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Insurance in developing countries: developments in 1980-1981

Study by the UNCTAD secretariat

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INTRODUCTION

(i) At its second session (April 1967), the Committee on Invisibles and Financing related to Trade requested the Secretary-General of UNCTAD "to carry out at least once every two years reviews of developments in insurance, with special reference to developing countries". 1/ The present document, covering the period 1980-1981, has been prepared pursuant to this request. 2/

(ii) As in the past, part of the information and particulars needed for the preparation of this study was supplied to the UNCTAD secretariat by the Governments of developing countries in response to a request made by the Secretary-General of UNCTAD. This information has been supplemented from very diverse private sources, especially trade journals and periodicals. It has not, of course, been possible to verify the accuracy and coverage of the information obtained in this way.

(iii) This document does not claim to provide comprehensive information. The information included has been selected mainly on the basis of its relative importance to the development of the insurance sector in developing countries. More particularly, it tries to identify the factors which have hindered the expansion of this sector and those which have promoted its individual and collective potential.

(iv) Chapter I of this study deals with domestic insurance markets and their structural developments. Chapter II includes information on measures adopted with a view to increasing the strength of these markets. Chapter III deals with the problem of State supervision and the new measures which were adopted on questions of solvency and contractual relationship between insurers and insureds. New developments in the field of reinsurance are included in Chapter IV. Chapter V deals with co-operation among developing countries in the field of insurance and reinsurance.

(v) The study includes an annex prepared by Mr. André Melly, a French professional insurance journalist (Paris).

The Annex contains information on "captive" companies in developed areas and their possible influence (positive or negative) on developing countries: (a) The setting-up of "captive" companies in developing countries might be considered desirable for industrial, transportation, and banking organizations, co-operatives and other economic entities of those countries whose pattern of production and spread of economic risks permit a larger degree of self-insurance; (b) The increasing number of captives set up by large financial organizations and transnational corporations in developed countries are more and more involved in the insurance of property situated in developing countries and of liabilities there incurred, with the result that the local insurance markets are deprived of this business. This shift of premiums from developing to developed insurance markets has become more pronounced during this period and is a cause of concern for many domestic insurers.

1/ See Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3 (TD/B/118/Rev.1), annex I, sect. A, para. 6.

2/ The periods 1968-1970, 1971-1972, 1973-1974, 1975-1976 and 1977-1979 were dealt with in documents TD/B/C.3/99, TD/B/C.3/107, TD/B/C.3/122/Supp.1, TD/B/C.3/141 and TD/B/C.3/169 submitted to the Committee on Invisibles and Financing related to Trade at its fifth, sixth, seventh, eighth and ninth sessions (December 1971, July 1973, November 1975, December 1977 and September 1980, respectively).

Chapter I

DEVELOPMENTS CONCERNING THE INSURANCE MARKETS IN DEVELOPING COUNTRIES

A. The structural changes and the setting up of new domestic companies

1. Major structural changes (paras. 5-7) were rather the exception during the period under review. As was to be expected, the few changes reported are a reflection of more drastic transformations of the political scene in the countries concerned and they were all already anticipated or put into motion the period before.

2. There are some indications that fewer domestic companies have been set up during this period than in former years (paras. 8-12). The slow-down of entrepreneurial initiatives probably results from a general slow-down of economic activities in the countries concerned, leading to a probable decrease of profitability of insurance business in developing countries, and a very high level of interest rates which made it difficult to raise share capital for the formation of new insurance ventures. A certain saturation of the markets, after the intensive efforts in the setting up of new companies in the decade of 1970s, has also contributed to the stagnation. The few examples of new companies reported below are not intended as representative of a particular trend. They rather reflect interesting developments particularly related to the direct support given by governments in some developing countries to the organization and formation of new insurance companies, particularly companies meant to provide cover to key economic activities in the countries concerned.

3. There are also a few examples (e.g. Argentina) of countries where the government has provisionally banned the registration of new companies. In fact, there seems to be an increased awareness that an active and efficient insurance market may be encouraged by an increase, a limitation, or a decrease of the number of different insurance organizations so that opposing approaches may converge.

4. The policy of "localization" of insurance business in developing countries (paras. 13-15) received new incentives and encountered new obstacles during the period under review. Incentives arose from an increased awareness of the importance of a domestic insurance sector in the development process, as recognized once again in the International Development Strategy for the Third United Nations Development Decade. 3/ The new obstacles belong to many different categories 4/ to which

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3/ General Assembly resolution 35/56, para. 69 reads as follows: "The international community will take appropriate measures to help the establishment and growth of local insurance markets in developing countries where such potential exists. As regards those insurance operations that cannot be carried out without using external insurance services, it is essential that the terms and conditions of international insurance and reinsurance transactions are equitable for, and meet the needs of, all parties concerned, in particular those of the developing countries."

4/ As, for instance, those reflected in an address from the Barbados Prime Minister and Minister of Finance and Planning to the Third Conference of the Insurance Association of the Caribbean, who said among other things that "a higher degree of localization should be preceded by the emergence of more qualified insurance specialists able to take over and manage life insurance operations satisfactorily". Quoted in Reinsurance (London), January 1981.

reference will be made in this review, including those which, as in the case reflected in paragraph 18 (Republic of Korea) are the direct outcome of the forces actively engaged in the international market place. 5/

1. Basic structural changes

5. In early January 1980 in Chile the Government introduced new legislation which changed the character of the market. For many years the Chilean market had been characterized by a system of a reinsurance monopoly (carried out by a State company), a very tight regulatory policy and a system of protectionist measures which hampered the operations of foreign companies in the internal market. The new legislation (see paragraph 94) has eliminated the reinsurance monopoly and the system of supervision over premiums and made access to the market more easier for external companies. The "Caja Reaseguradora" is now changed into a State-owned limited liability reinsurance company. Subject to special rules, Chilean nationals will now be allowed to take out insurance with companies not established in the country.

6. In contrast, in Iran and Nicaragua the Governments have taken full control over the insurance industry, establishing virtual monopolies. In Iran, after June 1979 all privately owned insurance companies became State-owned, and this measure affected twelve local insurance companies. 6/ Another important similar step was taken in the field of reinsurance. In Nicaragua 7/ the Government decided also to place all insurance and reinsurance activities under State control. The Nicaraguan Insurance and Reinsurance Institute (INISER) was established as the only legal entity with authority to transact insurance and reinsurance business in the country. All domestic insurance companies had their operations transferred to INISER. Foreign companies operating in the country were permitted to continue their activities until the end of their contractual obligations or the expiration of the issued policies, but were prohibited from transacting new business. The condition on which these insurance interests were transferred to the State included compensation for the former owners in the form of public bonds carrying 6.5 per cent annual interest with five years maturity period. The bearers of the bonds can use them to write off their financial or fiscal obligations towards the State.

7. In Algeria a recently issued insurance law (No.80-07 of 9 August 1980. See paras. 45 and 103) reaffirmed the principle of State monopoly in the insurance and reinsurance fields. Operations may only be transacted by "State insurance companies" [sociétés d'assurances de l'Etat]. However, mutuals and co-operatives which prior to the law operated on a non profit basis may be authorized to carry on insurance business.

5/ Mr. John R. Cox, president of the Insurance Company of North America, in testimony to a Senate Committee, urged the United States Government to "embark on a crusade to open up markets abroad" in view of the existing "legal barriers to entry, exchange controls and restrictions on the placing of insurance". In his testimony, he pointed out that in the past several years the United States share in worldwide insurance premium income had dropped from 63 per cent to 48 per cent while shares of major competitors increased. "The battle for world markets is fierce and many of our competitors are taking steps not only to protect their domestic service industry but to enhance their capabilities to secure world markets". Quoted in International Insurance Monitor (New York), October 1980.

6/ See TD/B/C.3/169, para. 3.

7/ See TD/B/C.3/169, para. 4.

2. New companies of special interest

8. In Suriname the Government has taken an active role in the setting up of a genuine domestic company with local capital, by contributing 40 per cent of the said share capital. In a move towards localization, the Government has requested all foreign owned companies to place 70 per cent of their shares in the local capital market.

9. In Malta, too, the first genuinely domestic company is expected to be operational soon.

10. In the Seychelles, a State Insurance Corporation was established under Government decree (Act 21 of 1980) to carry out the business of insurance and reinsurance of all kinds. The initial share capital (S.Rup. 5 million) may be subscribed either by the Government or by any person or corporate body that may be authorized by the Government. Provision is also made for the compulsory reinsurance with the corporation of a share of every policy issued by insurers in the Seychelles, such share to be prescribed by the Government (see para. 148).

11. In Argentina the Government does not accept any new registration of new companies. The professional press points out that the apparent reason is an increasing saturation and depression of the insurance market. A large number of companies (about 300) are competing in a market whose total volume of premiums in real terms is below that registered in 1976. About 70 per cent of the companies wrote 20 per cent of the total premium income in 1978. It is reported that under-insurance - or the lack of adaptation of monetary insurance values to the real values - and the number of uninsured losses have both increased.

12. In Guyana, too, there has been a refusal to allow the registration of new private sector companies both local and foreign.

3. The policy of "localization"

13. Efforts towards localization have been actively pursued in various countries.

14. In the Caribbean area that policy is said to result now in 80 to 85 per cent of the total insurance business being handled by local corporations. In this area, however, the limited geographical spread of risks of each of the individual countries concerned and the possible magnitude of losses in case of natural catastrophes - to which the area is so much exposed - make the concept of strict "localization" less workable than in other developing areas. In addition, a number of goals, policies and institutions that the Caribbean countries have in common have contributed to temper the localization policies with some elements of regional integration.[8/]

8/ "I believe that there is some merit in the governments of the region moving towards localization of the industry but having said that I will also express the firm belief that the individual countries of the Caribbean cannot go it alone and it is clear to my mind that integration is the only wise and logical way. In my view it would be suicidal for the companies and the industry if the companies incorporated in the different territories were, through legislation, forced into operating only in the territory of their incorporation". Mr. Cecil F. de Caires, President of Life of Barbados Insurance Company, Reinsurance (London), January 1981.

15. In Barbados the localization efforts have been supplemented by the establishment of the Insurance Corporation of Barbados to take care of the insurance requirements of the Government and its statutory bodies and to provide insurance cover for all assets in which the Government has financial interests. In Trinidad and Tobago all major foreign insurance companies have either established local subsidiaries or transferred their portfolios to locally registered companies. The "Reinsurance company of Trinidad and Tobago" has been established to take and to cede reinsurance with companies operating both locally and abroad. (However, press reports indicate that "foreign insurers have tended to leave the territory rather than conform to government regulations on localization, with new companies all locally owned"). 9/ The same professional periodical indicated that, Jamaica "has also achieved a mix between local and foreign interests, with a recent trend toward stronger local concerns with greater capacity".

16. In Upper Volta, the Government has approved the transfer to the "Société Nationale d'Assurances et de Réassurance" (SONAR) of the whole portfolio of the Union des Assurances de Paris, whose licence to operate in the country has been withdrawn.

B. Activities of international insurers and reinsurers in developing countries

17. The following paragraphs provide some information on the most obvious and widely publicized developments on matters related to the establishment of insurance enterprises of developed countries in developing markets. It has not been possible to include information on less obvious forms of involvement, such as participation in the shareholding of domestic companies, either directly or through national intermediaries, or other forms of market penetration whose global outcome is probably more important than that of the open establishment of subsidiaries and branches.

18. In Republic of Korea AFIA World Insurance International (USA) is broadening its operations following the granting of a full local business licence by the authorities. 10/ The new licence lifts certain restrictions and permits AFIA to market fire and allied lines (including builder's risk and business interruption) and third party liability protection to local nationals and to joint venture organizations.

19. In Kenya, General Accident Kenya Ltd., was established as a general non-marine and marine/aviation insurer to take over and develop the existing Kenya representative office of the Group. General Accident (London) has the majority shareholding in the Ksh 5 million company. In addition, Taisho Monarch Insurance Co. Ltd., Nairobi, was formed under the sponsorship of the United States ten-company foreign underwriting

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9/ World Insurance Report (London), 24 October 1980.

10/ "The Korean authorities undertaking to review the foreign companies' position was in response to an approach from the office of the United States Government's international trade representative in Washington ... after American International Group Inc., New York, filed a formal complaint with the office in the name of its subsidiary American Home Assurance Co. (World Insurance Report, (London), 30 January 1981).

association AFIA World Insurance (USA). Furthermore, the Kenyan portfolios of the Provincial Insurance Co. Ltd. (UK) and the National Employees Mutual General Insurance Association (London) have been transferred to a newly formed Provincial Insurance Company of East Africa (Nairobi). In addition, Union des Assurances de Paris (UAP) has obtained a license for Union Insurance Company of Kenya Ltd., to operate as its Nairobi based subsidiary. The new subsidiary is authorized to write fire, accident and general business.

20. In Bahrain, the Arab Japanese Insurance Company (AJIÇO) has been established by the Saudi Arabia Alayan Group and Taisho Marine and Fire Insurance Co. (Japan). Its capital is equivalent to $US 1 million and its activities are said to concentrate initially in the Saudi Arabian market.

21. In Dubai, the Government has given authorization for the establishment of the Al Sagr Insurance Co., UAE, Ltd. This is a public company whose shareholders and founders are prominent business figures in UAE, the Hong Kong Bank Group, the New Zealand Insurance Group and the Hong Kong Reinsurance and Central Insurance Company Ltd. The foreign group holds 49 per cent interest and management will be provided by the New Zealand Group. The company has a paid capital of $1.06 million.

22. In the Ivory Coast, Union des Assurances de Paris (France), has converted its subsidiary into a local domestic company.

23. In Saudi Arabia, a new affiliate of the AFIA World-wide Insurance (USA) Company has been formed for operation in that country.

24. In Chile, the American International Group (USA), has set up two new operating subsidiaries - the Interamericana Compañia de Seguros Generales, SA and Interamericana Compañia de Seguros de Vida, SA. AIG subsidiaries are among the first to be licensed under Chile's revised insurance legislation, enacted in April 1980.

25. Gras Savoye (France) is planning to expand its activities in the United Republic of Cameroon and Togo through the establishment of subsidiaries with local participants.

26. In Malaysia, the Zurich Insurance Co. (Swiss) has bought 30 per cent of the equity of Brokers and Manufacturing Assurances Corporation. The newly formed company will carry all lines of non-life insurance business, including marine and fire. It is to operate in the Asia-Pacific region.

27. In Sudan, the El Nilien Insurance Company has been set up with the participation of Hogg Robinson (Insurance Brokers), London (20 per cent of the total capital).

C. "Captive" insurance companies and off-shore markets 11/

28. The growth of "captive" companies and off-shore markets reached unprecedented levels during the period under review. In Bermuda alone there are now more than 1,000 such companies, accounting for more than $US 4 billion of premium income

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11/ More information on "captive insurance companies" is included in the Annex.

or 5 per cent of the total property-liability market of the United States. The Cayman Islands, a territory with 17,000 residents, has more than 640 companies of which 200 to 250 are "captive". 12/

29. Many captives are set up by transnational corporations with the main purpose of covering their own property and liability risks. In fact, in a restricted sense, the establishment of a captive is a way to perform self-insurance. The modalities of the operation may vary. Thus, the risks transferred to the captive may, or may not, concern the country where the head office of the parent company is situated. For example, one of Sweden's largest export groups and another industrial group in the same country have recently set up their own captive, but only for risks situated outside Sweden (30 affiliated companies around the world).

30. As expected, the captive movement has been most active in the United States. One of the reasons for this is that most TNCs are based there. As Mr. John R. Cox, President, Insurance Company of North America, has pointed out 13/ "MNCs [multinational corporations] often operated overseas automatically, using an insurance buyer approach with local [insurance] carriers. Evolution of large insurance brokers and risk managers has led to firmer controls and more co-ordinated approaches. [As a result], MNCs have been increasing their use of self-insurance, including "captives". At year-end 1980 some 189 of the 500 United States corporations selected by Fortune magazine had "captives". He went on to refer to the elimination of gaps and duplicate coverages that the use of captives permits. The interest of the information is enhanced if account is taken of the fact that the "500 largest corporations" to which he referred had sales of $US 1,200 billion, or 16 per cent of the gross world product in 1978, according to the information which he himself provided. "MNCs are making growing use of risk management techniques broader than just [risk] transfer ... They generally have large economic bases and operate over broad geographic areas." This suggests that the main basis for self-insurance, or for the setting up of a captive company, is therefore met, and it is only logical to expect that TNCs will make use of it to the largest possible extent.

31. Although, as pointed out above, the captive movement mainly concerns a few industrialized countries, its expansion might constitute one of the major problems facing the domestic insurance markets in developing countries. In fact, a solution should be found to reconcile the financial strategies followed by transnational corporations - with the objective of reducing insurance costs and carrying out rational risk management - with the legitimate interests of developing countries and their need to expand their domestic insurance markets.

32. For developing countries, the impact of the services of the captives is twofold: First, as risks covered by captives concern mainly property and liability of transnational corporations located in part in these countries, their domestic market is thus deprived of a volume of business which, by many accounts, is substantial and essential to their growth. This deprivation of insurance business is often compounded by distortions of the functioning of the internal markets,

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12/ Other sources quote a more modest figure. See, for example, the annex where only 123 companies are recognized as captive.

13/ AEAU/RIMS International Conference, 12-14 October 1981, in Monte Carlo.

whether or not these markets are regulated, which captives often bring about. The following comments, which have clear implications for developing countries, are quite illustrative:

> "In countries where non-admitted insurance is not prohibited, the captive can function as a direct insurer up to the limit which the affiliate can afford, with excess insurance or reinsurance above that amount. Where prohibitions against non admitted insurers are strict (as it is the case in many developing countries) the captive may act as a reinsurer of a fronting locally admitted insurance company ... Although fronting arrangements are looked upon with suspicion by most conventional insurers, some insurers have decided that it is better to front (i.e. to take the business and transfer it to the captive) than to be left behind. For a service fee, a fronting insurer will reinsure as much as 90 per cent of even 100 per cent of the risk with the captive". 14/

33. The volume of business emanating from developing countries thus transacted by captives is not known but the above remarks suggest that it is substantial.

34. The second implication of captives for the economies of developing countries relates to the necessity to find them a comfortable home, where legislation and fiscal laxity is the rule. Parallel to these efforts, some developing countries have drawn up special legislation and fiscal standards in order to attract captives and related companies to their shores, thus laying the basis for an off-shore market. A representative example of these developments follows:

35. In the Cayman Islands a law came into effect on 17 June 1980 with the following main provisions:

1. Licenses must be obtained:

Class A for Domestic or External companies (an External Company would normally be one already licensed to do business in another country). License fee is $US 1,800 p.a.

Class B (restricted or unrestricted) for Exempt (offshore) companies. An unrestricted B licensee may transact unrelated business in addition to that generated by the parent. License fee is $US 3,600 p.a.

2. Licence application forms call for full disclosure, including detail of:

(a) Shareholders, through to ultimate ownership.

(b) Directors and officers.

(c) Companies providing technical and/or underwriting services (underwriting managers based in the Cayman Islands must themselves be licenced).

14/ Norman A. Baglini, American Institute for Property and Liability Underwriters, in a lecture to International Insurance Seminar, Rio de Janeiro, June 1981. Quoted in International Insurance Monitor, (New York), 27 August 1981.

(d) Business plan for three years ahead.

(e) Reinsurance arrangements.

(f) Full financial detail.

None of the above information becomes of public record.

3. All companies, with the exception of pure captives and certain approved external companies, must comply with the minimum net worth requirements, namely:

(a) For general business only: $US 120,000.

(b) For long-term business only: $US 240,000.

(c) For both general and long-term: $US 360,000.

The actual requirements will be calculated individually at the discretion of the Superintendent.

4. Once licenced, companies are required to submit annual returns, the complexity or otherwise will depend on both the class of licence and the nature of business transacted.

(a) All companies are asked to furnish audited annual statements.

(b) All companies, excepting A's licenced elsewhere, must provide a Certificate of Compliance to the effect that business has been conducted in accordance with information given in the application.

(c) Domestic Class A and Unrestricted Class B companies must provide an expanded financial report dealing especially in underwriting performance.

36. Some developments in the Bahamas, Hong Kong, Bermuda, the Isle of Man and other territories go in the direction of attracting captives. Panama, Singapore and other countries direct their efforts towards the setting up of a captive market specialized in reinsurance. The following paragraph reports on a development of a similar nature:

37. In the Philippines, an "offshore insurance system" is being proposed. To this effect, the Insurance Commission "has proposed a parliamentary bill which will authorize branches and offices of overseas firms to accept 'special' and 'hard-to-place' risks, particularly risks which produce a minimum annual premium in excess of Pesos 500,000 per policy. The bill further seeks to exempt such risks from form and rate regulations thus providing flexibility and relief from expensive and delaying filing requirements", as the press reported. 15/ The bill also sets other stringent requirements: "a licensing fee of $US 1 million and a statutory deposit of at least $US 1 million, half of which should be in Philippine Government securities. While the offshore insurance units can transact foreign business freely, onshore transactions shall be subject to domestic laws and regulations. As an inducement, however, the bill provides that gross transactions of offshore insurance units shall be subject only to a final 10 per cent tax and shall be exempt from all other domestic fees, dues and other such burdens". The article went on to quote predictions made by the "Insurance and Surety Association of the Philippines" that "offshore insurance units will gobble up and monopolize the large risks" and that "the offshore insurance system may virtually spell the demise of the domestic market".

15/ The Underwriters Post, (Manila), April 1980.

Chapter II

STRENGTHENING OF DOMESTIC INSURANCE MARKETS, INCLUDING MEASURES AIMED AT INCREASING THE VOLUME AND DIVERSIFICATION OF INSURANCE BUSINESS

38. In spite of intensive marketing efforts made by the domestic insurance industry in developing countries, the slowdown in economic activities hindered an increase in the volume of insurance business and in the diversification of risks. The result is that the much needed insurance capacity - a capacity which is generated precisely by the volume of business and its diversification - stagnated, or increased only very marginally. Simultaneously, new industrial projects, as well as new infrastructure, technological systems, means of transportation and other investments, usually located in geographically concentrated areas, reached unprecedented values, thus rendering the insurance industry in many developing countries even more vulnerable and increasingly dependent on foreign reinsurance markets (see chapter IV).

39. One aggravating factor consists in the new industrial and processing systems being increasingly vulnerable to one single accident. The total economic costs of fires and of criminal actions, for instance, increases faster than the number of such fires and events, simply because these accidents generally affect an interrelated system, with effects extending to multiple directions at the same time. A breakdown of a central computer in a large industrial complex may result in a general blockage of a vast range of activities and bring about economic losses of a size no one could expect only some years ago. "Consequential losses" or "machinery breakdown" categories of insurance are therefore acquiring unprecedented importance - in terms of premium income, amounts at risk and concentration of liabilities - as compared with the total volume of business in developing countries.

40. Against this background, the insurance industry, the governments and the insurance regulatory bodies tried to promote an increase of business for the domestic markets and helped find new sources of operations. Regulatory measures to involve local companies in the insurance of transportation of imports, for instance, were part of these efforts and were successfully applied in some developing countries. 16/ In some cases, however, such endeavours met with resistance from outside, mainly when insuring imports locally substantially decreased the external markets' insurance of exports. This resistance has taken many forms, either open or covert, including representations and "formal complaints", of which the most widely publicized was filed by the "American Institute of Marine Underwriters" (AIMU) against what has been reported as "Argentina's use of measures detrimental to free trade". 17/

16/ Conference resolution 42 (III) recommended developing countries to provide cover for domestic risks, including those derived from foreign trade. Resolution 9 (VII) on marine cargo insurance, adopted by the Committee on Invisibles and Financing related to Trade in November 1975, also encouraged developing countries to take action with this in view. The previous issue of this Review (TD/B/C.3/169, para. 46) also refers to this issue.

17/ See, for instance, International Insurance Monitor, September 1980. The article goes on to refer to "restrictive marine insurance measures and discriminatory marine insurance practices enforced by no fewer than 39 countries".

41. The developing countries' efforts to diversify and increase the volume of business were also sometimes resisted by foreign investors, who in many instances were reluctant to resort to local markets for the insurance of their investments in developing countries. The previous issue of this Review referred already to the conflict which often arises between the insurance strategies and arrangements of the foreign investor, on the one hand, and the interests of the local insurance markets, on the other hand (TD/B/C.3/169, para. 45). It appears that the "captive" trend, referred to in paragraphs 28-37, may have further aggravated this problem. The result has been developing markets being deprived of a substantial volume of business and of diversified portfolios, which are necessary if they are to expand their retention capacity. This has probably been one of the major problems of the biennium under review, which surely calls for co-ordination and negotiation with developed countries and the internal markets.

42. Other developments reviewed in this section relate to the necessity to promote new forms of insurance covers and new categories of business contributing to the process of development. Crop insurance, export credit insurance, and other insurances related to internal and external trade, promoted in many developing countries, are not aimed directly at increasing premiums and business for the domestic market, but rather at setting up a domestic market to cater for specific needs of the countries concerned, including needs derived from international trade and those inherent in credit and finance.

A. Promotion of insurance business in developing countries

43. In Malaysia, the Government announced the introduction of a new regulation whereby insurance of Malaysian property, ships and aircraft should be effected locally. The respective owners are required to declare information pertaining to the insurance arrangements of their property. This measure was further complemented with a number of tax incentives, namely (i) reduction from 40 to 5 per cent of tax on profits earned by Malaysian incorporated insurers on coverage of off-shore risks; (ii) double deduction from income tax for Malaysian importers on cargo insurance premiums paid to local insurers. A group set up to study the outflow of foreign exchange due to insurance costs and other invisibles ascertained that the amount in 1981 paid abroad in insurance premiums totalled approximately 500 million ringgit, i.e. some $US 232 million.

44. In Tunisia, inward bound cargo will be compulsorily insured with domestic companies. Insurance business on imported goods in 1980 was estimated by the Government to be in the region of D 50 million, only one-third of which was the Tunisian insurers' participation.

45. In Algeria, the Government decided that all goods imported, irrespective of type of transport used, must be insured locally and that all imports must be effected on "cost and freight" conditions, instead of c.i.f. Previously, the insurance of goods was effected by the party designated in the contract. The law of 9 August 1980 states that all ships registered in Algeria have to be insured in the domestic market. Obligation to insure - in the domestic market - includes also fire and hail for agricultural enterprises; fire insurance for industrial and commercial enterprises and for buildings administered by public enterprises and corporations. Airports, architects, entrepreneurs, transporters, doctors and medical officers, pharmacies, food and cosmetic industries, travel and holiday agencies, and other trade and activities are all required to take out insurance in respect to their professional liability. Owners of automobiles have also to insure their liability.

46. In Suriname, the Government plans to introduce legislation very similar to that reported above, while in Chile and in Togo the obligation to insure third party motor liability has been established - or it is about to be established - by law.

B. Promotion of new categories of cover for domestic risks

47. Economic development in developing countries generally results in new and concentrated risks which call for the increase in the domestic underwriting capacity. The two following examples illustrate the burden put on the domestic insurance industry and the challenge it faces.

48. In Sudan the Kenana sugar project inaugurated recently required an insurance cover of some $US 1,200 million. An industrial risk package included a cover for the factory and plant, the sugar cane crop and associated perils, and the five townships in the Kenana complex. Also, main cargo insurance was arranged to cover transportation of goods and parts. Aviation insurance was needed in connection with the aircraft operated by the Kinana Sugar Company, as well as vehicle accident, public and product liability cover, group life and disability scheme for the 11,000 employees. All those covers were obtained from the Sudanese insurance market. Obviously, adequate reinsurance facilities were secured from the international reinsurance markets. However, it is reported that the share of the local market is large, with just over one-third of the reinsurance being placed with the State-owned company, the National Reinsurance Corporation of Sudan.

49. In Bahrein the Arab Shipbuilding and Repair Yard, National Oil and Gas companies BANOCO and BANAGAS, Gulf Petrochemical Industries, Arab Iron and Steel Company, and Aluminium Bahrein, are major industrial projects representing many billions of dollars of sums insured, which are reported to be covered in domestic and sub-regional markets, naturally - with the co-operation of international reinsurance. Aluminium Bahrein (ALBA) is also a major project (insured for some $US 830 million) being handled by the internal and sub-regional market as from 1 January 1981. The professional press reported that the new premium under this arrangement is understood to be $US 700,000, compared with over $US 1 million the previous year - a significant saving for ALBA, and for the country as a whole.

50. In many other countries too, efforts have been made during the biennium to provide insurance cover for risks which so far were borne by enterprises and the population, or which were covered abroad. Here are some examples:

51. In China the People's Insurance Company of China resumed in 1980 the writing of domestic business, which was reinstated in most parts of the country where both industry and commerce are relatively concentrated. The domestic insurance business comprises properties of enterprises, household insurance, cargo transportation insurance, motor and third party liability insurance, and hull insurance on all types of vessels.

52. Likewise, there was a marked development in the foreign business sector following the increase in foreign trade and the adoption of diversified forms of external economic co-operation. The rate of growth in the volume of premium for transportation of imports and exports, hull and aircraft insurance was 23.4 per cent. At the same time additional classes of business were started. Industrial joint-ventures and other forms of foreign investments were also insured locally, as required by the legislation. These operations included mainly risks of oil exploration, machinery breakdown, compensatory trade and political risks.

53. In Bangladesh the insurance industry is gradually marketing new types of cover, including crop and cattle insurance, credit insurance and a special type of personal accident cover which is increasingly popular. Reports appeared that the State-owned Jiban Bima Corporation has introduced a new type of life and rural insurance.

54. In Pakistan the Federal Commerce Ministry proposed the formation of the Export Credit Cuarantee Corporation to provide pre- and post-shipment export credit insurance for the exporters of manufactured goods. The envisaged Corporation would grant export finance at concessionary rates to the exporters, provided they took out a post-shipment credit insurance guarantee. The Corporation would simultaneously issue an unconditional guarantee to the banks to enable them to discount the bills without a collateral.

55. In Yugoslavia the introduction of some mandatory form of flood cover is being considered in view of the widespread flood damage in March and April 1981 which resulted in agricultural losses of more than ND 1,500 million (approx. $US 45 million). The professional press reports that although more than 145,000 hectares of agricultural land was damaged in the floods, only 1,000 hectares in the affected areas were insured. Another important development concerns the use of loss prevention funds administered by Yugoslav insurers for the purchase of crop spraying helicopters for treatment against diseases of vineyards and olive groves. Damages estimated at 400 million dinars, equivalent to the purchase of 80 such helicopters, were caused in one season alone by such diseases, with only hand operated crop sprayers presently in use.

56. In Mexico a new law on agricultural insurance, including livestock and farmers' life insurance, has been laid down (law of 11 December 1980 entitled "Lay del seguro agropecuario y de vida campesino"). Agricultural insurance will be available for the coverage of investments made on crops, including labour inputs, against losses deriving from specific perils (including drought, excess humidity, freezing, floods, hail, fire and others) or from any loss for which the farmer is not responsible. Livestock insurance will cover death by sickness or accident; sickness, loss or decrease of production capacity of the insured animals. Life insurance will provide indemnities in case of death of the policy-holder.

57. The same law provides for the establishment of the "Aseguradora Nacional Agricola y Ganadera", the company which will carry out the insurance operations called for by the law. Existing stock or mutual companies are given the opportunity to co-operate with the "Aseguradora" and to reinsure their risks with it.

58. Insurance (crops and life) will be mandatory for crops covered by loans granted by official and private credit institutions.

59. In the Philippines the Government inaugurated in May 1981 the Philippine Crop Insurance Corporation (PCIC), created by Presidential Decree No. 1467, as an institution that would protect farmers against losses caused by natural disasters, through crop insurance.

60. While designed to cover all types of agricultural produce, initially PCIC insures only standing palay crops, to the extent of the cost of production inputs which include all costs of labour, fertilizers, pesticides, rodenticides, farmer's share of the insurance premium, and other cost items qualified for financing under the Government's supervised credit programme.

61. All palay farmers may avail themselves of crop insurance. Borrowing farmers or those who obtain production loans under the supervised credit programme of the Government, are covered on a compulsory basis. Such insurance will also be available to self-financed farmers on an optional or voluntary basis, provided they agree to place themselves under the supervision of an agricultural production technician for purposes of insurance coverage.

62. The authorized capital stock of PCIC is ₱ 750 million. Of this amount, ₱ 500 million is to be fully subscribed by the Government and ₱ 250 million is available for sale to or subscription by the general public. For the first four months of operations, premium collection reached ₱ 18.4 million. Studies are presently being undertaken to include coconut and livestock insurance (initially cattle and swine) in its coverage.

63. Mention should also be made of particular efforts aimed at enlarging the scope of insurance services and adapting them to the needs of the population. Developments in this area are reported in India, where (i) in the International Year of the Disabled, the Indian insurers have offered personal accident insurance to disabled persons at normal rates, terms and conditions as applicable to normal persons; (ii) novel types of cattle insurance have been offered. In some cases, premiums are subsidized by banks and other credit agencies. The insurance industry has appointed a number of veterinary surgeons who will suggest necessary curative and preventive treatment for the insured cattle; (iii) a special Group Personal Accident Insurance Scheme has been designed to cover agricultural labourers and small farmers with a low premium rate.

C. Other measures aimed at strengthening local markets

64. Strengthening local insurance markets demands more than simply increasing the volume of business and diversifying it. It also calls for a number of measures in various fields, particularly in the field of insurance education and training and in that of loss prevention.

65. In China it is reported that "the Insurance Institute of China was set up in November 1979 under the auspices of the People's Insurance Company of China with a view to promoting the study of insurance theory and the exchange of insurance study as well as to fostering the training of insurance personnel. Members of the Institute come from insurance, banking, foreign trade and shipping circles, and other economic sectors ...". The Institute publishes research papers on insurance theory and technology and prepares and publishes textbooks and other material on insurance. The People's Insurance Company of China also assists universities and colleges by providing textbooks, reading material, equipment and teachers to train senior insurance personnel. Insurance classes have been set up in vocational banking schools with the same aim in view.

66. In Tunisia an "Institut Supérieur d'Enseignement Tunisio-Algérien pour les Etudes bancaires et d'assurances" has been set up with the co-operation of the Algerian Government.

67. In Thailand certain minimum professional standards will be required of managers and administrative officers of the insurance companies, whose appointment is subject to approval by the Insurance Commissioner. Parellel to these decisions, it is reported that the Insurance Association has established a Thai Insurance Institute in February 1980 with the purpose of providing insurance training and increasing professional qualifications of insurance personnel.

68. In Upper Volta a decree will be issued shortly whereby general agents and brokers will be required to hold minimum educational standards.

69. As regards loss prevention - see information on Yugoslavia in paragraph 55, which provides an interesting insight into the role that insurance can play, not only as a mechanism for distribution of losses, but also as a means to reduce the size and intensity of losses.

70. Fighting maritime fraud is one of the most effective measures in the field of loss prevention. Although no specific evidence can be provided, it is highly possibl that maritime fraud was resorted to during the period under review through sinking of over-insured vessels, or sinking of vessels with non-existent cargo, which enabled the "cargo owners" to claim insurance for goods which never existed. Other forms of fraud used against insurers in developing countries include a much publicized embezzlement of some $US 60 million freight payments relating to three grain shipments to China and the issuing of a fraudulent letter of $US 56 million covering an Iranian shipment. Annual losses are currently estimated at $US 2-3 million, with a potential loss of about $5 million.

71. Against the above background, the involvement of the International Maritime Organization (IMO) in the matter is to be considered as an important development. At its eleventh and twelfth sessions, IMO considered the subject of "barratry, unlawful seizure of ships and their cargo and other forms of maritime fraud". A Working Party was set up as a result with the objective of studying the nature and prevalence of such acts and to make recommendations as to the action IMO should take.

72. The International Chamber of Commerce, also, recently published a Guide for the prevention of maritime fraud, which briefly explains the nature, types and characteristics of maritime fraud and offers advice on precautionary measures to be taken. Another important step taken was the setting up of the International Marine Bureau (IMB), the Board of Directors of which, selected by the International Chamber of Commerce, is comprised of a representative of IMO, as well as members of the banking, insurance and shipping communities.

73. The professional press reports that IMB now has about 35 members, mostly shipowners and insurers. Services include access to shipping information, a confidential fortnightly bulletin and regular details on fraud and suspect maritime practices. Special reports on troublesome areas are also being produced, with one on West African port conditions already published. The Bureau has its own powers of investigation in addition to liaising with law enforcement bodies. It envisages its investigative work eventually being undertaken by regional sub-bureaux in areas where maritime fraud is particularly frequent. For the moment, however, it operates internationally through the International Chamber of Commerce national committees.

74. Other national developments in the field of loss prevention and minimization are reported in the United Republic of Tanzania, where a car-repairing workshop, to deal with insured accident motor vehicles, was set up in 1980 as a subsidiary of the National Insurance Corporation of Tanzania.

75. In India, the Loss Prevention Association of India continued its educational efforts by a sustained programme of publicity, seminars and training. The Cargo loss minimization department continued to operate in Bombay, Calcutta and Madras, where the systems of screening of vessels was satisfactorily carried out during the period under review. An International Seminar on loss prevention in engineering industry was conducted in Bombay in November 1981 and was attended by about 300 participants from the country and from Sri Lanka, Malaysia, Kuwait, Thailand and Indonesia.

76. The Philippines established a "Marine Insurance Information Bureau" with the purpose of setting up a data bank on information relevant to marine insurance, in particular (1) marine insurance information including exposures and losses; (2) information on port facilities and port management; (3) information on shipping facilities and operations. The creation of the bureau was in response to a resolution sponsored in an UNCTAD/IIAP/SIDA seminar, held in Manila in 1978, to service possibly the whole Asia/Pacific region.

Chapter III

NEW REGULATIONS IN THE FIELD OF SOLVENCY AND ADMINISTRATION OF INSURANCE COMPANIES

77. This chapter deals mainly with the question of insurance legislation and supervision, with particular emphasis on measures aimed at ensuring the solvency of insurance companies and a fair legal and commercial relationship with their clients.

78. Considerations similar to those included in the reviews for the preceding periods on those issues would also apply to the period under review. 18/ The nature of the problem of State supervision, in fact, remains basically the same but its magnitude has increased. The new strains on the industry, the difficult economic and social conditions through which it underwent in 1980 and 1981 in most developing countries, and the difficulties of many governments in providing adequate trained personnel to their supervisory agencies have turned insurance supervision into an issue of concern for governments, for the industry and for the public in many developing countries.

79. It is also felt that adequate supervision increasingly calls for a very delicate selection among the many possible measures that have been adopted so far, a selection to be based on new criteria of effectiveness and costs. Apparently, however, many problems of identification, evaluation and implementation of these measures make this difficult to achieve.

80. The need for new measures and supervisory systems are particularly felt in issues such as the setting up and monitoring of efficient accounting methods, to cite only one example, and other subjects such as those reviewed by the newly set up Committee in Pakistan (see para. 93). It is often assumed that because efficient supervision in these and other areas does not yet exist in many countries, inappropriate accounting systems still prevail and it may well be that, as a result, critical financial situations are being disguised. Since not only small companies are responsible for this situation, problems of this type can even have devastating effects on the whole international insurance system. 19/

18/ See TD/B/C.3/163, paras. 71 and 72.

19/ Edward C. Matthews Jr., President of the Continental Reinsurance Corporation, in a paper presented at the Second International Non-life Insurance Seminar in Seoul, pointed out that "when the impact of recent major disasters has finally been adequately tallied, the reinsurance industry will be shocked at the magnitude of the losses, and by 1985 everyone in that industry will be demanding introduction of new and more capable accounting methods". Quoted in World Insurance Report (London), 4 July 1980.

81. Other opinions concur with the view that the insurance market is negatively affected when effective regulation is not carried out. Commenting on a report which recommended a reduction in supervision by the life and non-life insurance commissioners in Australia, the Chairman of the Parliamentary Committee which issued the report said that most of the collapses of insurance companies in Australia in recent times resulted from extensive premium discounting, inadequate solvency ratios, poor accounting procedures and unreliable reinsurance arrangements, all pointing to the need for greater control of the industry. He went on to say that in circumstances where many companies were relying on investment income and accumulating large underwriting losses, adequate powers to protect policy holders and employees in the industry were essential.

82. Some of the major developments in the field of insurance legislation and supervision are set out in the following paragraphs.

A. Solvency and accounting regulations

83. In Mexico the "Ley general de instituciones de seguros" was amended by a new decree ("Decreto de reformas de la ley general de instituciones de seguros"), passed on 29 December 1980. This law amends provisions for the licensing, capitalization and reserves of Mexican insurers and introduces an authorization system for agents of foreign reinsurers operating in Mexico. Restrictions for foreign concerns to transact insurance operations in Mexico, which used to be an administrative practice, are now part of the legal system. Other important amendments concern: (1) licensing of insurance stock companies, which will adopt a system of "concession" rather than the conventional authorization. This latter system will now apply only to mutuals. (2) Minimum capital for the establishment of a new insurer will be fixed at the discretion of the Government, instead of the fixed minimum capital requirement which was applicable so far. The shareholders' control over the companies is strengthened. Participation of any person or entity in the total shareholding is being limited to 15 per cent; special authorization is required for a share of 10 per cent or more. The functioning of mutuals is defined and so is the question of minimum members, their obligations and the conditions for winding up and liquidation. (3) A capital reserve to protect companies against fluctuations in investments will be established. (4) A register of foreign reinsurers will be set up. General representatives who have authority in Mexico to accept and cede reinsurance will be granted by the Secretary of Finance. (5) The law also requires a new deposit in the State Bank, comprising 50 per cent of funds and technical reserves, plus a further 25 per cent maximum in investments fixed by the Government (see para. 98).

84. Other interesting features of the new Mexican decree concern the competence of the Government in matters of administration of the companies under supervision. In this respect, it is stipulated that the Supervisory Authority will:
(i) determine the upper and lower retention limits for insurance concerns, on the basis of their volume of operations, the amount of their financial resources, the sums at risk, the loss ratio experience, the measures adopted by them in respect of reinsurance arrangements, in the country and abroad; (ii) determine upper limits for acquisition expenses; (iii) determine the maximum premium volume which may be transacted by a single agent or intermediary; a similar provision

applies to ceded reinsurance premiums. The interest of this last provision stems from the fact that too many companies, especially in developing countries, depend on one or on just a few brokers and intermediaries for the acquisition of new business and sales promotion; in these cases, the survival of the company, as well as its effective control, is in the hands of a very restricted number of outside people and it is felt that this is a source of unhealthy market practices.

85. A new law in Egypt provides for a general policy of supervision in the country. The supervision will be carried out by a new organ to replace the General Insurance Organization, the former holding of the State-owned insurance companies. Important features of the law are as follows:

(a) The objectives: (i) the safeguard of the rights of policy-holders, beneficiaries, third parties; (ii) to guarantee that the insurance sector operates within the social and economic objectives of the country, to safeguard national savings, to prevent outflow of foreign exchange; (iii) to increase insurance awareness in the country; (iv) to strengthen the local insurance market and to ensure its growth; (v) to strengthen the links of co-operation and integration with other insurance supervisory authorities in the region and outside; (vi) to contribute to the build-up of know how and expertise.

(b) The structure of the market: stock companies, mutual funds, co-operative companies, State Insurance Funds transacting business not traded by other insurance organizations. The minimum capital is LE 2 million, half of it to be paid up. Shares are nominal and will belong exclusively to Egyptian persons or corporations.

(c) Insurance funds to be maintained in the country include 100 per cent of the mathematical reserves (life insurance), gross reserves for unexpired risks (25 per cent of gross premiums in marine insurance, 47 per cent of gross premiums for motor third party liability insurance, 40 per cent for all other business), gross reserves for losses outstanding. Contingency reserves (for all classes of business) and solvency margins (10 per cent of net premiums) are also required.

(d) Reinsurance: all direct companies have to reinsure a share of their business, as fixed by the Government, to the Egyptian Reinsurance Company. Insurance and reinsurance companies operating in the country have to give priority for their facultative reinsurance cessions to other Egyptian companies, up to the limits of their capacity, before resorting to foreign markets.

(e) Off-shore companies: off-shore insurance and reinsurance companies are allowed to operate in free zones and outside the boundaries of Egypt. Their operations should be exclusively in foreign currencies. Minimum share capital should be the equivalent, in foreign currency of LE 2 million, half of it at least to be paid up. Off-shore companies should be registered but they are exempted from the provisions of the law with the exception of those referring to technical reserves, solvency margins and accounting the systems.

86. In Thailand some major amendments of the existing insurance law, concerning the financial strength of insurance companies, were introduced during the period. (1) Share capital of insurance companies will be at least 10 per cent of the gross premium written in the previous years, as opposed to the flat amount which prevailed so far. The Insurance Commissioner was given power to approve a lower percentage when the circumstances warrant it, but 10 million baht will be the minimum permitted. (2) The deposit effected by insurance companies with the Insurance Commissioner shall be increased to at least 2 million baht per class of business transacted. (3) Acquisition and sale of assets by insurance companies are more strongly controlled. (4) The insured has priority over all other claimants in case of bankruptcy of an insurance company. (5) Public auditors who certify the financial position of the insurance companies must be approved by the Insurance Commissioner. (6) Premium reserves will be calculated on the basis of the so-called "twenty-fourth" method; 20/ gross system of accounting is mandatory.

87. In the Sultanate of Oman a division in the Ministry of Commerce and Industry has been set up for the supervision of insurance and reinsurance companies established in the country. These companies are now required to keep a solvency margin, in respect of life and non-life business, to submit, with other returns, copies of treaty and facultative reinsurance arrangements and copies of policy forms and other contractual documents. Foreign companies, in addition, must submit copies of their latest balance sheets and profit and loss accounts. In Kuwait similar developments are reported. A new Civil Code, laid down in 1981, will also deal with insurance contracts.

88. In Malaysia the Government has introduced a new regulation whereby solvency margins are now required of general insurers (non-life). These will amount to 15 per cent of the written premiums in the previous financial year, or Mal.dollars one million, whichever is the greatest. This new regulation cancels the Mal.dollars one million capital requirement, which was the flat amount applied so far, irrespective of the premium volume.

89. In Botswana regulations under the Insurance Act of 1979 were enforced in April 1980. They mainly contain specific provisions in respect of capital and solvency standards of domestic and foreign insurers. Paid up capital will be not less than $US 126,000 in respect of general insurers, this amount being the excess of assets over liabilities. Life insurance companies are not required to maintain a solvency margin, but liabilities under life policies (mathematical reserves) must not exceed the amount of the life fund. Foreign insurers are required to maintain a principal office in the country and to submit annual returns on prescribed forms. All insurers will deposit with the Bank of Botswana such amount of approved securities as may be prescribed by the Government. The

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20/ Insurance legislation and supervision in developing countries (TD/B/393 and Corr. 1 and Add.1), United Nations publication (Sales No. E.72.II.D.4 and corrigendum and addendum) - Part Two: Insurance legislation and supervision in developing countries: study by the UNCTAD secretariat, para. 128.

regulations, in addition, stipulate a minimum rate of commission on reinsured business (see para. 144). Insurance brokers are required to deposit P 2,000 with the Bank of Botswana, to take out an indemnity insurance against damages for breach of professional duty and to submit annual returns on prescribed forms.

90. In Singapore press reports indicate that the Government is reviewing the insurance legislation to ensure that the industry will not be hampered by antiquated rules and regulations. A review of the present act pin-points major deficiencies, including inadequate minimum financial requirements for the licensing of insurers, absence of power to control intermediaries, lack of distinction in the treatment of direct insurers and reinsurers and lack of flexibility in statutory requirements.

91. In Bermuda the 1978 Insurance Act and Regulations are now operative, with the main objective of ensuring solvency of companies. The regulations require that Bermuda carriers institute statutory accounting principles; submit annual auditor's reports and a certificate of solvency which indicates conformity to minimum solvency margins for both general and long-term insurance business; calculate and provide the registrar with the ratio of premium to capital and surplus; and register their business, managers and intermediaries. The minimum solvency margins are a minimum of $120,000 in excess of assets over liabilities. Where premium income exceeds $600,000 the ratio is 20 per cent of net premium and where the premium is over $6 million the ratio is 10 per cent.

92. In the Cayman Islands all companies with the exception of pure "captives" and certain approved external companies must comply with the minimum net worth requirement for general business of $US 120,000, for long term business $US 240,000 and for both general and long-term business $US 360,000. Once licensed, companies are requested to submit annual returns, the complexity depending on the type of licence and the nature of business transacted.

93. The Government of Pakistan has set up a committee of experts to study the provisions of the Insurance Act of 1938 in an effort to align them with present-day requirements and practice. The committee was directed to:

(1) Study the provisions of the Insurance Act vis-à-vis similar enactments in other countries and align its provisions with present-day requirements and practice. Also, to resolve difficulties experienced by insurers and insureds, especially in the area of general insurance business: (a) to study the method of claims settlement by insurers and to suggest improvements in that procedure to avoid unnecessary delay; (b) to examine and suggest measures to check the payment of bogus and fraudulent claims by insurers transacting general insurance business; (c) to study the existing provisions regarding the powers of the Controller of Insurance under the Insurance Act and to suggest amendments for bringing about more discipline in the functioning of insurance companies transacting general insurance business; (d) to review generally the existing provisions of the law applicable to insurers transacting non-life business, especially deposits to be made by such insurers, investment of their assets in Pakistan and requirements as to paid-up capital of such insurers, etc.

(2) To examine suggestions for amendments in the provisions of the Insurance Act relating to the life insurance business brought before the Committee by the State Life Insurance Corp. or the Controller of Insurance.

(3) To suggest improvements in any other aspect of the insurance law concerning both life and non-life business where such laws as they stand now are found to be deficient.

94. In Chile a new insurance law (No. 3057 of 10 January 1980) replaced the legislation laid down in 1931. Important features of the new legislation are that companies are given full responsibility to fix their tariffs as they deem fit, but the wording of policies and conditions must be approved by the Supervisory Authority ("Superintendencia de Valores y Seguros"). Premiums are no longer subject to taxation. Increased minimum share capitals are requested from existing companies. There are no restrictions as to the country where, or the securities in which the assets are invested by the insurance companies. Reinsurance is not subject to supervision and existing restrictions on reinsurance transactions are abolished (see also para. 132). Another Chilean law (No. 3538 of 9 December 1980) sets up the "Superintendencia de Valores y Seguros" as the government organ for insurance supervision. The Superintendencia is an autonomous body which will be linked with the Government through the Ministry of Finance.

95. In Cyprus important provisions of the existing insurance law of 1967 were amended. The Council of Ministers is now empowered to exempt from the application of the law, or any of the provisions thereof, an insurance company if, in the Council's view, such provisions are onerous to such company. Other amendments relate to minimum paid-up share capitals and to the obligation for an insurance company to be properly reinsured.

96. Governments of some other developing countries (e.g. Tunisia) are also demanding increased share capital from the companies under their supervision.

B. New regulations on reserves and investments

97. In Colombia the Consejo de Estado adopted a decision whereby premium reserves (reserves for unexpired risks) in relation to cargo insurance, 40 per cent of gross premiums, should be maintained on the insurers' books for a period of one year (instead of six months, as previously laid down by the Supervisory Authority). An obvious outcome of this decision is that insurance companies must request their reinsurers to deposit with them a corresponding amount of reserves for a longer period than previously; this will result in an increase of domestic investments and in "lower actual returns in hard currency balances to foreign reinsurers", as the professional press commented. 21/

21/ World Insurance Report (London), 14 August 1981.

98. In Mexico (see para. 83) the new insurance law provides for (i) a reserve for fluctuations of the value of the assets, which will be cumulative and will be built up on the basis of a given percentage of profits. Drawing on this reserve will be permitted only when differences between actual values and evaluations of assets occur; (ii) a reserve for claims incurred but not reported (IBNR), which will be calculated on the basis of claims experience; 50 per cent of the funds generated by these reserves will be deposited in the Central Bank and will yield an interest rate comparable to that prevailing in the financial market (instead of being invested in Government securities, as was the practice before); 25 per cent of the reserves will be invested in priority national economic sectors, as determined by the Government.

C. Contractual relationship, intermediaries, taxation

99. Contractual relations between insurers and policy-holders seem to be a question of permanent concern to the regulatory authorities in many developing countries. Efforts made in order to ensure fair treatment of policy-holders and beneficiaries, particularly those in the lower social strata, probably attract a permanent attention of these authorities, although measures taken in this respect are not very widely known. Some interesting developments in this field have occurred in Malaysia, where a "cash-before-cover" scheme, mooted as a general principle three years ago, is now to be implemented for the proportionately large motor branch. The purpose is not only to improve motor insurers' cash flow, but also to clarify the protection afforded to the motoring public and victims of road accidents, to speed up the settlement of claims and to permit transport undertakings and fleet operators to budget for their insurance costs more efficiently. Commercial transport operators are allowed to make an initial payment of 30 per cent of premium with the balance due within 45 days.

100. In Pakistan comprehensive legislation is expected which will provide for: (1) prompt claims settlement for road accident victims on a summary award basis; (2) raising the compensation ceiling of Rs. 16,000 to Rs. 50,000 for all pedestrians and fare-paying passengers alike; (3) a substantial increase in the present statutory deposit of Rs. 350,000 with the State Bank of Pakistan in the interest of safeguarding road accident victims; (4) should an insurer default, the above statutory deposit shall stand forfeited to the Government and the licence for transacting motor insurance business shall be cancelled. Commenting on these developments, the professional press underlined the rarity of third-party claims "on account of cumbersome court procedures and overdrawn police investigations" 22/ - a situation that the new legislation is expected to redress.

101. In Thailand life insurance companies are required to enclose copies of the application forms and of the statements of the insured when issuing the insurance policies to their clients.

22/ Mr. M.A. Chishti, Executive Vice President of New Jubilee Insurance Company, in Best's Review, September 1981.

102. In the Republic of Korea a "cooling-off" system for life insurance contracts is now mandatory. In essence, that system provides for a short period during which the policy-holder may cancel the insurance contract he had accepted, without any financial compensation. The purpose is to protect the policy-holder against the effects of excessive sales pressure.

103. In Algeria the new insurance law (see paras. 7 and 45) includes a special section on insurance contracts and lays down a number of provisions on rights and obligations of the parties.

104. In other countries changes of basic insurance laws have provided the opportunity to include new regulations on agents and intermediaries, whose role and professional standards are so important in the contractual negotiations between insurers and their clients.

105. In Mexico the new "Reglamento de Agentes de Seguros" points out that: (1) an agent should provide evidence of his technical competence to carry out his trade; the supervisory authority will determine the standards of professional qualification; (2) in the case of corporate bodies the agency should be established as stock companies with a share capital of an amount to be determined by the supervisory authority; (3) insurance companies may only pay commissions and grant other compensations to duly authorized agents; (4) the activities of agents are put under the supervision of the "Comisión Nacional Bancaria y de Seguros" - the Government's agency for insurance supervision. These activities are subject to a number of commercial and ethical standards (e.g. no premium or part thereof to be refunded to policy-holders; premiums received from policy-holders to be transferred to the company within a maximum period of ten working days, etc.).

106. In the Philippines new regulations for the renewal of insurance agents' and brokers' licences were introduced by the supervisory authorities.

107. On the matter of taxation, it is reported that a new "Insurance Premium Act, 1980" of Saint Lucia provides for the payment of the following taxes on premiums: for resident companies, 1.5 per cent of premium income (gross premium less reinsurance) in the life business, and 3 per cent of gross premium (all premium collected, no allowance for reinsurance premiums) on general business. For foreign companies, the tax rates are 3 per cent on the life premium income and 5 per cent of the gross premium in general business.

108. In Turkey taxes on premiums were reduced from 25 per cent to 15 per cent.

109. In Trinidad and Tobago the Government has decided that life insurance policies issued by foreign incorporated companies would not qualify for tax relief. Some exceptions are allowed for companies incorporated in the CARICOM area.

Chapter IV

DEVELOPMENTS IN THE FIELD OF REINSURANCE

A. General review

1. Reinsurance demand in developing countries

110. Demand for reinsurance (particularly for foreign reinsurance) has increased steadily in many developing countries. It could have been expected that the slow-down of economic activities which affected many of them would have resulted in a parallel decrease in insurance business and, hence of reinsurance premiums paid for foreign covers. In fact, in a number of countries, the contrary has been the rule. Admittedly, less insurance was bought for medium and small risks - precisely those for which no reinsurance is generally necessary. The corresponding decrease of business tended to make insurance companies more vulnerable to losses affecting large risks (industrial plants and equipment, means of transportation, infrastructure, etc.) which explains a stagnation or a relative reduction in retention capacity and the need for an increased reliance on foreign reinsurance services, resulting in an aggravation of the secular dependence on international markets.

111. There are some obvious exceptions to that trend. These exceptions are mainly found in countries enjoying both insurance companies particularly endowed with risk bearing capacity and a large geographical dispersion of risks. 23/ In general, however, the capacity has stagnated or shrunk and this provided new incentives to set up new reinsurance facilities in developing countries and to encourage the local insurance industry to resort to these facilities whenever possible for their reinsurance needs.

112. Similar considerations apply to the setting up of new regional or subregional reinsurance organizations in developing areas. The establishment of the "Arab Insurance Group" (ARIG), to which reference is made in paragraphs 126 and 173, met in part the wish to make up for the shortfall of capacity of many direct insurance companies, at their individual levels, and also to make room for a larger policy of self-reliance in the presence of what was considered to be a lack of response of international markets to the region's aspirations. More modest projects than that of the giant ARIG have also materialized in Africa, such as the setting-up of the "CICA RE", a reinsurance company in which participate member countries of the "Conférence Internationale des Contrôles d'Assurance des Etats Africains", (see para. 165). Projects at a national level have also been initiated during the period under review but, in many instances, local reinsurers in developing countries, long established or newly set up, faced increased difficulties as international competition increased greatly and underwriting conditions deteriorated drastically.

23/ India, for instance, in 1981 reached unprecedented levels of insurance retention, with an over-all retention of gross premium in the order of 85 per cent. Departmentwise, retention percentages were: Fire: 82 per cent; Marine cargo: 88 per cent; Marine hull: 54 per cent; Motor: 100 per cent; Miscellaneous (including engineering): 90 per cent; Aviation: 10 per cent.

2. International competition in reinsurance

113. The co-operation of international reinsurance markets proved most effective in the sharing of risks of insurers in developing countries. This co-operation, in many instances, was encouraged by aggressive marketing systems and by a very active network of reinsurance brokerage firms, 24/ with the result that sales pressure reached unprecedented levels and that excess reinsurance capacity and deterioration of terms in many developing areas became commonplace. A main adverse outcome of the situation was that local reinsurers in many developing countries were faced with new and increased difficulties in adhering to "sound reinsurance practices".

114. Some national reports indicate that the high interest rates which prevailed during the period under review in the European and North American money markets are partly responsible for the above difficulties. Reinsurance business generates financial liabilities and, if the corresponding funds are invested by the reinsurers, they obtain an investment income the volume of which is directly related to prevailing interest rates. The higher the rates, the larger the capacity to offset underwriting (premiums less claims and expenses) deficits, and the criteria for the selection of business will be probably less rigorous. 25/ The problem is that investment opportunities available to domestic reinsurers are generally narrower than those enjoyed by international reinsurers, because of local foreign exchange regulations and other constraints which restrict their access to international money markets, so that they have to rely to a greater extent on the underwriting profits only and be more careful regarding the quality of business they accept from ceding companies. Their performance and competitiveness, therefore, are negatively affected. Also negatively affected has been the net retention of insurance business for the developing countries and for the regions as a whole.

115. A further danger facing the reinsured companies of developing countries is the possibility of the interest rates in international financial markets falling suddenly. Lower interest rates would lower investment income and the shortfall would leave the underwriting deficits uncovered. The question of solvency for a number of reinsurance companies would then become a crucial issue for their clients in developing countries. 26/

24/ Reinsurance brokers appear to have played a major role in the intensification of efforts to sell reinsurance services to developing areas and in the opening of new markets to the international reinsurance companies. "The reinsurance marketing system in Asia depends greatly on international brokers. It is estimated that UK brokers have over half the reinsurance volume in the area, while direct dealing reinsurers have about one-third. Regional reinsurance facilities, national facilities and exchange among local companies account for most of the rest of the business ..." (Best's Review, November 1980).

25/ "Companies deliberately accept business which is sure to make an underwriting loss because they hope they can take the premiums and invest them in the money markets or in bonds at a profit until claims fall due. The income from premiums invested is then used to offset the underwriting losses." The Economist (London), 24 April 1982.

26/ "It is a dangerous game. If interest rates fell suddenly, so would investment income ... Meanwhile, some insurers and reinsurers might not survive." (ibid.)

116. A partial but important remedy to the situation could be a stricter application of the principle of local investment of insurance (and reinsurance) funds and reserves, which was strongly recommended by UNCTAD during its first session in 1964, especially as this requirement is, legally or in practice, the rule applied in most developed countries. Insurance and reinsurance funds are in fact part of the domestic savings and if their investment locally was effectively enforced, the foreign reinsurer would have to deposit his own reinsurance reserves with the local ceding company. Among the obvious advantages of this system would be the improvement of competitiveness of the local reinsurers. However, for a number of reasons this requirement is not enforced in many developing countries, particularly as regards the reinsurance reserves for outstanding losses.

117. More adequate and stricter requirements related to reinsurance seem likely to be imposed by some governments of both developed and developing countries. Support for tighter control seems to come from the insurance industry itself, from academic circles and from supervisory authorities. An insurance executive predicted enactment of "legislative restrictions brought about by inadequate reserving in the worldwide reinsurance market and the subsequent failure of many in the retrocessional game of Pied Piper". 27/ A prominent professor apparently agrees, stating that in the United States "State insurance commissioners will be forced to regulate reinsurers more closely to prevent a chain reaction of insurer insolvencies". 28/ The Superintendent of Insurance of the State of New York, Mr. Albert B. Lewis, apparently concurs. He recommended that the National Association of Insurance Commissioners design model laws to regulate international reinsurance treaties and the intermediaries that place risks with the reinsurance market. He based his recommendation on investigations being undertaken by his department which, so Mr. Lewis stated, has uncovered much outright fraud in connection with worldwide reinsurance. 29/

3. Reinsurance supply in developing countries

118. Other obstacles, of more permanent nature, which have prevented a larger expansion of domestic reinsurance enterprises in developing countries during the period under review, have been recently identified by a prominent African reinsurer: 30/

27/ Dewey P. Clark, Vice-President, Prudential Re., Newark, N.J., quoted by André Melly in L'Argus International (Paris) Sept.-Oct. 1980.

28/ Bernard Webb, Professor of Actuarial Science and Insurance at Georgia State University, Atlanta, in a speech at a meeting of the American Risk and Insurance Association, 15-18 August 1982, Denver, Col. Quoted by Rhonda L. Rundle in Business Insurance, (Chicago, Ill.), 30 August 1982.

29/ See Business Insurance, 30 August 1982.

30/ Mr. J.O. Irukwu, Managing Director, Nigerian Reinsurance Corporation, Lagos, in an address to "AIRMIC International Insurance Conference", Paris, 24-26 March 1982.

"Dependence to some extent upon international expertise ... Risks getting more complex and more difficult to handle ... Acute shortage of experienced and qualified personnel ... Lack of expertise in the various supporting services ... Problems of currency convertibility due to exchange control restrictions and effects on the payment of reinsurance premiums and claims ... Management deficiency due to the environmental, political, ethnic and other human factors ... Absence of reliable information concerning the market due to the lack of vital statistics and other relevant information ..."

119. Lack of trained personnel in the reinsurance field in developing countries provides a competitive advantage to foreign reinsurance institutions and seems to have worsened during the period. A solution should also be found to the particular issue of recruitment and training of staff for the State-owned companies. "At present about 70 per cent of the national reinsurance corporations in the third world are State-owned public corporations. Being State-owned they are in most cases obliged to operate in accordance with the prevailing conditions of service and salaries available to all public officers and civil servants in the country in question. These conditions of service are usually inferior to those applicable in the private sectors of the economy and certainly not as good as those offered by the private insurance companies in the local market. The result is that the local national reinsurer is unable to attract good quality staff from the local insurance industry and has, in most cases, to manage with second-rate staff... These reinsurance corporations should be allowed to operate outside the civil service or public service employment terms ... Personnel engaged in international practice should be subject to the same standards as their counterparts in other parts of the insurance and reinsurance world, provided their individual productivity justifies such rewards ..." 31/

120. However, the above and related obstacles have not prevented reinsurance companies in developing countries from making substantial contributions to their markets and economies. Just to cite an example, in Nigeria - the country where the above difficulties seem to have been felt very strongly - the setting up of a reinsurance corporation in 1977 permits its promoters to announce the following achievements:

"... The corporation generates an annual gross premium income of about $US 150 million, out of a gross market income of about $650 million. We have built up reinsurance expertise and are already involved in the running of a number of reinsurance pools. In addition to the Corporation's reinsurance functions, the Corporation as an agency of the Nigerian Federal Government, plays a vital role in promoting discipline within the Nigerian and West African insurance markets and I have no doubt that the over-all effect of the presence of the Corporation in the Nigerian market has operated to the advantage of not just the Nigerian and African insurance markets, but to the international insurance community as a whole ..." 32/

31/ J.O. Irukwu: Reinsurance in the Third World, Lagos, 1980.

32/ Ibid.

4. Supply of reinsurance by developing countries to international markets

121. Expansion of off-shore reinsurance enterprises in a number of developing countries has continued through a consistent policy of encouragement of foreign companies to base their offshore operations in their countries (see paras. 28-37 on captives). Panama, to mention only one example, now boasts of 40 reinsurance and 28 reinsurance administration companies on its territory, handling $US 89 million of premium income. Singapore is another case in point.

122. The period under review has not been positive in a number of cases in respect of the activities of reinsurance companies of developing countries in the international market. Only recently, the professional press reported that important losses were incurred by companies of developing countries involved in business transacted in the London market and other developed areas. 33/ It is true, however, that no final conclusions should be drawn from this kind of information. The period under review has been characterized by particularly bad marine underwriting, and final results will only emerge in the medium and long term. The question remains, however, whether these and other poor results stem from difficulties of access to international markets or whether they are common to all other companies operating there. 34/

123. Markets of developed countries seem to be more accessible - but not necessarily more profitable - if joint ventures are entered into with domestic companies there. A widely known case in point is the People's Insurance Company of China, which in October 1980 set up a joint venture (China-America Insurance Company) in Bermuda, with the co-operation of the American International Group (United States), through which it transacts reinsurance business from North America and other industrialized countries. It also promoted the China Reinsurance Company, operated in Hong Kong by the China Insurance Company, the Tai Ping Insurance Company and the Ming An Insurance (HK) Company. In 1981, it opened a liaison office in London to expand international operations in the London market.

B. The setting up of new reinsurance companies in developing countries

124. Arab countries: Public and private reports indicate that the decision made by the London market (20 July 1979) to impose a war risk premium on ships trading in the Persian Gulf was a major turning point in the Arab insurance market. Lloyd's underwriters were instructed to double to 0.05 per cent the premium on the value of the hulls of ships visiting the Gulf. Although the premium increase was not implemented immediately and was later cancelled, it drew protests from many quarters. These included Arab Governments, insurance companies, Arab trade associations and chambers of commerce, including the Arab British Chamber of Commerce in London, and shipowners and City and other underwriters and brokers.

33/ See, for instance, World Insurance Report (London), 19 December 1980.

34/ Obstacles to access to international markets do not apply only to reinsurers in developing countries but to any form of international competition. A Swedish company wishing to transact business in the United States has only recently complained of a combination of legal and market barriers which add up to a most difficult entrance to the reinsurance market of the United States (as reported by Mr. Steven Fass, Executive Vice President of Folksamerica Re., New York, a subsidiary of Folksam Reinsurance Corporation, Stockholm). Quoted in World Insurance Report (London), 11 September 1981.

125. Lloyd's move provided the stimulus for the creation of two big Arab insurance groups whose aim is to protect Arab interests and make them less vulnerable to sudden and uncontrollable actions by foreign parties. Interestingly enough, Lloyd's members late last year expressed support for an offer to co-operate with the two newly-created groups.

126. The first of the above-mentioned groups is the Arab Insurance Group (ARIG), with an authorized capital of $US 3,000 million, of which 5 per cent ($150 million) has been paid up. It was set up in April 1980 in Bahrain, with the participation of Kuwait, Libyan Arab Jamahiriya and the United Arab Emirates. For the time being it concentrates on reinsurance only, and available reports indicate that $80 million of the reinsurance premia have been written in only the first eight months of its existence.

127. The other group is the Arab War Risk Insurance Syndicate (AWRIS) which started business in Baghdad on 1 January 1981. AWRIS, which will channel some of its business through ARIG, will cover only marine cargo and hull. Its member countries so far include Iraq, the United Arab Emirates, Saudi Arabia, Bahrain, Qatar, Kuwait and Oman. National and other Arab insurance companies whose paid-up capital is at least 51 per cent Arab-owned can join the syndicate. Members will transfer their traditional war risk cargo and hull reinsurance business to AWRIS, whose total cover for cargo and hull is about $156 million a vessel. Premium income of about $6 million was expected to be generated by December 1981.

128. Other developments at a national level include the following:

129. In Tunisia the "Société Tunisienne de Réassurance" was established in March 1981, as a private corporation (société anonyme de droit privé), with a share capital of 2 million dinars. Shareholders are the Government (10 per cent), insurance companies (47 per cent) and banks (43 per cent). The new company's participation in the existing reinsurance treaties of its shareholders is some 20 per cent. It is also involved in the existing Tunisian marine and aviation pools, for the surplus of the existing domestic capacity.

130. In Argentina a new privately owned professional reinsurance company, Reaseguradora Argentina, started operating on 18 April 1980 with a capital of $2.27 million. It is the first of its kind to be registered in Argentina and to develop a domestic portfolio there since the establishment of the State-owned INDeR. Reaseguradora will be able to receive retrocessions from INDeR in addition to the normal retrocession funds placed by INDeR with local companies. The structure of INDeR was substantially modified by law about two years ago, making it more commercial by changing its administrative and management structure from that of a State agency into that of public corporation. Reaseguradora will write exclusively international reinsurance.

131. In Colombia Hemisferica SA, a new private reinsurance company, was set up with an initial capital of $2.7 million. The shareholders represent more than 60 per cent of the Colombian market, including 21 of the 31 insurance groups in the country. Hemisferica SA was to write an international portfolio from 1981 onwards.

C. Regulatory measures on reinsurance

132. In Chile new reinsurance companies may now be set up and reinsurance abroad is permitted. The Caja Reaseguradora de Chile, until now the monopoly of Chile's nationalized reinsurance sector, has been changed into a State-owned limited liability

reinsurance company and its monopoly status ended. In some quarters, this development has been applauded as a break-through on the way to market freedom and economic efficiency. The Supervisory Authority pointed out that the national retention, in terms of premium, went down from 80 per cent of total premium income in 1979 to 59 per cent in 1981, and that the corresponding ratio between reinsurance premium paid abroad and total premiums has increased from 20 per cent in 1979 to 40.6 per cent in 1981. The same comments refer to an improvement of administrative costs during the same period which have decreased from 31 per cent (of the total premium) in 1979, to 27 per cent in 1981. 35/

133. In Trinidad and Tobago the government-owned "Reinsurance Company of Trinidad and Tobago" has been opened to the participation of 22 local insurance companies for an amount of approximately $1.4 million, or just over 20 per cent of the capital issued to date. The Government intends that locally incorporated insurance companies and brokers be allowed to participate up to a level of 40 per cent of the issued capital. The company operates on a 5 per cent voluntary reinsurance cessions scheme in respect of all fire and allied business and is a facultative seller of reinsurance. It also manages motor claims involving government-owned vehicles.

134. In Ghana projects to separate the government-owned Ghana Reinsurance Corporation from its sister corporation - the State Insurance Corporation - are under way. The project would, among other things, revise the capital structure of the Reinsurance Corporation and permit the expansion of its operations.

135. In Thailand by an order issued in May 1980, new conditions were introduced for companies establishing reinsurance business. Prior to the granting of a licence to undertake business in respect of general and life insurance, the company is to furnish details of its capital, names and particulars of the promoters, estimated expenses in establishing the company and a five-year plan of operations. Conditions for establishing the company include: minimum registered capital of B 50 million with not less than B 25 million paid up; value of each share not to exceed B 100; Thai nationals to hold 75 per cent of the total number of shares and no one person to hold more than 5 per cent; board of directors must comprise nine members, of which three-fourths of Thai nationals.

136. As a result of the newly introduced Mexican Insurance Law, a register of foreign reinsurers is to be set up listing the general representatives who have authority in Mexico to accept and cede reinsurance and who will be granted a special permit to operate by the Secretary of Finance. At present there are approximately 60 foreign concerns of either foreign reinsurers, or brokers, who have underwriting authority.

137. In Iran, following the nationalization of the insurance industry, important steps were taken to centralize reinsurance. Previously, insurance companies operating in Iran were compelled to pass 25 per cent of their reinsurance and 30 per cent of their treaties to Bimah Markazi. Since the centralization became effective in April 1980, however, all reinsurance activities are restricted to Bimah Markazi, thus reducing connections with the international markets. The consequences of this action are expected to be the elimination of small companies and the strengthening of the financial and technical ability of the remaining companies. Because there will be no intermediaries, lower acquisition costs are expected; there will be no coinsurance among companies since the companies will co-operate directly with the Bimah Markazi in the reinsurance business.

35/ See Valores y Seguros, September 1981.

D. Other measures on retention and reinsurance: 36/

138. Reports indicate that some of the measures adopted in previous years are now yielding tangible results and have brought about important modifications in matters of reinsurance planning; for example, in Colombia, where regulations laid down in 1967 limited reinsurance cessions abroad to 40 per cent of the gross premium income, 37/ the result has been an obvious trend away from the use of the traditional proportional reinsurance systems to excess of loss treaties, which seems to reflect the companies' increased concern with the use of more economical and better adapted reinsurance systems.

139. In the Philippines non-life companies were requested to restructure their reinsurance treaties according to set levels of treaty limits and reinsurance premiums for certain categories of business. Since 1980 those non-life insurance companies whose treaty limits and premiums cessions do not exceed the corresponding limits are not allowed to cede reinsurance to unauthorized insurance companies unless the authorized ceding companies first prove to the satisfaction of the government regulatory authority that they will obtain from such an unauthorized company inward reciprocity business of comparable profitability. Under these circumstances the aforementioned treaty limits and premium cessions may be reduced by an amount not exceeding 20 per cent thereof. The set treaty limits and reinsurance premium cessions are:

- Fire: treaty limit $P 2 million ($US 266,660) and premium cession $P 1.5 million ($US 200,000).

- Marine: treaty limit $P 1 million ($US 133,330) premium cession $P 750,000 ($US 100,000).

- Other (except automobile): treaty limit $P 300,000 ($US 100,000) and premium cession $P 200,000 ($US 26,660).

140. As regards the life insurance business, no reinsurance may be placed abroad where the amount of risk is $P 2 million or less, per life standard risk, graded down for substandard lives and for additional accident covers, where the accident risk does not exceed $P 1 million per standard risk. Further, reinsurance abroad on all other life insurance policies, including group life insurance, may be made only after it has been proven by the ceding company that the risk cannot be absorbed by the Philippine market.

141. The order issued by the Colombian Superintendencia, dated 20 June 1980, requires direct insurers to report to the Banking Superintendency all facultative reinsurance they propose to cede abroad. When returning the relevant form of notification, companies are required to indicate their actual contracts capacity, a statement of total direct premium and insured values in branches specified, over-all value and limits of automatic contracts, the insurers' gross retention, automatic contracts, facultative reinsurances to be arranged locally and abroad, identity of reinsurers

36/ See para. 85 on compulsory reinsurance cessions in Egypt.

37/ This measure was reported in document TD/B/C.3/122/Supp.1.

with premium ceded and percentage commission in each case. Meanwhile, local reinsurers are offering cedents of facultative business certain apparently competitive benefits. These involve the possibility for the cedants to retain up to 40 per cent of facultative premiums payable, even if subject to prior claim and other charges, for an interest charge of only 5 per cent per annum.

142. In Barbados all Barbadian insurers will be required to cede to the Insurance Corporation of Barbados a 10 per cent share of every fire and property insurance accepted or renewed. The 10 per cent is based on the gross acceptance, before the deduction of any other reinsurance. Commission is set at 32.5 per cent on original premiums and profit commission of 25 per cent is to be paid on annual profit. Claims are to be lodged within 30 days of the end of each quarter.

143. In Oman the insurance Law of 1979 obliges foreign companies to cede in co-insurance to local companies a minimum of 15 per cent of every policy written in the country. In addition, every company has to retain at least 15 per cent of every policy it issues for own account or to cede a part of this 15 per cent to locally licensed companies. The Law also provides that no reinsurance can be effected outside before exhausting the capacity of the local market.

144. In Botswana minimum rates for reinsurance commissions are stipulated under the new insurance regulations (see paragraph 89). In Fire reinsurance, rates are 40 per cent (quota-share) and 37 per cent (first surplus); in Motor, 20 per cent (quota-share). The obvious objective is to reduce the amount of net premiums ceded to foreign reinsurers.

145. In Kuwait a gentleman's agreement between the domestic insurance companies has been signed to the effect that at least 20 per cent of all their business be ceded to the Kuwaiti Reinsurance Company.

146. In Fiji the Fiji Reinsurance Corporation, in which the Government has a 20 per cent share, introduced a scheme from 1 September 1980 whereby Facultative Reinsurance facilities were made available to local insurers. Under this scheme the local insurers agreed to place all reinsurance over and above their retention and treaty capacity with the Fiji Reinsurance Corporation Limited. The Fiji Reinsurance Corporation Limited places as much locally as the other companies can hold and then places the balance overseas in the usual way.

147. In Thailand reinsurance cessions for life policies will be limited to a given proportion of the effective amount at risk. Retention and reinsurance will therefore be based on the difference between the amount for which the ceding company is liable and the policy reserves built up for any given policy. The mortality rate - and not the original premium rate - will apply to the reinsurance.

148. In the Seychelles the law providing for the setting up of the "State Assurance Corporation of the Seychelles" (see para. 10), also includes the conditions under which compulsory reinsurance cession will be effected to that Corporation by all insurers operating in the country. The reinsured proportion of every policy and the reinsurance terms and conditions will be prescribed by the Government.

149. Some countries have introduced - or are considering the introduction of - taxes on reinsurance premiums. In Colombia taxes on net reinsurance premiums, to the amount of 0.68 per cent, are aimed at covering the cost of maintaining the insurance supervisory office ("Superintendencia Bancaria").

Chapter V

CO-OPERATION AMONG DEVELOPING COUNTRIES IN THE FIELD OF INSURANCE

A. Institutional co-operation among Governments, supervisory authorities, trade associations and other organizations

150. In Asia, the ASEAN Association of Insurance Commissioners held their sixth and seventh meetings in 1980 and 1981 respectively. At the sixth meeting, (Manila, October 1980) three recommendations were endorsed, as follows: (a) the establishment of a Technical Committee on Insurance Education, which will draw up an ASEAN programme on insurance education and training to meet the needs of the staff of the supervisory authorities of the region; (b) the formation of a research team to carry out further studies of imports, taking into account the objective of maximizing the ASEAN countries' share in the insurance of their own international trade; (c) the formalization of the ASEAN - European Economic Community (EEC) co-operation in insurance.

151. During the seventh meeting (Bangkok, 9-11 December 1981) the three areas mentioned above were further expanded with the inclusion of the regional studies on export credit insurance and installation of a marine risk data bank. In addition, the meeting discussed the progress on the ongoing projects, that is, the project on the unified forms of insurance statistics and the project on the harmonization of ASEAN Insurance Laws.

152. Also in Asia, the 10th East Asian Insurance Congress, (Manila, October 1980) discussed "How can the East Asian insurance industry cope with the challenges of the eighties?".

153. In Africa the Ministers responsible for insurance supervision of the member countries of CICA (International Conference of African States on Insurance Supervision) met in Paris 38/ in September 1980. This opportunity permitted to recall the main achievements of CICA in the field of supervision and harmonization of insurance regulations in member countries, which have permitted theeestablishment of adequate legal grounds for the setting up of domestic companies which boast now a turnover of 80 per cent of the total insurance operations in the countries concerned, as against 25 per cent in 1975. Discussions were held on the modalities of reinsurance cessions to the newly-established CICA RE (see para. 165); on the educational activities carried out by the CICA's sponsored "Institut International des Assurances" in Yaoundé (United Republic of Cameroon); on the grave problems facing the insurance sector in the field of automobile insurance.

154. In Central America, the Central American Council of Comptroller of Banks, Insurance Companies and other Financial Institutions considered a project for a uniform text of a life insurance policy. Another meeting of the Council considered some aspects of a project aimed at drafting a uniform insurance law for all the countries of the area.

155. The Executive Committee of the Federation of Afro-Asian Insurers and Reinsurers (FAIR) held its 18th and 19th meetings during 1980. The 7th general meeting of the Federation took place in Manila in June 1981. Decisions were made on (a) agricultural insurance and (b) the present position and capacity of the Afro-Asian markets and the ways and means of optimization of the retention capacity of the FAIR member companies.

38/ France has observer status with CICA and hosted the meeting.

156. On agricultural insurance, the FAIR Executive Committee felt it necessary to proceed further with the study on this subject so as to: (1) indentify the major crop(s) in the member countries of FAIR; (2) select the major perils likely to cause considerable damage to such crop(s); (3) report on the availability of cover, with particular reference to the reinsurance facilities which may be created by pooling arrangements within the FAIR itself and/or using the international reinsurance markets; (4) consider, in studying the reinsurance arrangements, imposing a monetary limit on the cover for the benefit of a wider scope cover; (5) consider establishing a special FAIR Agricultural Reinsurance Pool to provide additional reinsurance cover for member countries.

157. Following this, at the 19th meeting, the Agricultural Committee reported the difficulty encountered in collecting data and also the probable impossibility of implementing a crop insurance scheme including its protection by external reinsurance. Instead, the Committee forwarded a proposal to members to consider establishing an agricultural fund which would be generated by a tax on the farmer or the consumer or by seeking assistance from international bodies. The meeting also endorsed UNCTAD's resolution to the effect that each country set up a crop insurance programme with international reinsurance support in the form of a Reinsurance Scheme or Fund. 39/ Consequently, FAIR, as proof of its commitment to the above resolution, set up a special FAIR Crop Reinsurance Pool to protect its members.

158. In the Caribbean area, a team of experts was appointed by the CARICOM Council of Ministers at their 16th meeting held in Guyana, early in March 1980, with the purpose to develop a strategy for the integration movement during the 1980s. The team was specifically requested to consider the "need to develop and implement effective regimes on the regulated movement of capital and of certain categories of scarce personnel, the right of establishment and the right to provide services, and on the facilitation of joint ventures and regional projects". At the fourth Caribbean Insurance Conference (Freeport, Bahamas, September 1980) the feeling was expressed that the conclusions of the expert group would have an important bearing on the integration efforts in the insurance and reinsurance fields in the Caribbean. 40/ Obstacles to these efforts consist in lack of movement of capital, shortage of technical expertise, variations in insurance legislation and in building and safety codes, the lack of sufficient data. "Increasing economic difficulties could however give some impetus to overcoming these problems, making the need for regional integration in the Caribbean more urgent". 41/

159. In the specific field of insurance education, regional co-operation has permitted a number of activities which most probably were beyond the reach of the individual educational facilities of the countries concerned. In Africa (Monrovia, Yaoundé) and Asia (Manila) regional institutions continued to provide education and training on a regional basis. In Central America the "Instituto de Estudios e Investigaciones del Seguro de Centroamérica, Panamá y el Caribe" (ISCAP) has also continued its training and educational activities and organized several technical seminars on the topics that are of highest concern to the insurance industry of the region (e.g. on intermediaries, on marine cargo insurance, on accounting, on administration, on third party liability, on loss adjustment, etc.).

39/ See resolution 19 (IX) of 3 October 1980 of the Committee on Invisibles and Financing related to Trade.

40/ Mr. Cecil F. de Caires, President of Life of Barbados Ltd., in a report to the "Caribbean Insurance Conference", 4th session, 1980.

41/ World Insurance Report, (London), 24 October 1980.

160. At the Third World Insurance Congress (Buenos Aires, March 1980) the problem of co-operation among developing countries in the field of insurance at the widest possible level was examined. A number of interesting proposals were made. It was felt, in particular, that the expected co-operation should be stimulated through two main vehicles: a Third World Association of supervisory authorities and a Third World Insurance Federation. This Federation would undertake to disseminate information and encourage: exchanges of experience; the establishment of facilities for training of insurance staff on a broader and less costly basis than that involved by training facilities at a national level; the establishment of specialized services not available at a national level; the setting up of collective covers of certain categories of risks, especially new risks, large risks and those of a catastrophic nature; the establishment of co-operation in the field of reinsurance; and the dissemination of industry information to insurance authorities regarding insurance laws and regulations. All these and other proposals were made against a background of "inadequacy of technical expertise, the lack of insurance consciousness among (third world) peoples, the continuing dependence on the developed nations", as Mr. Cesar Virata, Minister of Finance of the Philippines, pointed out in his opening address to the Congress.

B. Operational co-operation among developing countries

161. Exchange of insurance and reinsurance business among insurance organizations in developing countries has intensified during this period, in spite of the many problems as those outlined in preceding sections of this review. The regional projects, such as the Asian Reinsurance Corporation and the African Reinsurance Corporation, whose establishment was reported in earlier issues of this Review, 42/ are now fully operational.

162. The Asian Reinsurance Corporation (ASIAN RE) commenced its operations in January 1980. To date nine countries have become members, but all developing countries of the Asian and Pacific region which are members or associate members of ESCAP are eligible for membership. Each member Government subscribes to the capital of the Corporation an amount of $US 500,000 half paid in United States dollars and the balance in national currency. Least developed countries can pay the entire capital in national currency. The paid-up capital of the Corporation now stands at $US 4.5 million.

163. Each member Government assures a minimum flow of business to the Corporation by giving either 5 per cent of all reinsurance treaties placed outside the country or $US 500,000 of acceptable reinsurance premium, whichever is less. The functions of ASIAN RE are set out in the agreement establishing the Corporation.

164. During its short period of operation ASIAN RE has not only initiated many measures with a view to improving markets and assisting insurers in member countries but also provided more specific assistance to individual markets. The measures taken include:

- establishment of a panel of experts from which individual markets and insurers can draw expertise to undertake specific programmes or required expert technical assistance;

42/ See TD/B/C.3/169, paras. 133 to 135.

- arrangement of a large risk reinsurance schemes under which companies in the region could place large risks at normal terms and commissions with certain leading London brokers. These brokers have agreed to set up a fund of 2.5 per cent of the premium to finance training programmes;

- other schemes such as High Profit Fire Treaty Pool and Cargo Network of insurers were also initiated but lack of sufficient market support has prevented their realization;

- insurance education and training.

165. In Africa, in addition to the regional AFRICA RE, a new intergovernmentally-sponsored regional reinsurance entity, CICA RE, has been founded by twelve francophone African countries which are all members of the International Conference of African States on Insurance Supervision (CICA). CICA RE is designed to enable African markets to handle, or at least control, more of their reinsurance programmes without automatic recourse to foreign reinsurers. This would be secured by agreed partial compulsory cession by both nationalized and private insurers and reinsurers in the member countries.

166. It is proposed that CICA RE have an initial authorized capital of Fr. CFA 600 million, 75 per cent paid up. It is expected to receive compulsory cession of 10 per cent, with cedents in the 12 founding countries having priority for retrocession by CICA RE.

167. There is currently a proposal to form WAICA RE, which will serve the West African region.

168. Another form of co-operation at the operation level is the setting up of pools. Thus in Asia a major step towards the development of reciprocal exchange of insurance business among the five member countries of the Association of Southeast Asian Nations (ASEAN) has been taken by the ASEAN Insurance Council (AIC) as its newly-organized ASEAN Reinsurance Pool commenced operation in early 1981. The business to be ceded to the Pool at the initial stage, consists of fire and miscellaneous accident. At a later stage, aviation risks will be considered in the business, under a proposed Aviation Pool that could take in business covered by the national airlines of the ASEAN member countries. The pool will have an initial target of $US 2.5 million premium income to be derived from member countries. For this to be achieved the pool must at least have 20 per cent cession from each market but not exceeding 30 per cent.

169. The Arab countries decided to establish a pool of marine coverage of tankers. Underwriters of most of the Arab states under whose flag tankers are sailing, namely Saudi Arabia, Libyan Arab Jamahiriya, Kuwait, Iran and the United Arab Emirates, are participating in the pool. At present about 70 per cent of such tankers, which are more modern than those sailing under flags of convenience, are insured by this consortium.

170. In the same region, important developments have taken place in 1980; namely, that national companies of the Persian Gulf area countries have succeeded in agreeing and adopting a common position when confronted with unilateral decisions for foreign markets on matters of particular concern to them. Thus during the period under review two major arrangements were negotiated and finalized between national insurance companies or Arab countries. These are: The Arab War Risks Insurance Syndicate AWRIS), which was founded by 34 Persian Gulf area insurers and

reinsurers. The decision to establish the syndicate was in response to measures taken by some foreign underwriters to remove the Gulf area from standard war risks cover for shipping and to rate each joinery separately. In addition the surcharge imposed on ships using the Persian Gulf, which towards the end of the last quarter of 1980 increased 30-fold, was also another catalyst for the realization of the project.

171. The syndicate aims to deal with sudden decisions by foreign-based insurers to increase war risks premium crossing the Persian Gulf; insure vessels crossing the Gulf and set its own war risks premium, to be shared collectively by member countries in proportion to their participation in the pool's capital.

172. The syndicate commenced operations in January 1981 after the completion of negotiations on reinsurance facilities with a consortium of London underwriters. Under the terms of the agreement AWRIS rates and conditions are tied to those prevailing on the London market. Its first year premium income is forecast at $US 6 million, of which $US 1.75 million is expected to go to the London reinsuring underwriters.

173. The Arab Reinsurance and Insurance Group (ARIG) was set up under an agreement signed between Kuwait, Libyan Arab Jamahiriya and the United Arab Emirates in early 1980 and commenced operation in 1981. ARIG was established with an initial capital of $US 150 million in equal share, and a guarantee to provide an authorized capital of $US 3,000 million (see para. 126). This important sum, the Company pointed out, will make ARIG an important source of investment funds. 43/

174. Bilateral co-operation has found new channels during the period. Iraq's State bank is to open an insurance company in which it will retain 50 per cent interest, the other 50 per cent being subscribed by the Banco do Brasil. The move is said to come as part of a major financing programme between the two countries. The Governments of Barbados and Trinidad and Tobago have decided that one half of the obligatory reinsurance business (10 per cent) ceded by the insurers in Barbados to the Insurance Corporation of Barbados is retroceded to the "Reinsurance Company of Trinidad and Tobago" from 1 October 1981.

43/ As reported in World Insurance Report (London), 24 October 1980.

Annex

CAPTIVE INSURANCE COMPANIES */

Why "captive"?

1. The immense size attained by the major industrial corporations, their internationalization, the growing burden of taxation and overheads, high and rising interest rates and the development of new management techniques have given rise to new requirements which at first went unperceived by the traditional insurance market. These various factors are briefly analysed in the present annex with a view to considering all the various forms of self-insurance, which are meeting with growing success.

2. An insurance premium is commensurate with the size of the risk insured. It represents a considerable sum of money which, besides being the cost of transferring the risks to the insurer, is an expense with no immediate counterpart. When there is a lengthy period without losses, the total premium paid to the insurer is capital lost to the insured. The premium represents funds placed in reserve by the insurer, the payment of which places a burden on the finances of the insured and deprives him of useful earnings.

3. The internationalization of the major industrial corporations has not been accompanied simultaneously by a similar movement on the part of the insurance companies. The need for over-all risk cover and unified coverage came up against a highly compartmentalized supply of insurance. The increasing importance of reinsurance results in part from this inadequacy.

4. The combination of generalized inflation and very keen competition gave rise to heavier overheads and a relative stagnation in turnovers. This situation necessitated a reduction in non-productive expenditure, including insurance. The growing burden of taxation made devices allowing profits to be transferred to tax havens attractive.

5. The development of risk management methods embodied an awareness of the economic fragility of enterprises and of the fact that they needed not only to produce and sell their output but also to protect themselves. It became necessary for firms to become more familiar with their risks, to reduce them and to assume part of them themselves, instead of transferring them all to a third party.

6. This slow evolution took place without insurance and sometimes even in opposition to it. This is hardly surprising when the very concept of insurance is being called in question and the role of the various economic and trading partners in insurance is unilaterally redefined at the outset by the insured.

7. The lack of preparation, the slow pace and even the hostility of insurers, together with a genuine internal restructuring of the industrial corporations, naturally led the latter to give full consideration to the demand for insurance and to stimulate a supply consonant with their needs. Numerous forms of self-insurance then emerged, of which captive insurance companies are one.

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*/ This annex has been prepared by Mr. Andre Melly, a French professional insurance journalist (Paris). The views expressed are those of the author and are not necessarily shared by the UNCTAD secretariat.

What is a captive company?

8. Although the captive company is only one possible form of self-insurance, it is probably the most complete. It is a company set up by one or more insureds (e.g. association captives) with the aim of covering all or part of their risks. Hired captives also exist, which are more flexible than association captives. These are companies set up by brokers or insurance companies which act as a "cover" hired out to one or more customers for a specific period. The latter two forms allowed companies whose turnover did not justify the establishment of an independent captive, or whose domestic legislation was very hostile to such a concept, to gain access to the captive market without problems. In the Cayman Islands, for example, out of 123 captives, 56 are association captives and there is a very marked trend to develop them, particularly for workers' compensation.

9. The creation of a captive company must not be confused with the purchase by an industrial firm of an existing insurance company, such as the acquisition of Hartford Insurance by ITT in the early 1970s. The one is an organic restructuring, while the other is a financial investment which does not affect, or hardly affects, the group's insurance programmes.

10. Captives do not require much capital; they are set up in countries with favourable fiscal, administrative and legal regulations. They need only a small staff and a very slight infrastructure, or may even be directed by management companies created for the purpose. They have ready access to the international insurance and, particularly, reinsurance market.

11. In addition to tax advantages and substantial savings on premiums because of very low management costs, a captive can earmark funds for technical reserves which will revert to the insured after five years if no claims have been made. A captive company has direct access to the reinsurance market from which the insured was excluded in traditional forms of insurance, and can thus take advantage of the rates and the remuneration of this market, in which it generally operates as a ceding agent.

12. The captive's initial purpose is to underwrite the risks of the parent company. Certain countries such as the United States and the United Kingdom, however, are drawing up legislation which will transform captives progressively into insurance companies, i.e., companies which will underwrite a substantial share of foreign risks for their parent company. It is thought by some that this would distort the captives and call into question their structure, their raison d'être and their management function. In any event, this diversification of their portfolios, even if artificially induced, will bring about an increase in costs and an even greater dependence on brokerage and reinsurance.

13. While it is obvious that recourse to a captive company can be a practical means of tax avoidance, it does not seem sufficient to induce an industrialist to create one. If that were the main motive, most captives would be inactive, mere letter boxes used to "launder" profits. In fact, out of the known 1,562 captives existing, a mere 200 are inactive.

Importance and operation of the captive market

14. The volume of premiums handled by captives is growing rapidly. The captive market of Bermuda alone has a premium income half that of Lloyd's of London. The captives of the oil groups are the most active. The Ancon Insurance Company, for example, Exxon's captive, had gross premiums of $US 169.6 million (net $126.3 million) in 1981; non-Exxon risks in the Exxon group account for 10 per cent of this total. Oil Insurance Limited, owned by 37 oil companies, had gross premium receipts of $US 111 million (net $104.8 million) for the same financial year.

15. Captive companies' business is largely in the categories of workers' compensation and civil liability. Of 123 captives established in the Cayman Islands, 21 cover medical malpractice, 9 product liability, 26 general liability and property and 28 workers' compensation. The remaining 39 are more heterogeneous and are particularly active in reinsurance.

16. It must be stressed that quite a large share of the premiums reverts to the parent company in the form of dividends. The Ancon Insurance Company, for example, paid $US 55 million, about one-third of its gross premium receipts, to Exxon in the form of dividends for the financial year 1981. The repatriation of these sums to the United States is not essential in the case of transnational groups, although there are methods, which in tax terms are irreproachable, for repatriating such profits to the country of origin of the parent company. The enormous dividends paid by the captive to its parent company show that there is a two-way movement of the money which certainly deprives the international insurance and reinsurance market of part of its funds.

17. Outside the major groups, in which the volume of premiums is sufficient to justify the independent creation and development of a captive, the management of captives is generally entrusted to specialized companies, often offshoots of United Kingdom and United States brokers, which have developed at breakneck speed. Of the 63 interviewed by the United States magazine Business Insurance, 38 have been created since 1975 and only 5 existed prior to 1960; 21 are branches of brokers and some 12 belong to insurance companies.

18. There are 140 companies for captive management in Bermuda and 29 in the Cayman Islands (only 12 of which are locally established). The 56 companies reporting their number of clients to Business Insurance manage over 1,000 captives and 29 of them alone have an annual premium income of over $US 2 billion, or nearly three-quarters of the total volume of the world captive market. Among these 29 companies are the branches of major United States brokers. The branches of Marsh & McLennan in the Bermudas, Guernsey, Tennessee and New York, for example, managed a total premium income of $US 392 million in 1981. The branches of Alexander & Alexander established in the Bermudas and in Colorado managed premiums of $US 180 million. The two brokers, however, with the most outstanding activity in this sphere are Frank B. Hall (Bermuda), with some $US 400 million and, particularly, Johnson & Higgins (Bermuda, Cayman Islands, Colorado), with $US 456 million.

19. These major companies for captive management have, since 1980, been progressively installing highly sophisticated data-processing equipment so as to be able to deal with the pressing demand from their costumers, who require year-end accounts. This equipment can also provide a service to clients when, because of the size of their business, they organize an independent captive.

20. Contrary to widespread belief, the captive market does not charge inadequate rates. On the contrary, those in charge of captive companies complain that the traditional markets, particularly London and New York, have given rise to a dangerous decline in rates. This situation has reached such a point that on very compartmentalized markets like France and the Federal Republic of Germany some companies tempted to set up or "rent" a captive have temporarily refrained from doing so because of the low premium rates quoted for industrial risks on their own domestic insurance market.

21. It seems, however, that this situation should not affect the success, or at least the lasting nature, of the captive market, since the decline in rates should not last indefinitely. Insureds who currently have a captive know that they can use it when the time comes to induce traditional insurers to reduce their rates. The captive therefore also represents an alternative, should rates rise as spectacularly and suddenly as they dropped. United States insurers still remember the years 1974-1975, when the total deficit on the market amounted to $US 4 billion (compared with a profit of $300 million in 1973) and when dividends dropped from 12 per cent to 4 per cent, leading to tariff increases amounting to as much as 300 per cent, particularly in the case of medical liability cover.

Tax havens

22. The number of countries or territories in which captives are established has continued to grow since the early 1970s and appears to have been increasing rapidly for the past two years. There are currently 16 countries (soon to be 18), with about 1,562 captives, i.e. more than 12 per cent of the total number of insurance companies in the world. Bermuda accounts for more than two-thirds of this total, with 1,150 approved captives (some 100 of which are still inactive), followed by Guernsey (13), the Cayman Islands (123), the Netherlands Antilles (30), the Bahamas (20), Vanuatu (20), the Isle of Man (15), Panama (15), Gibraltar (10), Hong Kong (10), Cyprus (3), Singapore (2), and three States of the United States of America: Colorado (28), Tennessee (5), and Vermont (1).

23. Other countries are preparing to amend their legislation so as to be able to receive captives, notably Jersey and Mauritius. The latter actually adopted the "Export Services Zone Act" in June 1981 under which a tax of less than 10 per cent will be applied to profits derived from insurance of foreign risks. This law also exempts shareholders from all taxes on dividends for a period of 10 years. Various rules reinforcing the provisions of the Export Services Zone Act 1981 are envisaged in a bill which is expected to come into law in 1982.

24. The attraction of these countries as tax havens stems from several factors:

(a) They often have very liberal, special legislation governing captive companies, different from that applicable to local insurance companies;

(b) Appreciable tax benefits are granted, for example, exemption from taxes on premiums or profits;

(c) Conditions for approval are not demanding: low minimum capital stock, extremely low registration costs, no control or only very limited control of activities and in numerous cases the possibility of using a front.

25. The geographical situation of these countries has much to do with their success. Most of them are close to the major insurance markets (United States and London) and take advantage of the wave of business attracted by these markets. Thus, Guernsey lies in the shadow of the London market and could be selected by the American captives installed in Bermuda requiring a European base. These countries, however, must have satisfactory domestic and foreign means of communication and a well-developed urban infrastructure. This partly explains the predominance of Bermuda, the Cayman Islands and Guernsey over some of their competitors.

26. There have been two main trends in the development of the international market in captive companies: the desire of host countries to enhance financial and administrative control over captives established in their territory and the efforts made by the industrialized countries (especially the United States) to stem the flow of capital towards the tax havens. These two trends probably have a common origin - the concern of the industrialized countries to protect their economy against destabilization processes by taking a compromise line but also by putting pressure on other countries which live off their economies and by multiplying the obstacles to be overcome to have access to them.

27. The case of Bermuda illustrates the first trend. The 1978 Insurance Act, amended on 29 May 1981, provides for future control of the accounts of captive companies by the Government, which requires a margin of solvency and minimum amounts of reserves according to categories of risk. The new Act is very severe with regard to the establishment of technical provisions for product liability risks. The minimum capital of the companies has been raised and the use of fronts restricted or even suppressed. In addition, there is talk of making the international companies installed in Bermuda subject to the 5 per cent income tax already in force for companies of local origin. The administrative costs of the new control system, possibly increased by the tax on earnings, certainly increase the financial burden of the captives, and this could lead some of them to decide to leave Bermuda for other host countreis, particularly the Cayman Islands. This movement does not seem to have started yet, however, since 118 new captives settled in Bermuda in 1981 - a number equivalent to that of the two previous years.

28. The captives established in Guernsey are currently subject to a 20 per cent tax on their profits. The United Kingdom Government would like to abolish this tax reduction granted to captives, which has caused much consternation, that may well be not unconnected with the recent liberal measures taken by the Isle of Man, where the British brokers Hogg Robinson and Alexander Howden (A & A) have just opened management companies, and with proposals under consideration in Jersey for the same purpose. Although there is no formal financial control over captive companies in Guernsey, control is nevertheless exercised by consent of the captives and the island's Advisory and Finance Committee. A proposal is, however, under consideration for instituting a private approval procedure.

29. The companies competing with Bermuda and Guernsey are trying to take advantage of these changes by advertizing their desire not to amend their legislation or else by actually amending it in the opposite direction. In addition to the Isle of Man and Jersey, mention should be made of the Bahamas, where a bill aims at repealing or amending the Acts of 1969 and 1975 with a veiw to greater liberalization. In the Cayman Islands, the accounts of captive companies are controlled under the 1979 Act, but secrecy is strictly applied with regard to the identity of the founder member or members. Secrecy cannot be lifted without special permission from the local authorities.

30. The second trend is illustrated by the desire expressed by several states in the United States of America to take in captives (Colorado, Tennessee, Vermont, Virginia) or to organize on their territory insurance and reinsurance exchanges benefiting from administrative and tax advantages (New York, Illinois, Florida). These two endeavours have met with the refusal of the Internal Revenue Service (IRS) to consider the premiums paid to captives as tax deductible. This refusal by IRS is not particularly aimed at domestic initiatives ("onshore" captives) but concerns especially "offshore" captives. Since United States companies with captives very often deduct the premiums from their tax statements, the situation gives rise to many conflicts. It is estimated that 50 per cent of such companies have been the subject of a tax inquiry in the past five years. The movement would seem to have been aggravated still further by the desire on the part of the Administration to reduce the federal deficit. These inquiries have resulted in court cases that have aroused great interest, such as the case won by IRS against the Flowers Insurance Company of Bermuda, a captive of the Carnation Food Company. The case has, however, not given a clear answer to the basic question of whether a captive is an insurance company. This question will perhaps be answered by cases now being heard, such as those brought by IRS against Mobil Oil, Texaco Inc., Ashland Oil Company, Castle and Cook Inc., Ingram Corp., and Stearns-Roger Corp.

31. With regard to the attitude of European countries, the situation is very diverse and the problem of less significance, since the interests involved can hardly be compared with those in the United States. A distinction should be drawn between countries like the United Kingdom and the Netherlands, which do not recognize any domestic insurance obligation, and most of the other European countries, where this obligation exists (except in some cases for transport risks and major large exposures).

32. Numerous United Kingdom or Netherlands oil, industrial or trading groups have captives in Guernsey or other tax havens. This is the case, for example, of Imperial Chemical Industries (United Kingdom), whose captive, Chemical Insurance Holdings Ltd., is established in the Cayman Islands. British Petroleum, Shell and Philips also possess captives. Even the Roman Catholic Church (United Kingdom) has set up a captive in Guernsey under the name of National Mutual Company, which took part in insuring the various journeys made by the Pope.

33. This movement was joined by United Kingdom and Netherlands insurers and brokers, who rapidly settled in Bermuda and other territories. Transglobe Underwriting Management (Guernsey) is a branch of captive C.T. Bowring (M & M). Century Insurance Company (Bermuda) belongs to Phoenix (United Kingdom), and the Netherlands group Ennia is established in Curaço.

34. According to the professional press, which has devoted much attention to this matter, the United Kingdom Government is concerned at the risk of tax evasion involved, but taking an extremely cautious attitude, aware that the London market reinsures a large part of the world captive market.

35. The situation is not the same in the other European countries, where the idea of captives is very unfavourably looked upon by the authorities, where insurers and brokers practically all keep away from the captive market and where risk management in enterprises is only in its infancy.

36. In a country like France, which maintains strict exchange control, and where the administrative framework is so dissuasive, the importance attached to insurance problems in business enterprises is so slight that general management takes a rather conservative attitude and uses traditional insurance systems rather than forms of self-insurance as radical as captives. Nevertheless, a large French oil group has been able to set up a captive. It is probably not the only one, but the information available in this regard is obviously not being divulged.

37. The Federal Republic of Germany is to some extent a case apart, since industrialists have for many years been setting up captive brokerage bureaux (sometimes called pseudo-brokers) and federal law permits insurance "by correspondence". This form makes it possible for an insurer not approved in the Federal Republic of Germany to cover domestic risks, provided that no company providing services intervenes to place a tariff on the risk or to evaluate the loss.

38. It is, however, difficult to monitor observance of these provisions, particularly when the company already possesses a captive broker. In addition, the offending party is not subject to any penal sanction but only to a small administrative fine (paragraph 144 of the Insurance Supervisory Act).

39. The situation may, however, change considerably in the next few years. The exceptional upsurge which led to a restructuring of insurance demand in the United States is now occurring in Europe. Risk and Insurance Management Society (RIMS), an important United States association of industrial insurers, organized a conference in co-operation with all European associations of the same type; the conference was held in October 1981 in Monte Carlo with more than 500 participants. Since this upsurge corresponds to a real economic need, it is doubtful whether national administrations or protectionism on the part of insurers can oppose it to any lasting extent. An increase in insurance premiums in the near future seems probable in the traditional markets, so that before the end of the 1980s Europe will find itself in a situation in which the captives will have acquired their "right of asylum". Some countries, like Sweden, seem to have understood this and have drafted legislation accepting the establishment of "onshore" captives in their territory.

Captives and the third world

40. Captives may well seem far removed from the concerns of the third-world countries since they are an outgrowth of wealthy companies whose problems are those related to their wealth. These companies, however, are often active in the third world, and it is interesting to consider the effects of the captive market on insurance markets in developing countries. In addition, since the captives represent a reaction against the monopoly of an insurance industry whose activities have not always been profitable to these countries, it is also interesting to inquire whether the experience of developing countries is useful for a developing country which seeks to create a domestic insurance market. An analysis of the positive and negative effects of the captives on third-world insurance markets is therefore called for.

41. The positive aspect: In Europe, the development of industry and insurance has been parallel but separate. Insurers had contacts with industry from the outside and endeavoured to structure supply in terms of what they understood to be its needs. For their part, industrialists, faced with considerable technological and social

problems, took no interest in insurance, nor even in defining their insurance needs. This gap between the insurer and the insured was filled by a complex arrangement of the terms of the insurance contract, which sometimes gave rise to lengthy discussion. For a long time insurance was more a question of law than a technical problem. The legal department occupied a much more important position than the sales branch. This situation has hampered efforts to modernize European insurance.

42. The development of captive companies, far from being a secondary phenomenon, is the result of a basic fact: the synthesis of insurance and industry, of insurance supply and demand. All the major world markets must henceforth take this situation into account and adapt to it.

43. It seems essential that third-world countries which are starting out in insurance and where insurance is not handicapped by its past history should be aware of the restructuring in progress in the industrialized countries. It would be an anachronism to build up a domestic insurance industry on more or less outdated bases characterized by excessive legalism.

44. It can thus be concluded that for those third-world countries which already possess an industrial and trade infrastructure it could be of interest to take advantage of this investment to set up an industrial risk market, the main task being to ascertain their own needs and define demand so as to attract a satisfactory supply. The establishment of domestic captives could in some cases be worth consideration.

45. While these comments can probably be applied to the insurance of industrial and trading risks, this is less so for private risks, particularly motor vehicle risks, where the protection of the insured is generally a matter for the State, whose only instrument for achieving its ends is legislation. Even in this case, however, the attitude of starting from analysis of the risk and not from an existing body of law remains valid. This technical approach to motor vehicle insurance has taken the form in some industrialized countries, such as some states of the United States of America and in Sweden, of the introduction of a "no-fault" system and generally speaking in an increasing number of countries (Switzerland, Denmark, United Kingdom) of the institution of an Ombudsman in order to facilitate the settlement of claims and minimize recourse to the courts.

46. The negative aspect: Traditionally, the question of insurance is dealt with during the negotiation of major industrial contracts (engineering, transport, etc.). In countries where there are export credit insurance bodies (such as COFACE in France, Hermes in the Federal Republic of Germany or Ducroire in Belgium), the exporter endeavours to sell c.i.f. so as to obtain the guarantee provided by these bodies. For exporters from countries where there are no such bodies, insurance is generally the object of a skillful arrangement by the brokers in which an insurance company from the importing country creates a front so as to satisfy local insurance requirements but where in actual fact the risk is covered by international reinsurance.

47. For the exporter, the interest of this system is not a direct one, since the transaction takes place between partners that are financially separate from him. On the other hand, his interest is direct in so far as his lack of trust in the solvency and quality of domestic insurers leads him to approve any form of cover whereby these shortcomings are rendered less serious. Logically an exporter with a captive also has a direct interest, since he is financially involved in the insurance transaction. A strict application of compulsory domestic insurance would mean not

only an inferior guarantee but also reduced business for the captive. It therefore seems, a priori, that captives should strengthen the determination of the exporter to support a system which keeps the insurance markets away from developing countries.

48. It should also be noted that in most cases (regardless of whether the exporter has a captive) it is the brokers who organize the insurance programme. Management of the captives is often entrusted to these brokers, and the exporter approaches them to associate its captive with the cover of an export risk. In this situation, the role of the captive seems to be more that of an additional instrument in the broker's commercial armoury than a means of pressure in itself.

49. For the developing countries, the negative aspect of captives relates less to their nature than to their function in the strategy of the major international brokers. On this matter there is no information which could justify the assertion that the strategy of the brokers has evolved adversely because it now includes a desire to develop the captive companies of their clients.