based on the Insurance Law, Accounting Law and other legislation in force, including instructions issued by the Accounting Department. The Insurance Law promulgates respective requirements and restrictions, for assuring the list and amount of assets necessary for guaranteeing technical provisions. The Law requires an insurer to invest all its financial assets and other assets, with consideration given to the highest security and profitability, but also the principles of diversification and spread of investments and adequate liquidity proceeding from the nature of business. The Supervisory Authority controls adherence to these requirements through the analysis of periodical accounts and on-site inspections. It may bring the attention of insurers to deviations from the requirements or other infringements. The new Insurance Law that will be enforced in 1998, will make the requirements concerning the investment of assets more secure and detailed.

Accounting

With regard to article 43 of the Insurance Law in respect of accounting and reporting by insurance companies, the Government has established special rules governing the principles of insurance accounting and the procedures for preparing annual and semi-annual financial statements and accompanying notes. All insurance enterprises must prepare annual accounts according to this regulation (first enacted in 1993, amended in 1995) and present them to the supervisory body on the date or dates prescribed by a decree of the Supervisory Authority. The EU standards provided in Directive 91/674/EEC of December 19th 1991 have been closely followed in preparing the accounting system for insurance companies. The new Insurance Law that will be enacted in 1998 will also cause some changes to be made in the instructions for accounting and financial reporting. Necessary amendments will be introduced after the Law is enacted.

Data collection

The obligation proceeding from the Insurance Law, to collect statistical and economic data, has now been divided into separate forms: a statistical report and an annual insurance journal that is compiled on the basis of accounting results. The new Insurance Law will require insurers to publish their annual accounts and also require the Supervisory Authority to ensure adherence to this publication requirement and the correctness of the date thus published.

5.4 Prospects

The priorities for the insurance sector are to draft legislation on insurance intermediaries, insurance contracts and supervision of insurance companies. These three essential fields will be covered by the Law drafted to replace the current Insurance Law. The drafted Insurance Law will comprise four major sectors, two of which will be dedicated to regulating insurance intermediaries and a closer definition of the rights and obligations of the Insurance Supervisory Authority. For example, part IV of the drafted law will regulate supervision of the insurance market. Insurance contracts will be regulated by two laws, one of which shall be included in the Law on Insurance and the second of which will fall under the jurisdiction of the Law on Debt Right in Estonia. Further development of pension scheme systems is also essential. A draft Law on Pensions, that will be the second compulsory insurance line in Estonia, operating through insurance enterprises and public insurance funds, is to be adopted in the nearer future.

6 Latvia

6.1 A brief history of the insurance market

The state held a monopoly on the insurance market for more than half a century and it was only in 1991, that the first private insurance companies were established. In that same year, the State Insurance Supervision Department, the forerunner of the present State Insurance Supervision Inspectorate, was established within the Ministry of Finance.

6.2 The current situation

The number of insurance companies operating in Latvia was 28 in 1997 (32 in 1996, 37 in 1995; 43 in 1994), 8 of which were writing life insurance, and 20 writing non-life insurance business. There were no composite companies, as by 1995 the separation of life and non-life insurance business had been implemented. The number of insurance companies controlled by foreign shareholders was 11 in 1997.

6.3 Legislative development

Organisational Structure of the Insurance Supervisory Body

The insurance supervisory body in Latvia is the State Insurance Supervision Inspectorate, employing a staff of 22. The activities of the Inspectorate shall be financed by deductions from the total premium income of insurance companies, observing the procedure and in the amount specified by the Cabinet of Ministers.

Licensing

According to the Law On Insurance, insurers can be:

(1) joint-stock companies;

(2) mutual insurance associations.

Minimum capital must be:

(1) LVL 1,000,000 for life insurance companies;

(2) LVL 500,000 for non-life insurance companies;

(3) LVL 15,000 for mutual insurance companies.

To obtain a license the applicant must submit to the State Insurance Supervision Inspectorate a motivated application plus the following documents:

- a copy of the company's registration entry,
- a copy of the company's foundation documents,
- a list of shareholders (the State Insurance Supervision Inspectorate has the right to demand supplementary information about shareholders, including references of their honesty),
- a bank receipt certifying 100 per cent contribution of the founding fixed capital,
- a receipt certifying payment of the state license fee,
- information on the staff's professional skills,
- a sample copy of an insurance policy (this is waived where the company carries out exclusively reinsurance operations),
- an operations plan.

A candidate's application is to be examined by the State Insurance Supervision Inspectorate within a period of 3 months. The State Insurance Supervision Inspectorate does not apply any economic needs test.

Foreign investors (foreign insurers) may also conduct insurance operations in Latvia after establishing insurance companies that do not include the participation of Latvian entrepreneurs. The main licensing requirements for foreign insurers are the same as for domestic insurers. There is no maximum limit of foreign participation in joint ventures between foreign and national shareholders. Foreign insurance companies are not permitted to operate branches in Latvia.

Foreign investors shall have the right to conduct reinsurance operations, without the need to establish insurance joint-stock companies or participate in such companies

Financial soundness

Technical provisions

The Law On Insurance includes regulations concerning investments which are included in technical provisions. Technical provisions include:

– a received but as-yet unearned premium reserve;

– a reserve for claimed but as-yet unpaid insurance obligations;

– a reserve for anticipated future insurance obligations;

– reserves on life, health and pension insurance.

Life insurance companies must employ an actuary. The duties of the actuary include evaluation of technical provision adequacy. The State Insurance Supervision Inspectorate has the right to examine the adequacy of an enterprise's technical provisions.

Accounting Documents

Insurance companies must submit the following documents to the State Insurance Supervision Inspectorate:

(1) monthly reports - every month;

(2) quarterly reports - every quarter;

(3) investments structure reports - every quarter;

(4) annual reports (balance sheet, profit and loss account, cash flow, audit report and appendices).

Solvency Margin

The Law On Insurance requires that an insurer shall at all times have funds at its disposal that correspond to its solvency margin. The amount and the calculation procedure for the insurer's solvency margin shall be determined by the State Insurance Supervision Inspectorate. The solvency margin is calculated according to EC directives concerning solvency margin requirements.

Auditors

Latvian insurance company's' annual reports are audited by qualified auditors or auditing companies. Qualified auditors or auditing companies must be authorised by the Latvian State Insurance Supervision Inspectorate to conduct insurance company annual report audits.

Policy Conditions and Premiums Rates

The State Insurance Supervision Inspectorate supervises policy conditions for all classes of insurance. It does not monitor claims data. Claims data is not shared between insurance companies.

Distribution

Employees of insurance companies, insurance agents and insurance brokers may operate as intermediaries in Latvia. In order for an intermediary to render insurance services a special permit (license) must be obtained from the State Insurance Supervisory Inspectorate. This is only issued to individual persons and is valid for a period of three years.

Investments

Valuation of investments is based on their historical or purchasing costs. If the increase or decrease in value of an investment is a long-term trend, valuation is based on its market price. If investments are listed on an official stock exchange, the valuation is based on their market price.

The insurer's investments of fixed capital, reserve funds and special (technical) reserve funds shall be safe, diversified and liquid, in order to ensure the financial stability of the company and guarantee the execution of the obligations provided for by insurance contracts.

The special (technical) reserve fund shall include:

(1) securities, issued or guaranteed by the Government of Latvia, Bank of Latvia or local government bodies;

(2) the insurer's resources in bank deposits;

(3) real estate;

(4) securities purchased on the stock exchange;

(5) shares, bonds, parts or stocks of entrepreneurial companies;

(6) mortgage loans;

(7) resources on the insurer's account in a credit institution;

(8) cash.

The amount of investment in any one entrepreneurial company may not exceed 10 per cent of the amount of the insurer's special (technical) reserve fund, while total investment in entrepreneurial companies shall not exceed 30 per cent of the above-mentioned capital.

The insurer shall not spend more than 25 per cent of the special (technical) reserve fund on purchases of real estate.

The insurer may not issue any loans, credits or guarantees or assume any other similar liability where the amount of any single transaction exceeds 10 per cent of the insurer's paid-up fixed capital. The total amount of the above-mentioned transactions may not exceed 30 per cent of the insurer's paid-up fixed capital.

There are no limitations on portfolio investment abroad.

Compulsory insurance

The Law On Compulsory Third Party Liability Insurance for Inland Motor Vehicle Owners has been in force since September 1st 1997. The aim of this law is to regulate the legal relations existing between motor vehicle owners and the insurers in respect of compulsory third party liability insurance for inland motor vehicle owners, in order to protect the material interests of accident victims.

Insurers may conclude compulsory third party liability insurance contracts for inland motor vehicle owners (standard contracts, complex contracts, group agreements, insurance contracts made on the border as well as international contracts (Green Cards) in accordance with the provisions of the Law On Compulsory Third Party

Liability Insurance for Inland Motor Vehicle Owners).

Standard policies for compulsory third party liability insurance for inland vehicle owners must be approved by the Cabinet of Ministers. Insurance premiums are determined by the Cabinet of Ministers.

Reinsurance

There exists no domestic reinsurance company in Latvia. According to Latvian law, the State Insurance Supervision Inspectorate is not responsible for supervising reinsurance companies. Without reinsurance, an insurer has no right to conclude an insurance contract with a separate insured on risk, exceeding 10 per cent of the insurer's charter capital and reserve fund.

Latvia permits cross-border reinsurance transactions.

Winding-up

An Insurer may transfer all its insurance contracts or part of them to another insurer. For the performance of such a transaction, approval must be obtained from the State Insurance Supervision Inspectorate. In order to receive such an approval, the insurer that is to take over the insurance contracts concluded by another insurer, must prove that he will be able to execute his obligations to the insured after acquisition of the above mentioned contracts.

Concluded insurance contracts must be transferred together with an adequate sum of the special (technical) reserve capital.

The insurer shall notify the insured of the intention to transfer the insurance contract to another insurer, and shall publish an announcement in at least one central newspaper and one local newspaper.

If the insured does not approve of the transfer of the insurance contract to another insurer, he has the legal right, within a period of 60 days from the press publication, to cancel the insurance contract and retrieve his premium, which in life insurance classes shall be paid out in full, whereas for other classes of insurance he shall receive that part of the premium, paid for the period remaining until the end of the contract's validity.

The Traffic Bureau, in co-operation with insurers, shall set up a fund for protection of the interests of those insured under the compulsory third party liability insurance for inland motor vehicle owners (hereafter referred to as the Interest Protection Fund), the aim of which is to ensure insurance indemnity in the event of the insurer's insolvency.

The State Insurance Supervision Inspectorate, together with insurers, shall form a fund for protection of the interests of insured parties, providing for its establishment, structure and operation. All domestic insurers are required to participate in the fund.

The task of the fund is to pay insurance compensation in the event of an insurer's insolvency. The amount of the compensation is 100 per cent for life insurance, 90 per cent for the compulsory types of insurance, and 50 per cent for other classes of insurance.

The fund shall not disburse any insurance compensation for insurance on loans, various types of financial loss or guarantees, or where an insurer's insolvency results from illegal activities by the insurer, or where the policy-owner is a legal entity.

7 *Lithuania*

7.1 A brief history of the insurance market

The Lithuanian insurance market began its development in 1990 when the Law on Insurance was passed by parliament. This law changed the concept of insurance-related legal relationships, by establishing an institution for the supervision of insurance companies. Until that time, insurance had been regulated in a rather general way by Articles 462-6 of the Civil Code. This law contained articles dealing with insurance relationships, insurers, insurance organisations, the Council of Insurance Affairs, authority for insurance activities, property, personal, compulsory and voluntary insurance, insurance contracts, the terms of insurance contracts, funds and reserves of insurance organisations, and the rights and duties of the State Insurance Company. Three types of insurance organisations were referred to in the law: insurance joint-stock companies, insurance societies and mutual insurance societies.

Although adoption of this law brought progress, it was based on the old Soviet provisions and thus was not in line with EU directives. This situation changed in 1996, when a new Insurance Law replaced the former.

7.2 The current situation

The number of insurance companies has remained more or less constant. There were 33 insurance companies in 1994, 37 in 1995, 36 in 1996 and 30 in November 1997. At present, there are 11 life and composite insurance companies and 19 non-life insurance companies. There are four joint ventures with foreign capital (one Swiss, two German and one Russian).

7.3 Legislative development

The new insurance law

The new Insurance Law of the Republic of Lithuania was passed by the Parliament on July 10th 1996, replacing the former Law on Insurance (of September 20th 1990). This Law differs considerably from the previous one:

- the market is divided into life insurance and non-life insurance (according to EU directives);
- insurers are forbidden to carry out any commercial business other than insurance activities;
- an insurance company carrying out non-life insurance may not carry out life insurance and vice versa;
- the state monopoly on compulsory insurance is abolished and private companies may now also offer compulsory insurance (There is no compulsory insurance in Lithuania. At present a Draft Law on compulsory motor TPL is being considered by the Government.);
- new regulations on financial control are in place: the amount of authorised capital is increased; the technical provisions insurance companies must establish is defined, along with a list of investments of technical provisions; solvency margin requirements are established, etc.;
- the supervision of insurance activities, as carried out by the State Insurance Supervisory Authority under the Ministry of Finance is regulated in detail;

- the founding, liquidation and reorganisation of insurance companies is regulated in detail.

Technical provisions

On March 14th 1997, the Insurance Supervisory Authority Board approved methods for calculating technical provisions. These methods were more introductory than detailed. Precise technical provisions have to be calculated for the year 1997. On November 28th 1997, the Board approved improved and more precise methods for calculating insurance technical provisions.

Investment

The investment of authorised capital and the technical provisions of insurance companies are regulated by the Insurance Law. Investment sums are determined by resolutions of the Minister of Finance. Insurance companies may invest in securities, real estate, the deposit accounts of commercial banks, shares (public and private), bonds and mortgage loans. They can also invest abroad, on approval by the Insurance Supervisory Authority Board. The Board controls investment of assets through on-site inspections.

Accounting and reporting

Insurance companies like all other economic entities, carry out operations according to the Law on the Principles of Accounting and the resolutions of the Minister of Finance. At present, a new system on accounting and reporting is being prepared, which is to take insurance specifics into account. Insurance companies are required to submit to the Supervisory Authority their annual and intermediate financial statements (balance sheets, profit and loss accounts, cash reports, etc.), tables on authorised capital and investment of technical provisions, solvency calculation, statistical accounts on concluded contracts, premium written and losses paid, etc.

Foreign Insurers

No foreign insurance companies are permitted to operate branches. Foreign insurance companies may carry out insurance activity through subsidiaries or joint ventures only after registration in accordance with the laws of the Republic of Lithuania.

Policy conditions and Premium rates

The policy conditions and premium rates of all classes of insurance are subject to supervision. On-site inspections may be performed in this respect. Claims data can be monitored through analysis of the statistical data submitted to the supervisory authority on a quarterly basis. Claims data such as loss frequency and loss severity is collected by the employees of the State Insurance Supervisory Authority for all classes of insurance that the insurer carries out. The collected data is freely available to all insurance companies.

Intermediaries

According to the Law on Insurance, two types of intermediary are permitted, i.e. insurance agents and brokers. On November 18th 1996, the State Insurance Supervisory Authority adopted a Resolution that regulates the activities of insurance brokers. The main provisions are:

- insurance brokers must obtain permits for insurance mediation;
- two legal forms of insurance broker have been established: joint stock companies and closed joint stock companies;

- the qualifications required of management staff have been specified;
- the minimum amount for professional liability insurance has been set at LTL 100,000 (25 000 USD).

Other issues

There exists no legal monopoly in any of the insurance branches.

Reinsurance companies are not subject to supervision by the State Insurance Supervisory Authority.

7.4 Prospects

The Lithuanian insurance market is in a stage of development and growth. Due to the requirements concerning authorised capital of insurance companies, laid down in the new insurance law, it is expected that some companies may experience financial problems and some may be put into liquidation. Thus the number of insurers in the country may shortly be reduced. On the other hand, there is a growing tendency for banks to fund insurance companies. Changes in the market structure and the number of insurance enterprises will certainly have an effect on expected gross premium income and thus it is currently difficult to predict developments.

As yet, there is no trend towards the formation of reinsurance companies in Lithuania, but many companies reinsure large risks abroad. This is most probably due to the fact that there is no legal framework for the founding of reinsurance companies or for their activities.

The new Law on Insurance has been laid down in accordance with the White Paper's Stage I measures. Additional regulations under this Law are expected to be approved in the near future. These regulations relate to:

- the draft Law on compulsory motor TPL insurance, which has already been prepared and is now at the co-ordination stage. Adoption of this law will stipulate the foundation of a Green Card Bureau. This bureau will establish a guarantee fund, the resources of which will be used to compensate losses and damages suffered;
- the balance sheet and profit and loss account forms to be adopted by insurance companies and the methods for calculation of solvency margin will be established.

The measures specified in the White Paper's Stage II relate to:

- the creation of uniform insurance passports;
- co-operation between supervisory institutions;
- accumulation of a data bank and other administrative measures;
- rules governing further development and conciliation of life insurance and non-life insurance.

These measures are being considered but a schedule for their implementation has not yet been established.

8 Romania

8.1 A brief history of the insurance market

All private insurance companies were nationalised and consolidated into one organisation in 1948, ending 80 years of private insurance in Romania, where the first such company, Dacia, had been established by royal decree in 1871. Shortly after December 1989, when the communist regime was abolished in Romania, the process of liberalisation and privatisation of the whole economy determined the need for a new framework for insurance business. Prior to 1989, there had been only one state-owned insurer - ADAS (Administratia Asigurarilor de Stat - Administration of State Insurance). On January 1st 1991, ADAS was divided into three (still state-owned) joint stock companies: 2 insurance companies and one insurance intermediary.

8.2 The current situation

47 insurance companies had been authorised to operate in Romania by the end of 1996. There existed 3 companies with state-owned capital and 18 with a foreign capital majority. The total number of companies is expected to decrease after promulgation of the new insurance law with its one year deadline for increase in share capital.

8.3 Legislative development

Work began on the new legal framework for insurance in 1991, with the passing of Law no. 47 concerning the establishment, organisation and operation of insurance companies and intermediaries. This Law laid the foundation for de-monopolisation of the insurance market and for the setting up of private insurance companies, as well as for the creation of the Insurance and Reinsurance Supervisory Office (IRSO), whose powers are stipulated in Government Decree no. 574/1991.

Since that time, the basic principles of insurance business regulation and supervision have been implemented on the Romanian insurance market.

Licensing

The conditions governing an insurer's entry to the Romanian market are:

- its legal form may only be that of a public or limited liability company;
- the minimum subscribed capital is 25 million Romanian Lei for any one class of business from the 10 provided for by Law 47/1991;
- paid up capital may not be less than 50% of a company's subscribed capital;
- in order to obtain IRSO approval, the application for authorisation must contain: a company's memorandum of association and articles of association, a business plan, proof of its capital existence, information concerning the management of the new company, the policy conditions and in the case of life insurance, the premium tariffs based on actuarial calculations.
- a foreign insurer may operate through a branch office if it is incorporated in its country of origin, has operated for 10 years in the insurance field and is not insolvent or in financial difficulties. It must deposit with a Romanian bank a guarantee fund equivalent to the minimum capital provided by the law for Romanian companies and must obtain authorisation from IRSO.
- a foreign insurer may also operate through a subsidiary. In such cases, association with a Romanian national is required.

On-going supervision

General requirements

The operating requirements for an insurer are:

- to create and maintain technical reserves according to its intended activity:
- premium reserves for life-insurance, calculated on an actuarial basis and administered separately;
- premium and loss reserves for non-life insurance, e.g.:
  - unearned premium reserves;
  - loss reserves, calculated on the basis of estimations, statistical data or actuarial calculation, which may not be less than 40% of the difference between the premium income and the claims paid for the contracts in force during the respective year.
- its premium income net of reinsurance must not exceed 5 times its paid up capital plus capital reserves.
- Annual submission to the IRSO, until April 15th of the next year, of the balance sheet and the profit and loss account, certified by the general shareholders meeting, together with the auditing report, prepared in accordance with the law. There is no specialised form of balance sheet for insurance companies, but the accounting chart includes specific accounts relating to insurance.
- for the branches of foreign insurers, activity is limited to concluding insurance contracts with foreign individuals and legal entities or for their properties or reinsurance contracts with Romanian insurance/reinsurance companies;
- insurers may invest their capital, capital reserves and technical reserves in banks, properties and intangible assets.

Powers of Intervention

IRSO's powers of intervention are stipulated in Government Decree no. 574/1991, and include:

- the power to request that an insurer's general shareholders meeting or its executive board cancel or temporarily suspend those decisions that are against the law or unauthorised by IRSO as well as the power to replace those persons in the insurer's executive or managerial board that infringe the law concerning the establishment and operation of such companies;
- the power to interdict or restrict an insurers activities temporarily, for the company's whole operation or for certain types of insurance, in order to maintain the insurer's solvency;
- the power to request the relevant Court to declare the bankruptcy of an insurer, in the event of its insolvency.

Law no. 136 of 1995

At the end of 1995, Law no. 136 concerning insurance and reinsurance activities in Romania was issued. This Law is chiefly to provide for insurance contracts for compulsory insurance and reinsurance and to establish two Funds.

The main contents of the law are as follows:

- Motor vehicle third-party liability is compulsory.
- In the case of reinsurance, an insurer may cede reinsurance on the international market only where it is unable to place that risk on the Romanian market.

- There are provisions concerning the Policyholders Protection Fund, administered by the IRSO, established in the event of bankruptcy of an insurance company, and the Road Victims Protection Fund, administered by the Romanian Bureau of Motor Vehicle Insurers.

8.4 Prospects

The above mentioned regulations were only introduced as a stop-gap measure, and their terms are outdated and do not provide the range of provisions and the flexibility required of modern supervisory legislation.

For this reason, the IRSO is preparing new insurance legislation, adapted to the new conditions of the market and according to European standards.

The objective of the intended prudential supervision will be achieved by establishing a supervisory body that appropriately monitors the operations of individual insurers, measures their financial status by approved criteria and ensures adherence to prudent standards of insurance practice and management.

The draft legislation is designed to lay down a modern statutory framework that will ensure the solvency of insurers, encourage sound and profitable market growth, establish internationally recognised supervisory standards and move towards closer harmonisation with EU supervisory standards.

One of the main features of the new legislation is the provision of key components by way of regulations: this enables supervisory requirements to be introduced gradually and in keeping with market developments, and also to be reviewed and updated as required.

The main proposals for the amendments to Law 47/1991 are:

- an increase in minimum capital per class of business to ROL 500m (US $ 72,470) from ROL 25m for insurers and ROL 15m from ROL 1.5m for brokers;
- increased documentation requirements for licence applications, including a business plan, evidence of the commitment of the minimum 30% of share capital in cash and details on the background of directors;
- increased supervisory powers;
- regulations on the investment of technical provisions to encourage adequate spread; and
- extension of the rights of foreign representative offices to serve Romanian clients as well as foreigners.

This new legislation is to come into force in the near future.

9 *Ukraine*

9.1 A brief history of the insurance market

Insurance was developing slowly in the Ukraine prior to the Russian revolution. In the western part of the country, Polish and Austrian companies operated, whilst in the eastern part, under the control of the Russian empire, Russian companies competed with local ones.

Following the Russian Revolution, all insurance companies were nationalised and in

1921, all insurance activity within the borders of the Soviet Union was placed under the control of the state insurance organisation (Gosstrakh).

Until 1988, the Ukrainian insurance industry was a state monopoly and it was only in the early 1990s that a legal framework was established for operation of insurance companies.

9.2 The current situation

By the end of 1996, there were more than 800 insurance companies licensed by the supervisory authority. Only about 180 had begun operating by April 1997, following the increase in capital requirements. It is expected that the new limits in force may cause more insolvencies.

9.3 Legislative development

The principles governing insurance activities were laid down in May 1993, by Cabinet Decree On Insurance No 47, and later amended in 1996 by the Law On Insurance. Under this new law:

- All companies conducting insurance business in Ukraine must be licensed by the Insurance Supervisory Committee and must comply with the minimum capital requirements in force. Insurers may only engage in insurance and the provision of insurance-related services, while all credit operations are forbidden except for housing loans on life policies;
- Licenses are required for each class of insurance;
- Separation of life and non-life insurance activities is in force, so that an insurer licensed for life business may not transact non-life business and vice versa;

- Since January 1st 1997, the minimum capital requirement for a domestic insurance company is the local currency equivalent of ECU 100,000. There are additional restrictions on the form of initial capital. At least 60% must be in cash, which may include up to 25% of the total fund in state securities at nominal value. Funds obtained on credit or intangible assets are not admissible;

- For insurers with foreign investment, the minimum capital is the equivalent of ECU 500,000;

- Insurers are obliged to make regular business and solvency reports to the supervisory committee, which has wide powers over policy wordings, rates and reserve levels;

- Maximum permissible foreign participation in an Ukrainian insurer is 49%, but this rises to 50% in the case of a foreign investor that assumes all the outstanding obligations of a non-life insurer, which are subject to compulsory reorganisation by the supervisory committee;

- Reinsurance abroad is permitted, but is subject to control when considered excessive;

- No specific regulations exist for insurance or reinsurance brokers, although the law prohibits them from soliciting business on behalf of non-licensed companies;

- The law specifies in all 26 classes of insurance which are (or may become) compulsory. They include health insurance, personal insurance by the state for 15 categories of public employee and other occupational groups (including top-level sports people and blood donors); accident insurance for other high risk professions, members of fire brigades, air crews and other aviation staff; personal travel accident; motor TPL; passenger, cargo, baggage, mail and third party liability insurance for aircraft operators; aviation hull; and crop insurance for state and collective farms. The minimum sums insured and maximum rates or methods of calculation for compulsory lines are set by the government;

- Technical reserves must match liabilities. Reserves for unearned premium (calculated on a quarterly basis) and unpaid claims are compulsory and net assets must exceed 25% of premium income or 30% of claims paid, whichever is the greater, with a 90% allowance for reinsurance cession/recoveries. The net sum insured for a single risk may not exceed 10% of share capital and reserves.

- Reserves may only be placed in specified, approved investments (cash in settlement accounts, bank deposits, real estate, interest-bearing securities, government bonds, reinsurance receivables, long-term investment credits (for life insurers), and cash). No maxima or minima are specified.

APPENDIX 3: EVALUATION TABLES OF EXISTING SYSTEMS IN ECONOMIES IN TRANSITION

This part covers evaluation tables of existing systems of 17 counties in economies in transition, which supplement the analysis of Chapter 7. The countries cover in the tables are: Albania, Belarus, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Moldova, Mongolia, Poland, Romania, Russia, Slovakia, Slovenia and Ukraine.

The tables presented in this appendix are:

Table 1	Economic and market environments in economies in transition
Table 2	Market structure and development in economies in transition
Table 3	Licensing in economies in transition
Table 4	On going supervision in economies in transition

The overall evaluation taking into account the evaluation by four criteria (see table 1,2,3 and 4) is following:

Level I: Initial stage of economies in transition

Countries corresponding to this level are Albania, Belarus, Moldova, Mongolia and Ukraine.

Level II: Middle stage of economies in transition

Countries belonging to this level are Croatia, Bulgaria, Latvia, Lithuania, Romania and Russia.

Level III: Developed stage of economies in transition

No country in economies in transition has achieved this level. Countries close to this level are the Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia.

Table 1

Economic and market environments

Country	GDP growth	Inflation rate	Private sector share/GDP	Market capitalisation /GDP	Total
Albania	I	II	III	NA	**I**
Belarus	II	I	I	NA	**II**
Bulgaria	I	I	II	NA	**I**
Croatia	III	III	II	II	**III**
Czech Republic	II	III	III	III	**III**
Estonia	III	II	II	II	**III**
Hungary	II	II	III	III	**III**
Latvia	II	III	II	II	**II**
Lithuania	III	II	II	I	**II**
Moldova	I	II	I	NA	**I**
Mongolia	NA	NA	NA	NA	**NA**
Poland	III	II	II	II	**III**
Romania	I	I	II	I	**I**
Russia	II	II	II	II	**II**
Slovakia	III	III	III	I	**III**
Slovenia	II	III	II	NA	**III**
Ukraine	I	II	II	NA	**I**

Note:

Inflation rate (1997)
less than 10% III
between 10%-20% II
over 20% I

GDP growth (1997)
more than 4% III
between 0%-4% II
less than 0% I

Market capitalisation / GDP (1998)
more than 0.25 III
between 0.10 and 0.25 II
less than 0.10 I

Private sector share/GDP (mid-1997)
more than 70% III
between 50%-70% II
less than 50% I

NA - data not available

Data sources: Transition report 1997 (EBRD)
Emerging Europe (ING Barings: April, 1998)
Baltic Securities Market (TALINVEST SUPREMA SECURITIES, April 1998)

Table 2

Market structure and development

Country	Privatisation	Market share of the former monopoly	Market share of foreign companies	Total premium/ population (USD)	Total premium/ GDP (%)	Total
Albania	I	I	I	I	I	**I**
Belarus	I	III	I	I	I	**I**
Bulgaria	NA	III	I	I	II	**II**
Croatia	I	I	NA	I	II	**I**
Czech Republic	III	II	II	I	II	**III**
Estonia	II	III	III	I	II	**III**
Hungary	III	III	III	I	II	**III**
Latvia	II	II	NA	I	II	**II**
Lithuania	II	III	NA	I	I	**II**
Moldova	II	NA	NA	I	I	**I**
Mongolia	I	NA	NA	NA	NA	**NA**
Poland	I	II	II	I	II	**II**
Romania	I	II	II	I	I	**II**
Russia	I	III	I	I	I	**I**
Slovakia	II	I	II	I	II	**II**
Slovenia	II	III	NA	II	II	**III**
Ukraine	I	NA	I	I	I	**I**

Note:

Privatisation
privatised (state minor share-holding) III
privatised (state major share-holding) II
not privatised I

Market share of the former monopoly (1995)
less than 50% III
between 50% - 70% II
more than 70% I

Market share of foreign companies (1995)
more than 20% III
between I and III II
less than 5% I

Total premium/population (1996)
more than 1600 USD (EU level) III
between 400 and 1600 USD II
less than 400 USD I
* Data of Croatia, Moldova and Ukraine are of 1995

Total premium/GDP (1996)
more than 7%(EU level) III
between 1.5% and 7% II
less than 1.5% I
* Data of Croatia, Moldova and Ukraine are of 1995

NA - data not available

Data sources: OECD Questionnaire (1997 &1998), drafted by the author
Hearings of the supervisory authorities by the author (1998)
Sigma 1994, 1995, 1996 (Swiss Re)
EEIR (1996)

Table 3

Licensing					
Country	**Criteria**	**Life / Non-life activities**	**Foreign establishment**	**Minimum capital requirements**	**Total**
Albania	II ; III	II ; III	I	I	**I**
Belarus	II ; III	I	I	I	**I**
Bulgaria	II ; III	II ; III	III	III	**III**
Croatia	II ; III	II ; III	II	III	**II**
Czech Republic	II ; III	I	III	III	**III**
Estonia	II ; III	II ; III	II	III	**II**
Hungary	II ; III	II ; III	III	III	**III**
Latvia	II ; III	II ; III	II	III	**II**
Lithuania	II ; III	II ; III	II	III	**II**
Moldova	II ; III	I	NA	I	**I**
Mongolia	II ; III	NA	NA	I	**I**
Poland	II ; III	II ; III	III(1)	III	**III**
Romania	II ; III	I	I(2)	I	**I**
Russia	II ; III	I	I	III	**I**
Slovakia	II ; III	II ; III	I	III	**II**
Slovenia	II ; III	II ; III	I	III	**II**
Ukraine	II ; III	I	I	I	**I**

Note:

Criteria

clear criteria II ; III
no clear criteria I

Life / Non-life activities

separated II ; III
not separated I

Foreign establishment

100% foreign owned subsidiaries and foreign branches allowed III
no foreign branch allowed but 100% foreign subsidiaries allowed II
no 100% foreign owned subsidiaries and no foreign branches allowed I

Minimum capital requirements

life equal or more than 0.8 million ECU and non-life equal or more than 0.4 million ECU
(EU directives requirement) III
between I and III II
less than half of the level III (either life or non-life or both) I

NA - data not available
(1) - foreign branches will be allowed from the beginning of 1999
(2) - foreign branches are allowed with limited business scope

Data sources: OECD Questionnaire (1997 &1998), drafted by the author
Hearings of the supervisory authorities by the author (1998)

Table 4

On going supervision								
Country	**Control of technical provisions**	**Audits**	**Control of assets**	**Control of solvency margin**	**Control of MTPL**	**Control of products and tariffs**	**Policyholder protection measures**	**Total**
Albania	I	NA	NA	I	II	NA	II	**I**
Belarus	III	II ; III	II ; III	II	I	III	I	**II**
Bulgaria	II	II ; III	NA	II	III	NA	III	**II**
Croatia	II	II ; III	II ; III	III	III	III	III	**II**
Czech Republic	III	II ; III	II ; III	III	II	III	NA	**III**
Estonia	III	II ; III	II ; III	III	III	I	III	**III**
Hungary	III	II ; III	II ; III	III	III	III	II	**III**
Latvia	II	II ; III	II ; III	III	III	III	III	**II**
Lithuania	III	II ; III	II ; III	II	I	II	III	**III**
Moldova	II	NA	II ; III	II	III	II	I	**II**
Mongolia	I	NA	NA	III	III	II	I	**I**
Poland	III	II ; III	II ; III	III	III	I	III	**III**
Romania	II	II ; III	II ; III	II	III	II	II	**II**
Russia	II	II ; III	II ; III	III	I	III	I	**II**
Slovakia	III	II ; III	II ; III	III	II	III	II	**III**
Slovenia	III	II ; III	II ; III	III	III	III	III	**III**
Ukraine	II	II ; III	II ; III	III	III	NA	II	**II**

Note:

Control of technical provisions

general principles and calculation guidelines	III
general principles	II
no control	I

Audits

auditors examination	II ; III
no auditors examination	I

Control of assets

general principles and established evaluation measures	II ; III
no control	I

Control of solvency margin

effective solvency margin control (EU equivalent)	III
simple solvency margin control	II
no control	I

Control of MTPL

MTPL system compulsory (not monopoly)	III
MTPL is compulsory but dealt only by the former monopoly	II
MTPL is not compulsory	I

Control of products and tariffs

control based on statistics	III
general control	II
no control	I

Policyholder protection measures

policyholder protection measures (both prior to bankruptcy and in liquidation procedures)	III
policyholder protection measures (either prior to bankruptcy or in liquidation procedures)	II
no policyholder protection measures	I

NA - data not available

Data sources: OECD Questionnaire (1997 & 1998), drafted by the author
Hearings of the supervisory suthorities by the author (1998)

APPENDIX 4: POLISH INSURANCE MARKET SITUATIONS (ADDITIONAL TABLES AND FIGURE)

This appendix covers tables and figure with regard to the Polish insurance market, which supplement the analysis of Chapter 11 and 12. The following tables and figure are presented:

Table 1: Life insurance: Gross written premium by company 1991-1998

Table 2: Non-life insurance: Gross written premium by company 1990-1998

Table 3: Exchange rates between PLN and USD

Table 4-1: Gross written premiums by class 1990-1998

Table 4-2: Market share by class - based on gross premiums 1990-1998

Table 5-1: Gross written premiums by class within life insurance market 1990-1998

Table 5-2: Market share by class within the life insurance market –based on gross premiums 1990-1998

Table 6: Gross premium by class within the non-life insurance market 1990-1998

Table 7-1: Types of investment made by life insurance companies 1992-1998

Table 7-2: Proportion of each type of investment made by life insurance companies 1992-1998

Table 8-1: Types of investment made by non-life insurance companies 1992-1998

Table 8-2: Proportion of each type of investment made by non-life insurance companies 1992-1998

Figure: Total gross premiums by branches

Table 1 LIFE INSURANCE: GROSS WRITTEN PREMIUM BY COMPANY 1991-1998 (in PLN)

Insurance company	1991	1992	1993	1994	1995	1996	1997	1998
1. AGF Ubezpieczenia ycie S.A.	23,156.6	894,755.0	2,943,800.0	5,291,278.5	7,069,999.7	8,911,626.5	13,400,196.5	19,928,968.2
2. TU Allianz BG Polska ycie S.A.	-	-	-	-	-	-	19,891.8	8,855,065.7
3. STUn Alte Leipziger Hestia S.A.	-	-	-	-	-	-	233,448.8	9,507,880.9
4. PAPTUn iR Amplico Life S.A.	33.9	315,177.6	3,492,000.0	25,824,324.2	85,733,038.2	208,593,075.6	365,846,788.12	498,386,410.3
5. KU Filar- ycie S.A.	-	0.0	32,600.0	218,266.9	1,000,835.0	2,415,681.7	2,914,281.5	1,476,062.9
6. Cardif Polska S.A.	-	-	-	-	-	-	-	5,451.5
7. TU iR Cigna Stu ycie S.A.	-	-	-	-	-	0.0	19,646.0	526,177.7
8. Commercial Union Polska - TUn ycie S.A.	0.0	5,122.5	3,893,400.0	36,526,373.0	119,501,267.0	323,642,663.0	646,727,219.3	965,456,512.1
9. TU Compensa ycie S.A.	-	-	-	-	-	-	18,972.1	499,225.7
10. Garda Life S.A.	-	-	-	-	-	-	0.0	315,990.7
11. Gerling Polska TU na ycie S.A.	-	-	-	-	-	-	237,146.3	3,561,688.3
12. BTUiR Heros Life S.A.	-	-	-	62,140.3	12,509,876.5	24,931,261.2	15,537,742.5	22,201,383.8
13. TU Inter-Fortuna ycie S.A.	-	-	-	-	-	-	23,091.2	484,866.5
14. TU PBK- ycie S.A.	-	-	-	-	-	0.0	278,310.8	2,558,801.2
15. TUn Nationale-Nederlanden Polska S.A.	-	-	-	0.0	8,604,504.1	56,360,274.0	187,024,905.1	359,605,658.4
16. TU iE Petrus S.A.	-	-	-	954.7	35,934.4	223,491.2	465,232.6	863,899.3
17. TUn ycie Polisa- ycie S.A.	-	-	-	0.0	773,129.3	8,468,469.0	8,806,341.8	15,576,052.2
18. ZUiR Polonia- ycie S.A.	-	-	-	103,074.9	1,096,806.2	1,344,997.6	2,026,407.5	3,853,092.8
19. PZU na ycie S.A.	196,928,843.2	529,068,324.9	876,707,800.0	1,216,339,332.7	1,615,377,919.0	2,148,863,669.3	2,809,203,901.7	3,422,572,769.9
20. TUn Warta Vita S.A.	-	-	-	-	217,719.7	4,883,242.9	16,353,344.7	27,430,137.8
21. ZU Westa Life S.A.*	11,184,615.7	11,641,825.7	-	-	-	-	-	-
22. Winterthur ycie S.A.	-	-	0.0	169.2	6,578.0	103,750.6	979,701.0	8,488,394.3
23. Zurich Handlowy TU na ycie S.A.	-	-	-	-	-	-	-	1,278,467.6
24. TUW Rejent Life	-	-	-	-	0.0	2,277,823.0	2,388,418.0	4,913,682.0
Total Life	208,136,649.4	541,925,205.7	887,069,600.0	1,284,365,914.4	1,851,927,606.9	2,791,020,025.5	4,072,504,987.0	5,378,346,639.7

* company has failed
"0" means no premiums collected
"-" means lack of license

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Table 2 NON-LIFE INSURANCE: GROSS WRITTEN PREMIUM BY COMPANY 1990-1998 (in PLN)

Insurance company	1990	1991	1992	1993	1994	1995	1996	1997	1998
1. AGF Ubezpieczenia S.A.	-	919,608.5	6,456,048.8	18,479,900.0	19,588,492.2	20,657,803.3	34,324,492.8	50,376,207.3	70,660,239.3
2. TUwRiG Agropolisa S.A.	-	-	-	-	-	-	-	5,111,580.5	29,460,457.3
3. TU Allianz BG Polska S.A.	-	-	-	-	-	-	-	6,848,284.1	48,849,909.8
4. AIG Polska TU S.A.	-	553,093.8	3,268,752.6	8,126,000.0	10,643,448.8	19,687,514.2	29,673,053.2	48,191,520.1	60,299,264.7
5. Atu TU S.A.	1,700,000.0	3,444,794.2	7,717,307.9	14,761,700.0	16,218,394.2	18,649,141.7	42,723,858.7	123,200,675.3	170,314,332.9
6. TUiR Cigna Stu S.A.	-	-	-	-	0.0	1,676,139.3	14,182,866.8	45,980,461.5	52,786,897.1
7. Commercial Union TU - Ogólnych S.A.	-	0.0	145.9	11,700.0	17,550.0	27,400.0	279,500.0	13,900,836.8	23,807,151.7
8. TU Compensa S.A.	-	2,080,032.2	14,022,603.8	34,234,400.0	38,715,752.3	40,567,044.0	81,304,556.6	125,421,488.3	193,851,177.8
9. Daewoo TU S.A.	-	4,076,648.9	10,306,759.8	34,012,500.0	44,457,047.8	66,669,975.5	70,289,857.6	92,919,219.1	197,252,770.0
10. PTU Energo-asekuracja S.A.	-	-	-	-	0.0	7,339,177.4	39,830,948.4	97,586,952.6	122,485,111.5
11. TU Europa S.A.	-	-	-	-	0.0	7,561,908.8	19,800,570.9	12,918,758.8	13,665,605.4
12. TU Fenix S.A.*	-	221,867.2	3,511,920.9	10,680,900.0	31,751,004.4	65,210,788.0	43,563,334.8	0.0	0.0
13. KU Filar S.A.	-	-	199,098.7	2,882,600.0	10,545,764.5	21,804,901.7	46,384,155.3	67,439,525.0	87,114,121.9
14. TU Gryf S.A.*	-	1,618,605.6	9,336,841.4	36,562,800.0	77,597,090.3	109,265,036.6	-	-	-
15. TUiR Gwarant S.A.	-	-	-	0.0	0.0	4,327,554.4	16,043,939.6	34,154,092.9	44,575,151.8
16. BTUiR Heros S.A.	-	-	62,397.2	9,387,100.0	20,076,282.0	29,022,169.1	43,891,478.4	60,309,873.3	67,072,631.1
17. STU Hestia Insurance S.A.	-	942,796.4	17,140,181.8	47,225,100.0	78,685,230.0	93,266,972.8	178,031,745.4	237,607,454.7	390,857,132.9
18. ZU Hestja S.A.*	-	283,548.1	3,248,330.9	15,324,600.0	33,407,694.7	52,314,286.7	17,808,303.7	0.0	0.0
19. TU Inter-Fortuna S.A.	-	0.0	143,140.3	2,930,500.0	8,537,646.9	14,338,593.6	22,081,877.3	32,612,144.8	70,744,018.5
20. KUKE S.A.	-	17,616.5	31,009.9	125,200.0	1,062,731.0	3,296,447.4	5,211,335.0	8,388,416.7	16,315,246.8
21. TUiR Partner S.A.	-	-	-	-	-	-	825,950.3	10,847,839.2	20,974,473.2
22. TU PBK S.A.	-	-	-	-	-	32,454.2	15,889,000.4	126,695,222.0	134,929,736.0
23. TUR Polisa S.A.	290,000.0	11,560,040.9	29,885,772.0	58,993,400.0	95,785,521.8	123,095,090.3	199,193,494.9	330,111,703.1	418,947,085.4
24. ZUiR Polonia S.A.	-	5,215,179.8	23,104,557.7	46,573,000.0	65,686,839.9	96,946,922.3	158,673,622.3	243,244,094.3	274,984,622.2
25. PZU S.A.	569,630,000.0	872,943,606.8	996,391,913.2	1,449,960,900.0	1,739,478,767.1	2,247,826,468.0	3,527,402,810.4	5,171,832,569.4	6,010,274,329.7
26. TU Samopomoc S.A.	-	14,904,161.1	13,450,010.7	16,093,000.0	17,166,566.7	23,099,772.9	39,165,948.5	97,373,685.9	135,981,290.0
27. TUiR Warta S.A.	131,080,000.0	202,049,574.6	242,965,764.2	399,842,700.0	548,897,598.8	654,767,581.5	757,996,208.8	1,045,556,440.8	1,344,880,326.2
28. ZU Westa S.A.*	17,550,000.0	154,509,091.8	158,153,902.6	-	-	-	-	-	-
29. Winterthur S.A.	-	-	-	-	0.0	26,862.4	1,464,838.7	32,305,405.7	57,887,156.6
30. Zurich Handlowy TU S.A.	-	-	-	-	-	-	-	-	2,733,076.0
31. TUW Cuprum	-	-	-	-	0.0	5,150,743.5	6,038,404.0	6,902,961.1	7,782,272.8
32. TUW SKOK	-	-	-	-	-	0.0	2,484.0	6,419.8	2,636,187.1
33. TUW TUW	-	0.0	269,835.9	2,304,000.0	4,029,257.6	4,756,222.8	7,194,660.6	12,754,240.7	17,204,794.5
34. TUW Wielkopolska	-	-	-	-	-	-	0.0	5,146,030.4	8,691,677.7
35. PTR S.A.	-	-	-	-	-	-	485,276.1	104,981,497.6	108,898,576.4
Total Non-Life	720,250,000.0	1,275,340,266.4	1,539,666,296.2	2,208,512,000.0	2,862,348,680.8	3,731,384,972.4	5,419,758,573.3	8,250,725,601.5	10,206,916,824.3
Total - Life and Non-Life		1,483,476,915.8	2,081,591,501.9	3,095,581,600.0	4,146,714,595.2	5,583,312,579.3	8,210,778,598.9	12,323,230,588.5	15,585,263,464.0

* company has failed
"0" means no premiums collected
"-" means lack of license

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Table 3
Exchange rates between PLN and USD:
(1USD equivalent Polish Zloty)

Year	At the end of the year	Annual average
1990	0.9500	0.9500
1991	1.0957	1.0583
1992	1.5767	1.3631
1993	2.1344	1.8145
1994	2.4372	2.2727
1995	2.4680	2.4244
1996	2.8755	2.6965
1997	3.5180	3.2808
1998	3.5040	3.4937

Source: National Bank of Poland, Department of Foreign Operations

Table4(1) Gross Written Premiums by Class 1990-1998 (in millions PLN)

Type of Insurance	1990	1991	1992	1993	1994	1995	1996	1997	1998
Life insurance	57.12	189.50	580.00	906.50	1,258.54	1,851.93	2,787.51	4,059.21	5,378.35
Motor insurance (classes 3 and 10)	353.33	725.90	883.30	1,271.20	1,427.42	2,228.68	3,464.11	5,714.06	7,108.34
Property insurance (classes 8 and 9)	138.75	356.90	275.00	383.60	569.73	848.07	1,098.68	1,401.89	1,713.53
Liability insurance (classes 11, 12, and 13)	62.34	38.00	168.60	252.30	90.51	153.95	168.77	218.17	283.71
Financial insurance (classes 14, 15, and 16)	0.27	35.30	39.20	56.30	18.22	75.69	123.27	151.27	211.95
Accident and sickness insurance (classes 1 and 2)	18.23	71.90	83.30	109.80	167.39	248.21	310.05	405.36	496.51
Other insurance	59.85	73.40	99.90	135.00	139.74	170.42	201.17	212.18	239.64
Total	689.89	1,490.90	2,129.30	3,114.70	3,671.54	5,576.94	8,153.56	12,162.14	15,432.04

Table 4(2) Market Share by Class - based on gross premiums 1990-1998

Type of Insurance	1990	1991	1992	1993	1994	1995	1996	1997	1998
Life insurance	8.28%	12.71%	27.24%	29.10%	34.28%	33.21%	34.19%	33.38%	34.85%
Motor insurance (classes 3 and 10)	51.22%	48.69%	41.48%	40.81%	38.88%	39.96%	42.49%	46.98%	46.06%
Property insurance (classes 8 and 9)	20.11%	23.94%	12.92%	12.32%	15.52%	15.21%	13.47%	11.53%	11.10%
Liability insurance (classes 11, 12, and 13)	9.04%	2.55%	7.92%	8.10%	2.47%	2.76%	2.07%	1.79%	1.84%
Financial insurance (classes 14, 15, and 16)	0.04%	2.37%	1.84%	1.81%	0.50%	1.36%	1.51%	1.24%	1.37%
Accident and sickness insurance (classes 1 and 2)	2.64%	4.82%	3.91%	3.53%	4.56%	4.45%	3.80%	3.33%	3.22%
Other insurance	8.68%	4.92%	4.69%	4.33%	3.81%	3.06%	2.47%	1.74%	1.55%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Table 5-1 Gross Written Premiums by Class within the Life Insurance Market 1990-1998 (in millions PLN)

Type of Insurance	1990*	1991*	1992*	1993*	1994	1995	1996	1997	1998
Life insurance (class 1)	55.34	187.50	545.10	887.10	983.82	1394.63	1944.92	2557.00	3194.36
Marriage insurance, birth insurance (class 2)					8.03	10.35	20.43	31.92	44.92
Life insurance linked to investment funds (class 3)	0.00	0.00	0.00	0.00	36.42	120.26	356.21	810.64	1279.73
Annuity insurance (class 4)	1.78	2.00	0.40	0.50	0.40	12.41	20.50	7.24	11.14
Accident and sickness insurance if supplemental to the insurance referred to in classes 1-4 (class 5)	0.00	0.00	34.50	18.90	229.88	314.28	445.45	652.40	848.20
Total	57.12	189.50	580.00	906.50	1258.54	1851.93	2787.51	4059.21	5378.35

Table 5-2 Market Share by Class within the Life Insurance Market - based on gross premiums 1990-1998

Type of Insurance	1990*	1991*	1992*	1993*	1994	1995	1996	1997	1998
Life insurance (class 1)	96.88%	98.94%	93.98%	97.86%	78.17%	75.31%	69.77%	62.99%	59.39%
Marriage insurance, birth insurance (class 2)	0.00%	0.00%	0.00%	0.00%	0.64%	0.56%	0.73%	0.79%	0.84%
Life insurance linked to investment funds (class 3)	0.00%	0.00%	0.00%	0.00%	2.89%	6.49%	12.78%	19.97%	23.79%
Annuity insurance (class 4)	3.12%	1.06%	0.07%	0.06%	0.03%	0.67%	0.74%	0.18%	0.21%
Accident and sickness insurance if supplemental to the insurance referred to in classes 1-4 (class 5)	0.00%	0.00%	5.95%	2.08%	18.27%	16.97%	15.98%	16.07%	15.77%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

* estimate

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Specification	1991	1992	1993	1994	1995	1996	1997	1998
Total direct insurance	**1301.4**	**1549.3**	**2208.2**	**2860.3**	**3728.6**	**5367.3**	**8,105.3**	**10,052.2**
1. Compulsory insurance								
1.1 Third party liability of farmers	9.5	8.1	11.8	12.5	13.5	15.3	22.5	24.9
1.2 Insurance of farm buildings	51.9	46.2	85.1	98.6	113.2	137.2	162.1	209.1
1.3 Third party liability of owners of motor vehicles	480.6	477	653.0	778.2	1,002.0	1,511.6	2,889.9	3,714.9
1.4 Other insurance	-	-	-	-	-	-	5.0	8.1
Total Compulsory Insurance	542.0	531.3	749.9	889.3	1,128.7	1,664.1	3,079.5	3,957.0
2. Voluntary insurance								
2.1 Property								
a) Farm	8.7	8.4	7.1	9.1	10.6	35.4	-	-
b) Casco of land vehicles	245.3	406.3	618.2	887.8	1249.1	1,928.1	2727.3	3,275.6
c) Goods-in-transit	9.9	9.6	20.1	27.7	40.4	74.4	91.4	108.1
d) Casco of aircraft, vessels in sea and inland na	49.3	75.8	95.9	129.8	123.8	74.3	76.7	74.6
e) Foreign trade	32.9	22.3	27.8	34.8	34.4	-	-	-
f) Tourist	14.2	14.5	19.0	21.8	21.8	-	-	-
g) Fire and natural forces	250.6	160.1	215.7	300.0	378.7	446.3	637.6	773.8
h) Credit	1.7	1.5	1.9	2.6	12.7	-	-	-
i) Suretyship	0.6	14.3	24.7	34.4	40.7	-	-	-
j) Other damage or loss property	45.7	60.3	75.7	87.9	118.5	485.9	604.0	731.3
k) General liability	-	-	-	50.2	89.8	177.9	288.3	366.6
l) Various financial losses	0.1	1.1	1.9	6.6	15.2	32.3	28.9	54.4
m) Financial	-	-	-	-	-	90.6	122.0	156.7
n) Other property	28.5	160.5	240.5	223.0	248.3	-	-	-
o) Assistance and benefits	-	-	-	-	-	47.8	44.4	57.5
Total Property Insurance	687.5	934.7	1,348.5	1,815.7	2,384.0	3,393.0	4,620.6	5,598.6
2.2 Personal								
a) Accidents and occupational disease	37.9	67.7	99.6	142.7	194.3	252.5	327.3	403.4
b) Sickness	34.0	15.6	10.2	12.6	21.6	57.7	77.8	93.0
Total Personal Insurance	71.9	83.3	109.8	155.3	215.9	310.2	405.1	496.4
Total Voluntary Insurance (Property & Personal)	759.4	1,018.0	1,458.3	1,971.0	2,599.9	3,703.2	5,025.7	6,095.0

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Table 7-1 Types of investment made by Life Insurance Companies 1992-1998 (in PLN)

Type of investment	1992	1993*	1994	1995	1996	1997	1998
Government Bonds and Treasury	n.a.	251,497,056.23	816,333,984.90	1,354,617,329.60	2,245,127,970.74	2,997,180,714.81	4,834,469,423.52
Shares	n.a.	11,416,229.59	105,906,465.94	480,226,049.14	907,091,115.79	2,310,773,328.79	3,561,806,096.34
Fixed Deposits	n.a.	325,436,450.07	211,723,493.45	180,995,550.01	335,902,877.68	207,608,421.06	345,395,385.97
Land and Buildings	n.a.	6,226,068.91	46,905,939.07	77,783,311.53	102,787,289.71	149,508,934.08	290,629,348.15
Other Investments	n.a.	1,980,413.27	2,796,652.78	8,046,254.86	4,919,282.54	163,251,575.16	19,984,166.06
Total	n.a.	596,556,218.07	1,183,666,536.14	2,101,668,495.14	3,595,828,536.46	5,828,322,973.90	9,052,284,420.04
Investments of life insurance fund	0	0	0	2,092,875.85	35,164,090.90	203,475,647.28	558,194,363.89

Table 7-2 Proportion of each type of investment made by Life Insurance Companies 1992-1998

Type of investment	1992	1993*	1994	1995	1996	1997	1998
Government Bonds and Treasury	n.a.	42.158%	68.967%	64.454%	62.437%	51.424%	53.406%
Shares	n.a.	1.914%	8.947%	22.850%	25.226%	39.647%	39.347%
Fixed Deposits	n.a.	54.553%	17.887%	8.612%	9.341%	3.562%	3.816%
Land and Buildings	n.a.	1.044%	3.963%	3.701%	2.859%	2.565%	3.211%
Other Investments	n.a.	0.332%	0.236%	0.383%	0.137%	2.801%	0.221%
Total	n.a.	100.000%	100.000%	100.000%	100.000%	100.000%	100.000%

* estimates based on data from the Central Statistical Office

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Table 8-1 Types of investment made by Non-Life Insurance Companies 1992-1998 (in PLN)

Type of investment	1992	1993*	1994	1995	1996	1997	1998
Government Bonds and Treasury	n.a.	128,716,167.29	390,561,550.99	772,579,747.69	1,645,319,498.17	2,612,006,964.11	4,667,021,960.82
Shares	n.a.	87,161,375.14	260,257,469.71	319,983,490.86	373,529,975.51	877,453,986.47	882,219,952.83
Fixed Deposits	n.a.	467,326,942.75	562,612,641.89	478,539,765.68	534,306,937.29	904,500;368.83	1,361,271,955.21
Land and Buildings	n.a.	50,391,992.30	111,535,789.68	139,993,530.29	180,042,051.34	220,738,632.08	292,941,130.85
Other Investments	n.a.	64,704,204.46	59,647,703.81	53,505,588.86	79,578,999.98	99,644,193.03	99,172,721.95
Total	n.a.	798,300,681.93	1,384,615,156.08	1,764,602,123.38	2,812,777,462.29	4,714,344,144.52	7,302,627,721.66

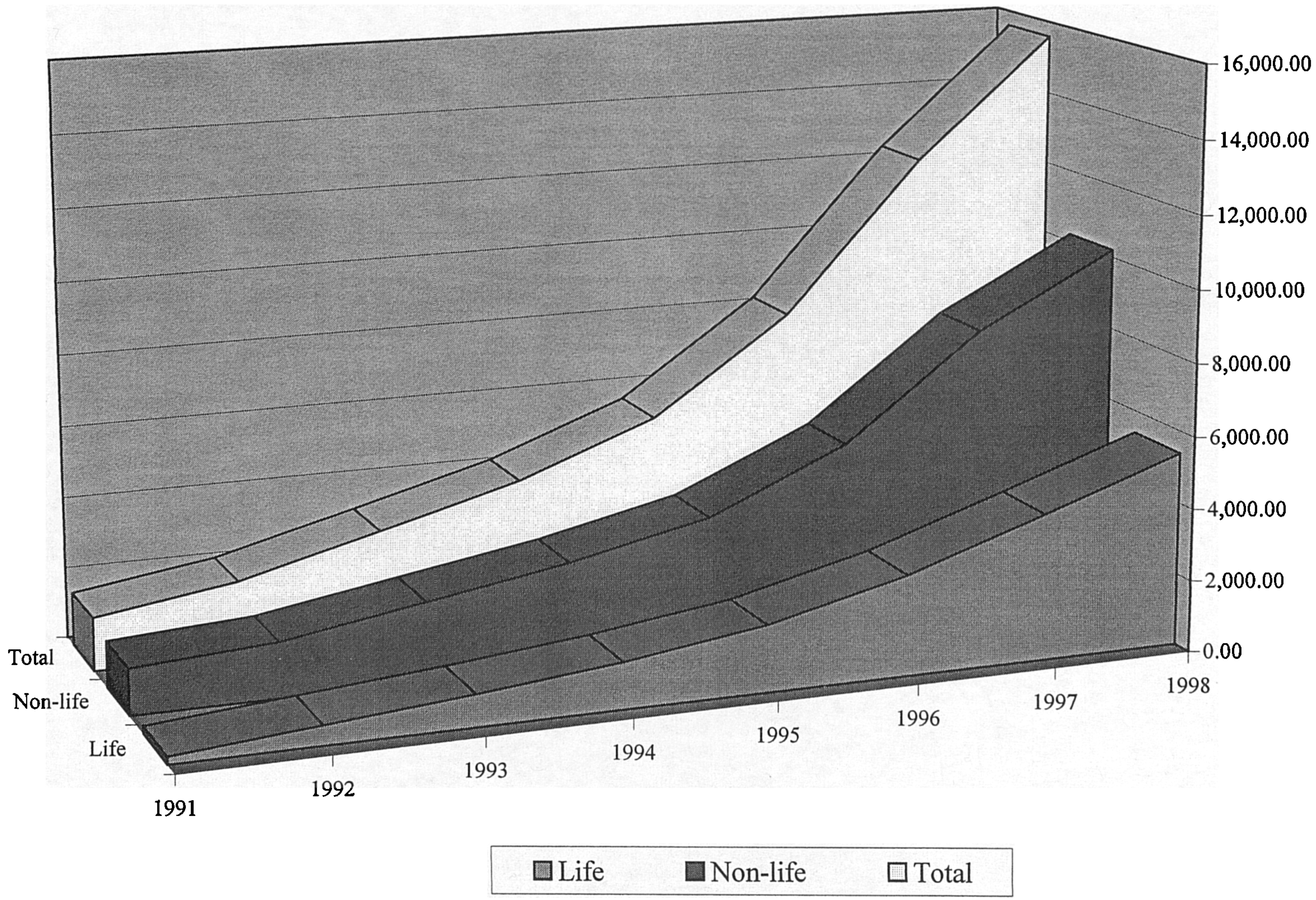
Table 8-2 Proportion of each type of investment made by Non-Life Insurance Companies 1992-1998

Type of investment	1992	1993*	1994	1995	1996	1997	1998
Government Bonds and Treasury	n.a.	16.124%	28.207%	43.782%	58.494%	55.406%	63.909%
Shares	n.a.	10.918%	18.796%	18.133%	13.280%	18.612%	12.081%
Fixed Deposits	n.a.	58.540%	40.633%	27.119%	18.996%	19.186%	18.641%
Land and Buildings	n.a.	6.312%	8.055%	7.933%	6.401%	4.682%	4.011%
Other Investments	n.a.	8.105%	4.308%	3.032%	2.829%	2.114%	1.358%
Total	n.a.	100.000%	100.000%	100.000%	100.000%	100.000%	100.000%

* estimates based on data from the Central Statistical Office

Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

Total Gross Premiums and Premiums by Branches, in Million PLN



Data source: The State Office for Insurance Supervision, Poland
The Central Statistical Office, Poland

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The EU first non-life insurance directive means "First Council Directive of 24 July 1973 on the co-ordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance (73/239/EEC)".

The EU first life insurance directive means "First Council Directive of 5 march 1979 on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance (79/267/EEC)".

The EU third non-life insurance directive means "Council Directive 92/49/EEC of 18 June 1992 on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC".

The EU third life insurance directive means "Council Directive 92/96/EEC of 10 November 1992 on the co-ordination of laws, regulations and administrative revisions relating to direct life assurance and amending Directives 9/267/EEC and 90/619/EEC".

The EU insurance accounts directive means "Council Directive of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings (91/674/EEC)".