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TRADE AND DEVELOPMENT ASPECTS OF INSURANCE SERVICES AND REGULATORY FRAMEWORKS

Note by the UNCTAD secretariat

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Executive summary

The insurance sector is one of the pillars of the financial services sector, along with the banking and securities sectors. As an infrastructural service, insurance plays a key role in economic development. A well-functioning insurance sector enables efficient allocation of a country's capital and channels national savings to investments. Given its dual role as an infrastructural and commercial service, the sector directly and indirectly affects the activities of individuals and businesses. Areas of interest for developing countries relate to the potential impact of the operations of insurance and reinsurance companies on the activities of policy holders and the economy as a whole, the impact of emerging trends in the global insurance market, the need to overcome supply-side constraints, and the role of the government as regulator and provider of insurance services. An effective domestic regulatory framework tailored to national policy objectives can contribute to realizing development gains.

Introduction

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

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

Insurance services and development

Insurance services and their contribution to development

3. The insurance sector is an infrastructural pillar of the financial services sector and the economy as a whole. It plays a key role in economic development. Several empirical studies suggest a strong correlation between the development of financial intermediaries and economic growth. According to some authors[1] there are two, possibly co-existing relationships between the financial sector and economic growth. The first is the case where the financial sector has a supply-leading relationship with growth, and where economic growth can be induced through the supply of financial services. The second is a demand-following relationship where the demand for financial services can induce growth of financial institutions and their assets. Developing countries have supply-leading patterns of causality of development and have considered locally incorporated insurance institutions or state-owned monopolies an essential element of economic development.

4. Recently, the economic importance of the insurance sector has been increasing in most developed countries and some developing ones. Insurance companies form a growing part of the domestic financial sector. They have also become significant players in the international capital markets. During the 1990s, the total assets of insurance companies in developed countries grew faster than the assets of banks, mainly through M&As. Other reasons for the sector's increasing importance are the liberalization of financial systems (including privatization), financial consolidation, the increasing use of contractual savings products, and market-seeking approaches.

5. The insurance sector is closely linked with macroeconomic factors (e.g. inflation, currency controls and the national income of a country), regulation and supervision, and the achievement of national development objectives, as well as the international trade regime. Given its dual infrastructural and commercial role, the sector has attracted great interest in the context of privatization and liberalization. There are several ways in which insurance services contribute to economic development:[2]

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

[2] Das, Davies and Podpiera (2003), *Insurance and Issues in Financial Soundness*, IMF Working Paper WP/03/138.

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

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

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

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

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

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

6. The insurance industry is quite heterogeneous, and the structure of the sector varies according to the prevailing level of economic development.[3] In fact, developed countries' insurance sectors usually include life insurers, non-life insurers and reinsurers. These companies may be stand-alone enterprises or parts of groups or conglomerates, and they may conduct business internationally. Developing countries' insurance providers, in turn, are smaller and generally do not engage in major international activities. There can also be differences between insurance institutions in a particular country or market segment. (For example, because of the wide range of risks to which they can be exposed, companies may differ in their risk profile.).

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

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

- building domestic capacity and overcoming supply-side constraints;

- establishing and implementing effective regulation and supervision;

[3] Das, Davies and Podpiera (2003), *Insurance and Issues in Financial Soundness*, IMF Working Paper WP/03/138.

- the role of the government as an insurance service provider;
- appropriate pacing and sequencing of privatization and liberalization of insurance services; and
- consumer protection.

Box 1. African insurance markets

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

9. Developing countries' markets depend extensively (technically and financially) on international services. Reasons for this include (among others) structural, financial and technical constraints, including the small size of markets, under-capitalization of insurance companies, and insufficient experience and know-how. Usually, insurance industries there also have a shortage of skilled personnel. There is also a dependence on foreign re-insurance, which has implications for the contribution of the insurance industry to national development, in particular with respect to savings promotion and mobilization.[4] Given that these constraints can significantly affect the shortage of insurance services, more research needs to be done on the supply side (including analysing the managerial issues) and on the nature of appropriate regulatory frameworks.[5] Prioritizing the strengthening of human capital is an important source of comparative advantage for insurance services and their export.

[4] See Vittas (2003), *The Insurance Industry in Mauritius*, World Bank Policy Research Paper 3034.

[5] See Outreville (1996), Life insurance markets in developing countries, *Journal of Risk and Insurance.*

Box 2. Development of China’s insurance industry

In the past decade, China’s insurance market has been one of the most dynamic markets in the Asia-Pacific region and in the world. The premium volume rose from 0.46 billion RMB in 1980 to 431.81 billion RMB in 2004. In 2004, although the total insurance premium volume attributable to China was US$52.171 billion, with 1.61% of the world market and eleventh in the world, China's insurance density (per capita insurance premium) was US$40.2, far less than the world average of US$502.1, putting it seventy-second in the world. The development of China’s insurance industry in the past 25 years can be divided into three stages consistent with the gradual progression of China’s economic system reform. The first is resumption and restoration (1980 to 1985), the second is market-oriented reform (1986 to 1991) and the third is opening up and rapid growth (1992 to the present). Here is an overview of insurance operators in China at the end of 2004.[6]

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

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

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

- ***Outsourcing and off-shoring*** (of insurance claims, call centre work related to insurance queries, marketing and claim settlements), provision of insurance advisory services through Mode 1 (e.g. the cross-border supply of auxiliary services, such as actuarial and risk assessment services, which require specialized knowledge) and development of offshore insurance centers. It is estimated that by 2010 more than 20% of the financial services industry’s global cost base will have shifted offshore.[7] To capture this potential, developing countries need to build language skills; understand the culture of the target market; comply with standards (e.g. privacy requirements); and develop the necessary infrastructure.

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

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

- ***Provision of insurance services through Mode 4*** **(**e.g. movement of local insurance specialists to other countries) ***and through Mode 3*** (e.g. Mode 3 establishment of firms from developing countries, particularly in neighboring countries and South-South investment flows).
- ***Distribution of insurance services and insurance intermediation.*** Distribution of insurance services is extremely vital for successful insurance penetration. Effective and efficient access to existing channels for insurance distribution is important. Insurance intermediation is a sector where developing countries can benefit by providing local knowledge of domestic markets to foreign suppliers and international knowledge of foreign markets to domestic suppliers.
- ***Local knowledge.*** Since the marketing of insurance products requires a thorough understanding of the domestic market, including consumers' lifestyles and consumption patterns. Acquiring such knowledge requires partnerships with local firms in developing countries. Such firms could also offer distribution channels, effective marketing strategies, and niche areas of operation.
- ***Portability of insurance.*** As developing countries can build up niche areas of services exports, (such as health services) and insurance services linked to them could be promoted domestically.
- ***Development of software services related to the insurance sector.*** Developing insurance-friendly software systems for use domestically, in other developing countries and globally. Certain insurance activities such as claim settlements, actuarial services and risk assessment could benefit from the use of enhanced software. Website development for insurance marketing and promotion is another area of potential export interest.

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

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

12. Another possible area of operation for governments is public services such as social security plans and social programmes. Most developing-country governments liberalizing their insurance markets need to know which insurance sub-sectors of social importance they should supply and how they can ensure that the interests of lower-income segments are taken into account.[8]

13. While government intervention in providing insurance services to the poorer segments of a population is important, governments also need to establish supporting mechanisms. First, they must create consumer awareness and interest. Second, they must create a favorable regulatory environment with incentives to insurance services suppliers to supply services to the poor, and with adequate enforcement mechanisms. Third, they could provide some level of subsidies, at least in the initial phase,

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

for activities in areas such as risk assessment, data collection and actuarial modeling. Fourth, they need to explore alternative insurance schemes, such as community-based schemes for rural populations, as well as alternative distribution channels or mechanisms (e.g. bank account holders receive insurance instead of interest on their deposits). The latter mechanism could be used to distribute health or life insurance, and it would encourage both banking and insurance. A means of subsidizing or capitalizing socially beneficial insurance schemes is a fund through which compulsory contributions of a specified percentage of insurance profits generated by public and private operators are channeled into providing insurance coverage in sectors like rural insurance or micro-credit. Finally, the government may choose to act as a reinsurer in order to encourage private-sector operations in non-profitable but socially important insurance sectors.

Global trends

A market overview[9]

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

15. World insurance premiums rose from approximately US$2.959 trillion in 2003 to US$3.244 trillion[10] in 2004, indicating an overall real growth rate of 2.3%.[11] Industrialized countries generate about 88% of world life insurance premiums and account for 90% of the world non-life market. While the collective premiums of industrialized countries[12] were higher than those of emerging markets[13], the overall real growth rate of the emerging markets for 2004 stood higher, at 7.5% as opposed to 1.7% in industrialized countries, indicating the existence of great potential in emerging markets.

16. Insurance penetration for industrialized countries stood at 9.02%, whereas for emerging markets the figure was 3.94%. In both developed and developing countries there are differences in insurance penetration. For example, the figure was 7.40% for South and East Asia, 4.89% for Africa,[14] 2.47% for Latin America, and 1.65% for the Middle East and Central Asia. In terms of insurance density, the world average for premium per capita was US$602. There is a big difference between the insurance density of industrialized countries (US$2966) and that of emerging markets (US$687). Differences can also be observed within emerging markets. For instance, insurance density for South and East Asia was US$67.8, for the Middle East and Central Asia it was US$48.4, for Latin America it was US$90.9 and for Africa it was US$43.4. The top 10 global insurance companies are from developed countries.

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

[10] Insurance can be divided into life and non-life insurance. World premium volume stood at US 1849 for the life insurance sector and USD 1395 for the non-life sector.

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

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

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

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

The World's 10 largest insurance TNCs, 2003

(ranked by foreign insurance income)

(million of dollars and number of employees)

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

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

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

17. Emerging markets, which include developing countries, differ in size, culture, insurance regulation and GDP, which leads to differences in growth rates for both life and non-life insurance. For example, in the life insurance sector, the emerging markets as a whole achieved a real growth rate of 10.5% in 2003. However, within this group, the real growth rate for 2004 was over 25% for Argentina and Hong Kong (China) and only 3.5% for China, Hungary and Israel.

Table 2. Global and regional share of world insurance market, insurance penetration and insurance density[15]

Country/Region	Premium volume (2004)[16]	Share of world market in %	Growth rate in real terms for 2004	Indication of insurance penetration[17] or premium as percentage of GDP	Indication of insurance density for 2004 (in US$) or premiums per capita
Total					
World	324 3906	100	2.3	7.99	602
Industrialized countries[18]	2 871 690	88.53	1.7	9.02	2 966
Emerging markets[19]	372 215	11.47	7.5%	3.94	687
America	1 216 900	37.51	1.8	8.27	1 404.3
North America	1 167 576	35.99	1.4	9.17	3 601.1
Latin America	49 323	1.52	10.5	2.47	90.9
Europe	1 198 184	36.94	3.2	7.89	1 427.9
Western Europe	1 156 511	35.65	3.1	8.41	2 359.5
Central/eastern Europe	41 673	1.28	5.6	2.97	125.2
Asia	736 036	22.69	2.1	7.40	194.3
Japan	492 425	15.18	-0.9	10.51	3 874.8
South and East Asia	229 558	7.08	9.0	5.19	67.8
Middle East/Central Asia	14 052	0.43	2.6	1.65	484
Oceania	55 177	1.70	3.2	7.65	1 736.9
Africa	37 609	1.16	-1.3	4.89	43.4

Source: Swiss Re.

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

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

[16] In millions of US dollars.

[17] Figures for insurance penetration and density is in this section exclude cross-border transactions.

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

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

Recent developments in the insurance services sector

19. In recent decades, the insurance services sector has undergone a series of changes in both the developed and developing world. Changes in the market structure showed two distinct trends. The first was the gradual move towards privatization and liberalization – either autonomously by countries, through bilateral and regional agreements, or as a result of commitments undertaken in the WTO GATS. The second trend, consolidation of insurance operations, is most pronounced in the global life insurance sector. The reason for this trend is essentially economic efficiency through economies of scale and consolidation of capital and human resources. As markets gradually become deregulated and admit competition, the financial services sector in general is seeing a natural process of mergers and acquisitions. In a competitive market only companies that have a large enough capital base to meet regulatory requirements and still make a profit are likely to survive. Consolidation is taking place across insurance sub-sectors[20] and within the financial services sector (for example, in the banking and insurance sectors).

Other trends include the following:

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

Break-up of the service being supplied. In the goods and services sector, this trend has been fairly obvious. In the insurance services sector, it could mean the fragmentation of distribution, underwriting, administration and fund management into distinct functions provided by different entities.[21] This disaggregation could be useful for developing countries, which could then invest in capturing specific markets such as policies administration, marketing, claim settlement/processing, and (depending on the level of skills and harmonization of qualifications acquired), fund management, accounting and underwriting.

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

Offshore centers. Offshoring centres aim to attract international insurance business by providing an attractive legislative environment, good infrastructural facilities, tax concessions and liberal

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

[21] Fragmentation occurs when the chain of events leading up to the delivery of a final product is broken up into various components and these are produced or provided by different business entities.

incorporation requirements.[22] Between 2003 and 2004, the number of financial institutions with offshore operations grew 39% globally.[23] This trend is being replicated, though cautiously, in the insurance services sector.

Still other trends include the shifting focus of regulation from what is being sold to how it is being sold, newer insurance challenges for governments and investors (such as coverage for terrorist and catastrophe risks) and, given the proliferation of liability cases (particularly in the United States), the emergence and growth of liability insurance.[24]

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

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

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

- ***The integrity of the sector.*** Given the importance of the insurance sector in mobilizing savings and investment funds, there are concerns related to insolvencies, mismanagement of insurance funds, and newer financial products, among others.
- ***Anti-competitive practices.*** Admission of large insurers could result in anti-competitive practices, including predatory pricing of insurance products and replacement of government monopolies with dominant insurance firms' products as a result of, among other reasons, privatization. All of this may negatively impact domestic insurance suppliers.
- ***Selective marketing to high-value clients*** (individuals or companies) while lower-value clients and sectors are ignored.
- ***The need to promote domestic insurance suppliers and nascent industry.***
- ***Potential loss of employment*** in the case of privatization of publicly owned insurance companies.
- ***Weak insurance supervisory and regulatory authorities***.

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

[22] Malaysia's offshore insurance centre in Labuan is an example.

[23] Deloitte (2005), "Top Ten Issues", *Global Insurance Industry Outlook, 2005*.

[24] Liability insurance includes employer's liability, product liability, public liability (which covers businesses) and professional liability (which covers professionals such as lawyers, doctors and accountants).

Scope and importance of insurance services

Definition of insurance services

23. Following the Financial Stability Forum,[25] one can classify insurance into three major categories: life insurance, non-life insurance and reinsurance. The WTO W/120 Sectoral Classification List[26] breaks down financial services into (a) all insurance and insurance-related services and (b) banking and other financial services. The former is further broken down into life, accident and health insurance services; non-life insurance services; reinsurance and retrocession; insurance intermediation; and services auxiliary to insurance. The Annex on Financial Services (Annex) defines financial services as any services of a financial nature offered by a financial services supplier. It specifies the inclusion of insurance and insurance-related products. The Annex goes on to list insurance and insurance related products as:

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

24. This broad listing of insurance products, coupled with technological developments and the creation of newer hybrid products, has in the current round of negotiations raised issues of classification.[27] Essentially there are three types of stakeholders in the insurance process: the insured (the consumer), the insurer (the provider of a service) and the regulator (generally the government or an independent authority). Other stakeholders in the sector include actuaries and auditors.

Some sectoral features and trends and their implications

25. Each insurance sub-sector has its own peculiarities and implications for developing countries. Following are some features of sub-sectors that fall into the life and non-life categories.

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

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

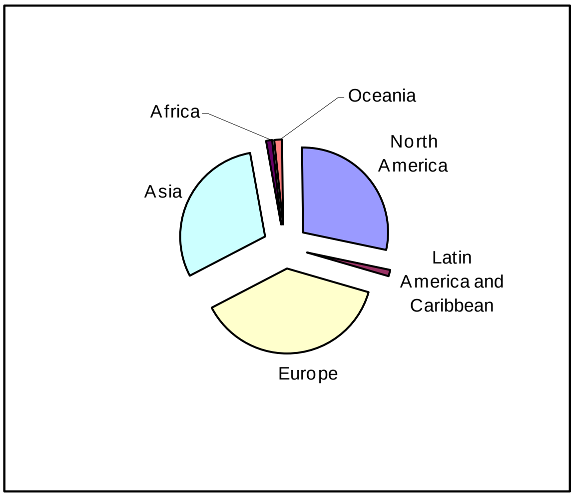
[27] Examples of hybrid products encompassing different financial services include *bancassurance* and insurance-linked derivates.

Life insurance

26. Life insurance (e.g. pension, savings, and health insurance) presupposes the existence of a large capital base, good distribution networks and direct selling and marketing. Life insurance has the most potential to benefit lower-income sections of the population. Industrial countries have the largest share of the life insurance market. In terms of insurance penetration or premiums as a percentage of GDP, Japan has the highest (8.26%), followed by Western Europe (5.1%) and North America (4.12%). Among emerging markets, South and East Asian economies lead at 3.77%, followed by Africa, which includes South Africa (3.41%); Latin America and the Caribbean (1.01%); and the Middle Eastern and Central Asian economies (0.47).[28]

Table 3. Life insurance regional trends for 2004

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



Share of regions in the world life insurance market.

Source: Swiss Re, SIGMA edition No.2/2005, World Insurance in 2004: growing premiums and stronger balance sheets.

Non-life insurance

27. The non-life sector includes motor insurance, marine aviation and other transport insurance (maritime, aviation and transport (MAT) insurance), fire and property insurance, insurance in international contracts. In terms of insurance penetration or premiums as a percentage of GDP for 2004, North America has the highest at 5.05% followed by Oceania (3.9%), Western Europe (3.2%) and Japan (2.25%). Among emerging markets Africa lead at 1.48%, followed by Latin America and the Caribbean (1.46%), South and East Asian economies (1.42%) and the Middle East/Central Asian economies (1.18%).[29]

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[28] SIGMA edition No.2/2005, *World Insurance in 2004: Growing Premiums and Stronger Balance Sheets.*

[29] ibid.

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

Reinsurance[30]

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

Table 4. Non-life insurance regional trends for 2004

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

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

Insurance services and regulatory frameworks

Regulation, its importance and elements to consider

30. Broadly speaking, the role of the regulator in the insurance sector is to ensure the viability, integrity and stability of the financial system, as well to ensure that public confidence in the institutional financial structure of the economy as a whole is maintained. Given that the insurance sector is rather heterogenic and increasingly complex, its regulation and supervision are considerably complicated.[31] In addition, during the last two decades, the rapid development of the insurance sector has made it difficult for regulators to keep up with the changes in the structure of the industry. Finally, the fact that financial conglomerates are frequently subject to multiple regulatory agencies creates coordination problems between regulators, possibly even leading to problems of regulatory arbitrage.

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[30] Broadly, this covers insurance for insurance companies.

[31] Based on Das, Davies and Podpiera, *Insurance and Issues in Financial Soundness*, July 2003, IMF Working Paper WP/03/138.

31. In developing countries, regulatory infrastructure is often minimal or inadequate leading to a gap between insurance regulatory frameworks in developing and developed countries. However, even developed countries have been faced with failures. Examples include Australia's experience with HiH, the country's second largest non-life insurer (the company's failure led to the halting of construction projects and bankruptcy of small businesses), or Japan's experience with the accelerated financial deregulation after the late 1980s (which led to a collapse of eight mid-sized life insurers during 1997–2001), as well as the Republic of Korea's experience after the 1997 financial and currency crisis (which resulted in massive nonperforming loans, including both banks and insurance companies).

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

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

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

Market-impacting regulation or the regulation of market conduct

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

Prudential regulation

36. Prudential regulations are measures the compliance of which allows an insurer to continue its operations within a given market. Prudential laws and regulations cover a broad range of aspects related to the operations of insurers ranging from consumer protection to establishment of reasonable solvency standards. The objective of prudential regulation is to ensure the security and solvency of the market and protect policy holders even if insurers fail. In that context, the prudential regulation also

ensures the integrity and stability of the financial system. Prudential regulations set by the regulator that insurance companies are required to comply with include:

- Adequate entry requirements, capital adequacy and solvency margins, which insurance companies are required to maintain as a hedge against unexpected changes, as well as asset quality, requirements for business operating plan and estimates, and requirements for actuarial and auditing.
- A system to monitor operations (effective reporting and accounting practices; continuous monitoring of capital adequacy, solvency, reserves and investment).
- Technical provisions which serve the purpose of meeting arising liabilities. An inaccurate estimation may lead to financial difficulties, insolvency or a loss of credibility.
- Regulations pertaining to the investments of insurance companies, which are generally focused on the investment of premium money and the need to ensure reasonable rates of return on investments made.

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

37. Indicators for the insurer's financial soundness can help. The following indicators have been identified,[32] most of which are relevant for both life and non-life insurance: capital adequacy, assets quality, reinsurance and actuarial issues, management soundness, earnings and profitability, liquidity, market-based indicators, group exposures.

38. The extent of government regulation of investment funds is an important question, which, in fact, is further complicated by the changing nature of financial products (e.g. high return/high risk) and their markets. While proponents of liberal investment rules suggest allowing insurers to maximize returns as they deem fit (including by investing in foreign markets), there is also an important role for regulators, in terms of setting out investment regulations[33] to avoid the collapse of insurance companies. An added objective for the regulator has been the reliance on the insurance sectors for investment into the economies infrastructural development and related sectors often through the purchase of specified instruments such as government bonds, real estate, secured loans, investment in local stock markets etc.

39. Information gathering is a valuable tool in the hands of the regulatory authority. Information could be transmitted through reporting requirements or at the behest of the regulators. The regulator could conduct on-the-spot checks, employ constant vigilance to determine unusual behavior, and hold regular meetings with the private sector and insurance associations. While insurance professionals such as agents/brokers and actuaries can play an important role, their role may also be misused leading to fraud and other exploitative practices. Regulation relating to insurance professionals could include registration, requirements regarding years of experience and specific knowledge of insurance products, a code of professional conduct, limits on the commission percentage that can be demanded by intermediaries, and bank guarantee. The insurance supervisors also look into cases of non-conformity, insolvency and anti-competitive practices. In cases of non-conformity with insurance legislation or regulation, the insurance supervisor may provide for a consumer redressal forum. In the case of insolvencies and mergers/acquisition, the question arises as to who would take on the insurance claims of the insolvent/acquired insurance company. Certain countries have set up a safety net in the form of

[32] See above.

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

guarantee funds.[34] Finally, the insurance supervisor can play an important role in controlling and preventing abuse of dominant position, ensuring competition in the fixing of insurance rates and thereby the price of the insurance product, and preventing the formation of cartels.

Regulation and its interlinkages with international standards

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

Harmonization of prudential measures and the need for international standards

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

42. From a business perspective, harmonization can also help create favorable conditions and a level playing field for investors, thereby facilitating easy operation of foreign insurance service suppliers. There is currently a move towards international standards in the insurance services sector. There are efforts to define those measures which may be resorted to for prudential reasons. Relevant international standards and guidelines for the insurance sector include primarily those formulated by the International Association of Insurance Supervisors (IAIS), the General Accepted Accounting Principles (GAAP), the International Financial Reporting Standards (IFRS),[35] the Basel Committee, the International Organization of Securities Commission (IOSCO), and those originating from the OECD.

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

[34] Guarantee funds are used in the US (State of New York), UK, EU and Canada, they are generally administered by the government but may also be administered by the insurance industry. Thailand set up the Insurance Stabilization Fund to handle insolvency cases.

[35] Twenty insurance Guidelines issued by the OECD, Decision of the Council on the exchange of information between re-insurers and the OECD guidelines for Insurers governance, adopted by the OECD council in April, 2005 and the OECD Code of Liberalization of Current Invisible Operations (this includes insurance and sets out that member states will deal with the authorization of a current invisible transaction in the most liberal and non-discriminatory manner).

Box 3. The work of the IAIS

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

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

45. Another relates to the fact that standard-setting bodies could be used to assess countries' prudential regimes. It has been suggested that the joint IMF/World Bank Financial Sector Appraisal Programme (FSAP) be used for this purpose.[36] While regulatory assessments can improve the understanding of best practices followed by other countries, differences in national insurance regulation as well as in the economic and institutional underpinnings of countries' financial services sectors suggest that any such best practices cannot be rigorously applied across the board. Technical assistance, including for the development of local expertise and appropriate institutional structures, as well as flexibility in the design and implementation of regulatory systems in accordance with national insurance policy objectives are likely to be key.

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

47. These questions are even more important in light of the fact that the GATS refers to both, international standards as well as measures for prudential reasons.[37]

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

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

48. Article VI:5 (b) of the GATS, for example, sets out that a determination of a Member's conformity with certain GATS obligations shall take into account international standards of relevant international organizations applied by that Member.[38] Thus, international standards may play an important role. Interestingly, the GATS explicitly refers to international standards applied by a Member, as opposed to international standards as such. Possibly, this is a response to the fact that in the area of "services", international standards are much/to date less developed than in the area of "goods".

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

The prudential carve-out

50. Article VI of the GATS covers domestic regulation. For sectors where a Member has undertaken specific commitments, it requires the reasonable, objective and impartial administration of regulations pertaining to services trade. Article VI also aims to ensure that domestic regulations do not constitute unnecessary barriers to trade in services, and do so, amongst others, by providing a negotiating mandate for any necessary disciplines to that effect.[39] Over time, there have been concerns about the extent to which Article VI, and any future disciplines developed under it, could constrain domestic regulatory prerogatives. The challenge in current negotiations of future disciplines is to navigate between establishing specific and effective disciplines to secure market access (including in sectors and modes of export interest to developing countries) and preserving domestic policy-flexibility and the right to regulate.

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

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

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

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

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

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

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

Insurance services in the GATS and developing countries

GATS and insurance services

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

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

58. The Understanding gives details about the sectoral scope and substantive nature of financial services commitments. For Modes 1 and 2, it lists the specific insurance services that would be covered (e.g. insurance of risks relating to, amongst others, maritime shipping, commercial aviation; goods in

international transit; insurance and retrocession; provision and transfer of financial information, financial data processing and advisory and other auxiliary services). For Modes 3 and 4, however, the sectoral coverage is open-ended to all financial services. The Understanding also specifies the nature of the commitments (e.g. for Mode 1 to permit non-resident suppliers of financial services to supply, as a principal, through an intermediary or as an intermediary, and under terms and conditions that accord national treatment; for Mode 3, the right to establish or expand within the Member's territory, including through the acquisition of existing enterprises, a commercial presence[40]). Finally, the Understanding contains provisions on: standstill; government procurement; new financial services (requirement to permit suppliers established in its territory to offer in this territory any new financial service); transfer and processing of information; best endeavour commitments to remove certain non-discriminatory measures; additional definitions (e.g. for "commercial presence") and clarifications (on national treatment).

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

Classification

60. The Annex on Financial Services broadly sets out definitions of what amounts to insurance and insurance-related services.[41] Given that this classification differs from the UN CPC classification, there are potential for conflict and lack of consistency or adequate coverage in definitions. This is also reflected in the scheduling of commitments.

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

62. However, it has also been pointed out that broad definitions can lead to conflicting interpretations and leave central questions to dispute settlement. The evolving nature of the global insurance sector further exacerbates this situation. A WTO background note[42] explains that the GATS

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

[41] Section 5 of the Annex on FS, defines insurance services as (i) Direct insurance to include life and non life insurance (ii) reinsurance and retrocession (iii) Insurance intermediation including brokerage and agency services (iv) Auxiliary services such as claim settlement, consultancy services, actuarial risk assessment etc.

[42] Background Note on Financial Services, WTO Secretariat, December 2, 1998, S/C/W/72

classification is well adapted to new products, as it is based on the content of services supplied. Some Members face difficulties translating their domestic laws formulated on the basis of financial institutions into their GATS commitments.

63. Switzerland proposed reviewing the entire classification system for financial services so as to take into account (a) differences in domestic regulatory structures, (b) new financial products that may be classified in more than one sector, and (c) emerging trends (e.g. bancassurance) that make existing distinctions obsolete.[43] Specifically regarding insurance, Norway suggested new definitions of marine and energy insurance and broadening the definition used in the Understanding to include insurance services with regard to passenger transport and larger fishing vessels. On energy insurance, the proposal suggests insurance of the commercial upstream or "offshore" segment of the market such as exploration, development, production activities and properties of petroleum sector, both onshore and offshore.

Services supplied in the exercise of governmental authority

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

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

Uruguay Round commitments

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

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

authorization and licensing requirements. Some have also included the application of economic needs tests and reciprocity conditions for entry.[44]

Current status of GATS negotiations on Insurance services

Market access and national treatment proposals

67. Following are selected aspects of current proposals relating to market access and national treatment:

- *Identifying sectors for further liberalization* (e.g. intermediation and auxiliary services including, actuarial, risk assessment and claims settlement services; life insurance; reinsurance and retrocession; transport services and reinsurance; marine aviation and transport);
- *Identifying the nature of commitments/the removal of limitations* (removal of mandatory cessation requirements; dismantling of state run monopoly insurance companies);
- *Identifying modes for further liberalization* (developed countries have asked for Mode 4 commitments in terms of temporary entry of natural persons, including the temporary movement of intra-corporate transferees and contractual service suppliers, nationality and residency requirements for executives and employees, and the reduction of limits on the number of foreign employees);
- *Identifying cross-cutting issues* (most proposals underlined transparency issues as important for reducing trade effects of post establishment regulatory barriers and some propose to schedule commitments according to the Understanding).

Modes 1 and 2

68. Developing countries have expressed concerns regarding Mode 1 and 2 liberalization given the sensitivity and importance of the financial services sector and weaknesses of their supervisory and regulatory frameworks.[45] It has been pointed out that any liberalization should take into account the financial, monetary and exchange policies of the countries concerned. Mode 1 specific concerns relate to volatile capital movements, which is further exacerbated by technological changes and the blurring distinction between Mode 1 and 2. Switzerland has recommended reassessing commitments in Modes 1 and 2 highlighting the need for greater homogenization and perhaps the possibility of merging the two modes in financial services. For developing countries, it could be useful to look at specific insurance sub sectors which could benefit from liberalization in Modes 1 and 2 and which cannot be provided domestically as they may require a large capital base and technical know how.

Initial and revised offers

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

70. Developed countries, which are key players in financial services-related activities, request for further liberalization in this sector, for example, by addressing caps on foreign equity participation. Other barriers to trade in insurance services include: restrictions on the type of legal entity (e.g. joint

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[44] Aaditya Mattoo, "Financial Services and the WTO: Liberalization in the Developing and Transition Economies," 16 March 1998, WTO Staff Working Paper

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

venture requirements), limitations on real estate purchase or rental, discriminatory tax and subsidy measures, nationality requirements, unspecified licensing and authorization requirements, ENTs, quotas, existence of monopolies, mandatory cession requirements, limitations of economic activity through geographical restrictions, minimum capital requirements, nationality and residency requirements for high-ranking personnel and/or board of directors.

71. Besides requests for reducing barriers to trade and classification issues (see above)[46] also regulatory issues have figured prominently in the current round of service negotiations. Members agree that an appropriate regulatory framework is a pre-requisite for opening financial markets. Accordingly, Members expressed their views about where to continue discussions on improving transparency: either sectorally (i.e. in the Committee on Trade in Financial Services) or in the Working Party on Domestic Regulation (WPDR). The latter has received more support than the former. Countries also acknowledged the need to consider the relationship between any future disciplines on domestic regulation and the "prudential carve-out." Some developing countries expressed concern about the prescriptiveness of current proposals on transparency and their possible impacts on a Member's right to regulate and to pursue national policy objectives.

72. Based on a recent summary of discussions,[47] some Members have mentioned their interest to see the following elements in future offers: (a) the use of the Annex for scheduling commitments; (b) more Mode 3 commitments, preferably full binding or at least the right to establish new and acquire existing companies in the form of wholly-owned subsidiaries, joint ventures or branches; (c) commitments on Modes 1 and 2 in appropriate sub-sectors; (d) elimination of national treatment and market access limitations including discriminatory application of certain laws and regulations and non-discriminatory limitations such as monopolies, numerical quotas, or economic needs tests; (e) transparency in the development and application of laws and regulations, and speedy and transparent licensing procedures.

Box 4. Transparency proposals

Transparency (for financial services in general and insurance in particular) has been the subject of proposals and discussions in current WTO negotiations. Main elements of the proposed transparency framework on financial services include: (I) *for new regulations or amendments*: (a) prior comment; (b) publication of the final text (and as appropriate addressing substantive comments received); (c) a mechanism to respond to public inquiries; (II) *for the application of regulations*: (a) public availability of all laws, regulations, procedures and administrative or judicial decisions of general application; (b) reasonable advance notice before requiring compliance with new/amended regulations; (c) listing activities requiring authorization or license to supply a service (plus respective procedures/criteria); (d) information about reasons possibly justifying denial; (e) information on types of conduct, practices, and activities, the violation of which could result in disciplinary actions (plus information on respective procedures); (III) *other principles*: (a) independence of the regulator; (b) acknowledging receipt of an application and informing the applicant of licensing and authorization decision within reasonable period of time; (c) upon request - giving reasons for denial of authorization or license and allowing for resubmission of an application; (d) procedures for review/appeal of administrative decisions, and for the service supplier to submit its views; (e) reasonableness of administrative requirements (e.g. fees). More specifically as regards the insurance sector, it was mentioned for WTO Members to: (1) not limit the ability of insurance service suppliers to provide information on their credit worthiness to the public; (2) make financial reporting information available to the public; (3) make regulations governing

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

[47] "Sectoral and Modal Objectives as Expressed by Members", Job(05)/237/Rev.1, 26 October 2005.

identification and handling of financially-troubled institutions available to the public; (4) mechanisms to accelerate the offering of insurance products by licensed suppliers; (5) avoiding certain requirements for product filing or approval; (6) allow the introduction of new products which will be deemed to be approved if no action is taken to disapprove them within a reasonable period of time; (7) avoid limits on the number/frequency of new product introductions.

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

Other Approaches to Liberalization

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

75. One of the proposals (by Japan) also offers specific ideas for complementary approaches in financial services. For example, it suggests undertaking commitments in all sub-sectors; commitments in Modes 1 and 2 in accordance with the “Understanding”; or a focus on Mode 3 (elimination of: limitations on foreign equity participation; on types of legal entity and on the total number of suppliers). Given the importance of governments' regulatory activities, it may be useful to carefully consider the potential implications of such proposals. Many developing countries are of the view that complementary approaches would reverse the logic and spirit of the GATS and the Negotiating Guidelines, and that this could lead to a substantial loss of current, built-in flexibilities. In addition, complementary approaches could not fully take into account the complexity of services sectors and their regulatory frameworks. Issues to be considered are: possible challenges of complementary approaches as regards insurance services; reduction of regulatory flexibility; changes in legal regimes, which are based on historical, social & developmental considerations; assigning negative scores to limitations (e.g. those referring to legal or institutional forms or those reflecting societal differences).

76. A model schedule for future commitments in insurance services has also been proposed,[48] with the objective of addressing effective market access for insurance providers. The model schedule would have two parts: one for commitments in the market access and national treatment columns (both for new as well as improved commitments), and one taking the form of additional commitments, covering domestic regulation type of measures (in the form of best practices). While the first part would be upon

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

individual Members to adopt, the second part would be uniformly adopted by a critical mass of countries.

Conclusions

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

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

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

80. ***Regulatory frameworks.*** The regulator performs a key role in terms of ensuring the viability, integrity and stability of the financial system and that public confidence in the financial structure of an economy is maintained. However, the heterogenic and increasingly complex nature of the insurance sector (including because of the fact that financial conglomerates are frequently subject to multiple regulatory agencies) makes the regulation and supervision of the insurance sector considerably complicated. Additional challenges arise from the rapid changes in the insurance sector over the last decades, which have made it difficult for regulators, to keep up with developments of the industry. While also developed countries have experienced failures, challenges are bigger for developing countries, whose regulatory infrastructure frequently remains minimal or inadequate.

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

82. Other areas for consideration include:

- Technology: Besides facilitating cost cutting, distribution and information sharing, technology can also prevent fraudulent practices. For example for the supervisor an online system of regulation, which individual insurance companies are required to constantly update could be a useful tool in the prevention of insolvencies
- Need for exchange of information and views between all stakeholders. This could include the private sector, supervisors, professional insurance associations and consumer associations
- Foreign exchange regulations: As in most financial services, the insurance services sector is susceptible to volatile and large cross-border transfers of capital potentially in sectors such as reinsurance and MAT. On the one hand, resort to international reinsurers and MAT may be a necessity; on the other hand, it may entail large outflows of capital either in terms of premium payment or in terms of claims made where a domestic insurance company is providing either reinsurance or MAT coverage to a foreign consumer or a local consumer resident abroad.

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

- What is the contribution of the insurance sector to economic and human development? What measures can governments/regulators put in place to maximize benefits and minimize challenges arising from international trade (and investment) in insurance services? What are the regulatory challenges arising from the global/international nature of such trade, including in terms of cooperation, monitoring and enforcement? What are possible responses at the national and international levels?
- What are the impacts of liberalization, privatization, and increasing investment in the insurance sector? Do impacts differ across countries? What are the trends and similarities?
- What are the measures, which governments/regulators can take to improve domestic efficiency and to address supply capacity constraints in developing countries insurance markets? More broadly, what is the role of governments, both as a regulator and as a provider of insurance services?
- What effects can economic and financial crises have on the growth of the insurance services sector, on employment and on economic development? What can governments/regulators do to minimize the potential of such crises?
- What possible impacts would the consolidation and restructuring of financial sectors have on financial services trade? Will they enhance competition and consumer welfare?
- What are the implications of technological innovations on the structure of financial services industries and markets?
- What are the implications of the international nature of insurance services transactions? What regulatory challenges may arise? What are possible responses both at the national and international levels?
- Is there a general trend towards the privatization of state-owned financial institutions in countries? If so, what effect has it had on the structure of the financial industries and markets, and what regulatory challenges do these changes bring about?
- How can the GATS and ongoing negotiations to liberalize services, including on domestic regulation, trade reflect the current realities in the insurance sector and respond to development challenges in the sector? What are the potential impacts of recent suggestions on complementary and other approaches?
- What technical challenges do WTO Members face? Have they encountered any problems in interpreting the scope of prudential measures as defined in the GATS Annex on Financial Services?
- What are the key technical assistance and capacity building needs of developing countries as regards international trade in insurance services.

Annex1

The World Leading Insurance Countries 2004

(Direct premiums written, US$ billions)

Rank	Country	Nonlife Premiums[49]	Life Premiums	Total Amount	Percent of total world premiums
1	United States[50]	603,018	494,818	$1,097,836	33.84
2	Japan	105,587	386,839	492,425	15.18
3	United Kingdom	105,241	189,591	294,831	9.09
4	France	65,811	128,813	194,624	6.00
5	Germany	106,261	84,535	190,797	5.88
6	Italy	46,728	84,535	128,811	3.97
7	Canada[51]	40,232	29,509	69,741	2.15
8	South Korea	19,944	48,680	68,623	2.12
9	Netherlands[52]	27,064	31,512	58,577	1.81
10	Spain	32,311	23,592	55,903	1.72

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

[49] Includes accident and health insurance

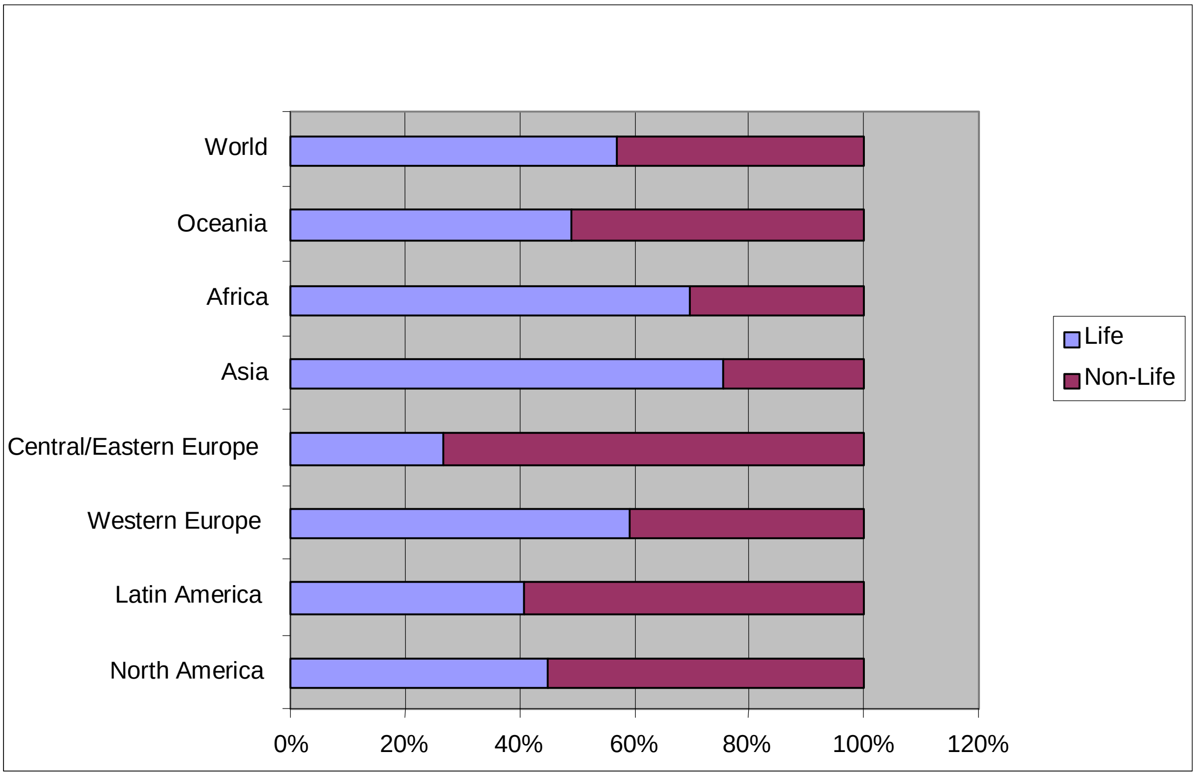
[50] Nonlife premiums include state funds, life premiums include an estimate of group pension business

[51] Life business expressed in net premiums

[52] Life business expressed in net premiums

Annex 2

Life and non-life premium portions worldwide, 2004



Source: Swiss Re, Sigma No 2/2005.