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INSURANCE IN DEVELOPING COUNTRIES: AN ASSESSMENT AND REVIEW OF DEVELOPMENTS (1989-1992)

<u>**Report by the UNCTAD secretariat**</u>

CONTENTS

ABBREVIATIONS

AIO	African Insurance Organisation
ALADI	Latin American Integration Association
ASEAN	Association of South East Asian Nations
CACM	Central American Common Market
CICA	Conférence International des Controleurs d'Assurance Africains
CIMA	Conférence Interafricaine des Marchés d'Assurance
EAIC	East African Insurance Conference
ECOWAS	Economic Community of West African States
EEC/EC	European Economic Community
ESCAP	Economic and Social Commission for Asia and the Pacific
FAIR	Federation of Afro-Asian Insurers and Reinsurers
FIDES	Federaciçn Interamericana de Empresas de Seguros
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IAA	Institut Africain des Assurances
IIA	Institut International des Assurances
IIAP	Insurance Institute for Asia and the Pacific
IMF	International Monetary Fund
ISTS	Instituto Superior Technologico en Seguros
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economical Co-operation and Development
PTA	Preferential Trade Agreement
TWIC	Third World Insurance Congress
UNESCO	United Nations Educational, Scientific and Cultural Organisation
UNDP	United Nations Development Programme
WAII	West African Insurance Institute

INTRODUCTION

1. The eighth session of UNCTAD, held in Cartagena in February 1992, resolved to give a new direction to the work of UNCTAD as expressed in the Cartagena Commitment (TD/364). Following the new approach adopted by the Conference, it was decided to suspend the existing main Committees of the Trade and Development Board, including the Committee on Invisibles and Financing related to Trade (CIFT), one of whose two sessions was devoted to insurance. The work on insurance is to be incorporated in that of the newly created Standing Committee on Developing Services Sectors: Fostering Competitive Services Sectors in Developing Countries. In implementing the decisions of UNCTAD VIII, the Trade and Development Board, at the second part of its thirty-eighth session, adopted the terms of reference of the Standing Committee (Board decision 398(XXXVIII)).

2. Paragraph 4 of these terms of reference applies to insurance, asking the Committee "to analyse prospects for developing and strengthening the insurance sector and enhancing the trade of developing countries in this sector." In addition, paragraph 1(a) of the terms of reference asks the Committee to focus on a "review of the development of services sectors in developing countries and comparative analysis of policies, including identification of domestic weaknesses and capabilities, aimed at creating the conditions necessary for the development of competitive service sectors and export of services." The preparation of the present assessment and review is in line with this objective.

3. Some of the data used for the preparation of the review were supplied to the UNCTAD secretariat by the Governments of developing countries in response to a request made by the Secretary-General of UNCTAD. Other information has come from papers presented at international insurance conferences and meetings, which have been made available to the secretariat. Much of the information has been taken from trade journals and periodicals. The coverage of countries included in this survey has therefore largely depended on the information available in the professional press. It has of course not been possible to verify the accuracy of the information obtained in this way. Also, some of the information may be outdated and superseded by new developments by the time the review is published. It should be noted that when reference is made to specific insurance problems of developing countries, the statements made often apply only to a certain number of countries and not to all of them, since they are at different stages of development. Some problems may also be more widespread in one region or on one continent than elsewhere.

4. The report is an assessment of the insurance markets of developing countries with particular reference to the problems faced by them, and a general review of developments that have taken place during the period under review. Chapter I deals with the functioning of insurance markets and their structural development. Chapter II deals with insurance regulations and supervision. Chapters III, IV, V, VI and VII review the specific insurance lines of life, motor, fire, marine and transport, and export credit, political risks and other insurances respectively. Chapter VIII discusses offshore and captive insurance markets. Chapter IX discusses the important issue of insurance for natural catastrophes. Chapter X considers reinsurance in regard to developing countries. Chapter XI deals with international co-operation in insurance matters.

Chapter I

PROBLEMS AND NEW DEVELOPMENTS AFFECTING INSURANCE

A. Introductory remarks

1. The problems affecting the functioning of insurance markets can be classified into two categories. The first category consists of problems arising from factors external to the insurance sector and relating to the general economic environment. The second concerns problems related to the practice of insurance itself, such as those deriving from a specific market structure, the level of skills and expertise present in the sector, underwriting factors and those relating to the evaluation of losses and settlement of claims.

B. Problems related to the general economic environment

Growth of insurance markets

2. The development and growth of the insurance sector in a country depends on the general level of economic development and on economic prospects in the immediate future. Generally, there is a positive correlation between the economic development of a country and the amount people spend on insurance. In addition, the demand for insurance is influenced by the general price level, prices of insurance services, the aversion to risk and the specific social and political features of a country. 1/

3. From table 1 it can be seen that the share of developing countries in world total insurance increased from 3.9 per cent in 1988 to 4.5 per cent in 1990. This increase is accompanied by contrasting performances in individual regions, subregions and even countries. While Africa's share declined by more than 23 per cent, mainly due to the decreasing premium volumes in the Northern African countries, the share of Asia grew by 26 per cent, mainly due to sharp growth in premium volumes in the Republic of Korea and in the ASEAN countries. Latin America's share, after a sharp fall in 1989, recovered somewhat to its previous levels. Changes in premium volumes were generally in line with the economic performance of the different regions, subregions and countries.

4. In Thailand in 1989, direct written premium grew by 39.4 per cent for non-life insurance following the strong economic boom. 2/

5. In Malaysia in 1989, the total written premium increased by 10.4 per cent while the GDP grew by 8.5 per cent.3/

6. In the Republic of Korea in 1990, direct premium income in the non-life sector grew by 36.1 per cent for the whole year. 4/

Inflation

7. A high level of inflation is a factor of great concern to the insurance industry in a number of countries. Conditions of high inflation result in premium levels being depreciated in real terms and create numerous problems for insurance companies. Very high levels of inflation or hyper-inflation may even render insurance inoperative in certain cases.

8. In Argentina, where the economy was characterised in the last years of the 1980s by hyper-inflation peaking at 200 per cent a month in 1989, the value of insured properties could not be adjusted because there were no indexes that could predict price increases. For example, in the motor insurance branch in 1989, despite the fact that policies were invoiced every four months, a car's replacement value estimated a month before could not be used a month later as a reference to estimate the total loss value, since that value would have been less than 50 per cent of a similar car's actual price tag. As a consequence the premiums charged were insufficient. 5/

Table 1
Total insurance business

Regions/subregions Countries	Premium volume in US$ billions 1988	1989	1990	World share in % 1988	1989	1990
World - Total	1,171.0	1,210.0	1,355.7	-	-	-
Developing countries:	46.0	50.9	61.8	3.94	4.20	4.56
of Africa	3.9	3.8	3.5	0.34	0.31	0.26
North Africa (Egypt, Lybian Arab Jamahiriya Tunisia, Algeria and Morocco)	2.2	2.0	1.7	0.19	0.16	0.13
Sub-Saharan Africa	1.7	1.8	1.8	0.15	0.15	0.13
of Asia:	33.5	40.0	48.9	2.86	3.31	3.61
ASEAN countries	3.8	4.6	5.6	0.33	0.38	0.42
India	2.7	2.6	2.8	0.23	0.21	0.21
China	3.5	3.6	4.6	0.30	0.32	0.34
Rep. of Korea	16.5	21.3	27.4	1.41	2.02	2.02
of Latin America:	8.6	7.1	9.4	0.74	0.58	0.70
Mexico	2.0	2.3	2.6	0.17	0.19	0.19
Brazil	1.0	1.2	2.5	0.09	0.10	0.19
Argentina	1.6	0.3	0.9	0.13	0.03	0.06
Venezuela	1.7	0.7	0.8	0.15	0.06	0.06
Chile	0.5	0.6	0.7	0.04	0.05	0.06

Source: SIGMA, Swiss Re. April 1990, February 1991, and April 1992.

9. In Peru, the inflation rate, running at 2,000 per cent in 1988, as well as the distorted foreign exchange rates made it increasingly difficult for insurers to provide cover in real terms. New regulations were adopted in December 1989 authorising the use of US dollars specifically for insurance. It was expected that almost 90 per cent of the policies would be changed to US dollar denomination.6/

10. In Guinea, it was reported that currency devaluation and inflationary tendencies constituted one of the basic problems of the insurance industry. 7/

Development of financial markets

11. The inadequate development of financial markets and a lack of opportunities for safe, liquid, and well-diversified investments that yield reasonable returns inhibit the development of competitive insurance services, in particular life insurance.

12. In Senegal, insufficient investment opportunities for premiums that would be generated are the central problem hindering a stronger development of life insurance. 8/ The lack of investment opportunities has even led some to argue that the principle of domiciliation of reserve funds should be reconsidered, and that life insurance companies in developing countries should be able to "invest outside their markets in order to guarantee their customers returns similar to those of their European competitors". 9/

Foreign exchange problems

13. The perennial problem of the lack of foreign exchange continues to affect insurers in certain developing countries. In most of these countries exchange régimes are established to control and regulate the outflow of funds in hard currencies. These regulations take the form of restrictions on the remittance of funds abroad, including insurance and reinsurance premiums. Many insurers find it difficult to honour their obligations because of these regulations.

14. In Africa, insurers experienced many difficulties as a result of delays in obtaining the necessary allocation of foreign exchange for the settlement of reinsurance balances. In some cases these delays were due either to a lack of the required foreign exchange, bureaucratic factors, or difficulties in complying with the

stringent regulations imposed by the relevant exchange control laws. In each case, the ceding companies in these markets were not able to pay their overseas reinsurers. The reinsurers in turn reacted by imposing stringent conditions and restrictive reinsurance terms, such as the unpopular premium payment warranty, which are generally detrimental to the interests of African ceding companies. Some international reinsurers reacted by raising the cost of reinsurance cover to abnormally high levels or by imposing high interest on reserves, while others refused to settle claims or to meet cash-loss requirements. 10/

15. In the Philippines "the difficulty in obtaining foreign exchange to service reinsurance obligations is one of the immediate problems and will be further complicated and accentuated by the recent reduction of remittances from the Philippine workforce in the Middle East, caused by the Gulf crisis." 11/

16. At an UNCTAD/UNDP Reassessment Workshop of African Insurance and Reinsurance held in Casablanca, Morocco, in October 1990, a recommendation specifically mentions that "African Governments should relax foreign exchangeregulations in respect of reinsurance operations". The problem of foreign exchange is of particular acuteness when dealing with large and sophisticated risks, as they are usually insured abroad, as well as in respect of marine insurance and reinsurance, where recourse is sought from overseas markets. Suffice it to say here that the problem of foreign exchange needs to be considered in the larger context of fully utilizing existing national and regional capacities.

Global approach to the financial services sector

17. Another development in the international insurance scene is the move towards an integration of banking and insurance in the financial services sector. This trend has also been observed in some developing countries. In these countries insurance activities are integrating with other sectors of financial services. Banks are moving into insurance activities and insurers are offering bank-related services.

18. In Mexico, insurance entities may be integrated in general depositories, financial leasing institutions, factoring institutions and other financial activities. 12/

19. In Nigeria, free personal accident insurance cover is being offered by two banks. Certain insurers are complaining, but the banks say that they are only acting as agents for insurance companies. 13/

20. In India, both the Life Insurance Corporation and the General Insurance Corporation have extended their activities by establishing subsidiary companies dealing with housing, finance and mobilisation of savings through mutual funds. 14/

21. Privatization of insurance enterprises and liberalization of insurance markets are taking place in a large number of developing countries. These developments have a significant effect on the insurance sector. In view of their importance, a separate document deals with these subjects in depth.

C. Problems related to insurance practice

The structure of insurance markets

22. While the establishment of domestic insurance markets was the prime concern in earlier periods, in recent years attention has been devoted to the structural characteristics of insurance markets and their satisfactory functioning. Changes in the structure of insurance markets are influenced by developments and reforms in the general economy and by specific action by government authorities in the field of insurance. In particular, with the privatization and liberalization of insurance markets, market efficiency and performance are receiving greater attention than in the past.

23. Two opposite but not necessarily contradictory trends are discernible. On one hand, monopolistic and oligopolistic market structures are being broken up. On the other, the view that fragmented markets, in which a multitude of small companies operate often under conditions of cut-throat competition, cannot provide the

high-quality and reliable services required by a modern economy is gaining ground. A higher degree of concentration may therefore increase their efficiency.

Concentration of markets

24. In a number of developing countries there has been a realisation that emphasis should be placed on increasing market efficiency and the provision of better insurance services apart from efforts to expand business volume. It is felt that it is in the interest of customers to have fewer but stronger companies, not least because the latter would have a better long-term financial viability. It has been observed that "a higher concentration in the market could be achieved either through government intervention or as a result of market forces. Government action would entail a stricter supervisory system and higher capital and reserve requirements, thus obliging weaker companies to merge. Higher concentration could also be a consequence of policies aimed to strengthen market forces. In a competitive environment insurers with superior efficiency would offer products at better prices and a selection process would occur enabling them to improve their market share." 15/ This might lead to increased benefits of economies of scale and might improve the insurers' capacity to finance product development. The solvency status of these insurers might also be of a higher rating. At the same time, concentration would not preclude commercial possibilities for smaller companies to successfully function in niche markets specializing in specific lines of business. In fact there is a difference between a "concentrated" market where companies act in a competitive environment, which ultimately benefits the consumer, and an oligopolistic market where companies act in a collusive manner (cartel), whereby the interests of the consumer are not taken into account.

25. In Chile the number of companies at the end of the 1980s was roughly one-quarter the number in 1980 when the market was liberalized. 16/

26. In Argentina the market of 230 private and government insurers is fighting hard to live with the overall premium estimated at about US$1.5 billion. 17/

27. Several country notes concerning the concentration of insurance markets follow:

Argentina: The 15 largest insurers (out of 230) wrote 50 per cent of the total premium. 18/

Brazil: The 10 top companies have a 72.8 per cent share of the market, and compared with figures for the early 1980s, concentration is a growing reality. 19/

Chile: 80 per cent of the Chilean insurance markets is dominated by eight companies, but there is no cartel and there is rather a high level of competition in the market. 20/

Mexico: In the non-life sector, 76.36 per cent of premium was produced by the six major companies. 21/

Philippines: The Commissioner of Insurance is reported to have stated that the top four companies wrote more then 75 per cent of the total premium income in the life sector. In the non-life sector, 25 companies wrote 70 per cent of the net total premiums, while the remaining companies are too small to compete and are actually not contributing to a competitive business environment. 22/

United Arab Emirates: Plans are being drawn up by the Ministry of the Economy to encourage mergers as the Emirates Insurance Association deems that there are too many insurance companies for the existing volume of business. 23/.

Zimbabwe: Three Zimbabwean insurers will merge to form one company. The new company is expected to reap the benefits of economies of scale and provide a better use of resources and skills. 24/

Singapore: The Insurance Commissioner has recommended to local insurance companies that they consider merging into larger entities for the benefit of both shareholders and insurance consumers. 25/

Insurance awareness, professionalism and training of staff

28. Insurance professionals in most developing countries have been complaining about the lack of insurance awareness in the general public. Despite the growth of business in recent years and the increasing importance of its economic role, the insurance industry has been suffering from an image problem. One of the reasons for this situation may be a mistaken perception or a misunderstanding about the role of insurance. Another could be the tendency on the part of the insurance industry to focus on short-term interests. High pressure to sell covers and insufficient emphasis on customer service may also be contributory factors. In his report to the above-mentioned African Insurance Reassessment Workshop in Morocco, a participant said that "it is unfortunate to note that no African ever sets out, on his own, to purchase insurance cover. He has to be prompted to do so by either his bank, lawyer or the insurance salesman, who is generally regarded as a nuisance. Apart from the general lack of insurance awareness, the industry suffers from the problem that in most African countries insurance has a very poor public image." 26/ The same Workshop concluded inter alia that it "regretted the general lack of insurance awareness in African countries and affirmed that it was of utmost importance that such awareness be enhanced so that the insurance sector could play more fully its vital economic and social role." It was also recommended that "national insurance associations should play a greater role in improving the public image of insurance, enhancing insurance awareness, self-regulation, establishing codes of conduct and in improving the relations between the industry, the public and the authorities."

29. During a seminar on motor insurance for the staff of ASEAN supervisory authorities, held in Kuala Lumpur in November 1991, it was reported that policyholders often did not present a claim for damages suffered because of a lack of awareness or unsatisfactory past experiences with the system. 27/

Public image of insurance

30. There is no single prescription as to how to enhance the public image of insurance, and a multi-dimensional approach might have to be adopted. Depending upon the specifities of the country situation, some of the strategies would be identification, assessment and analysis of the real insurance needs of potential clients, improvement of product design, efforts to explain the obligations of the insurer and the insured, improvement of the claims settlement procedure, and particularly a reduction of claims processing time.

Human resources development

31. Professionalism and the motivation of people working in the insurance sector will be a crucial factor. Increased emphasis on education in insurance subjects through well-devised training programmes will be necessary to improve the skills of the personnel.

32. Insurance companies have generally come to realize that the ultimate cost of not systematically training their personnel to match expected standards could be very heavy at a time of rapidly increasing competition and consumer expectations. Efforts have, therefore, been made to set up training programmes and develop, upgrade and diversify training modules for different categories of personnel. Apart from the general staff, agents and the field force have also begun to receive training in order to increase both their product knowledge and marketing skills. Many training centres have started to organize programmes for the managerial cadre, particularly the middle management. The curricula include, apart from insurance, subjects on general management and behavioural science. General managerial aspects have also been included in training programmes organised for senior personnel. The participation of senior managers in programmes for the junior staff would help promote professionalism and corporate culture. This should result in better team work in the office and may improve client service .

33. A seminar on Human Resources in the field of Insurance held in Lisbon in November 1990 made inter alia the following recommendations:

- Human resources development (HRD) responsibilities should be dealt with at the top management level;

- The HRD manager should take advantage of all opportunities to improve the industry's image with a view to encouraging better quality recruits;

- The insurance industry should be convinced that investment in HRD and adequate training capacities will provide benefits to the entire industry and a positive return on its investment. 28/.

34. In the Arab/North African countries the "insurance industry and market have as basic characteristics .... a general shortage of skilled insurance professionals ..." 29/

35. The representative of Guinea to the African Insurance Reassessment Workshop in Morocco reported that one of the basic problems of the insurance sector in Guinea was a weak penetration of the market and a lack of insurance professionals. 30/

36. In the Philippines, one of the immediate problems facing the insurance industry is to develop technical qualities and abilities. 31/

37. In Malaysia, guidelines on duties and responsibilities of Directors and Chief Executives of insurers were issued to emphasize the need for insurers to be governed by professional and dedicated directors. A directive was issued requiring all insurers to spend at least one per cent of their previous year's gross salary cost on training to develop human resources to meet the increasing demand for suitably qualified and more professional manpower. Any shortfall below the minimum one per cent would have to be compensated by a payment into an Insurance Training Fund which is to finance training and education programmes for the benefit of the industry. 32/

38. It is reported that in Nigeria, "a code of ethics and practice for the Nigerian insurance industry" was introduced in 1991. The code was drafted by the insurance industry as a measure of self regulation.

39. In Lesotho, determined efforts have been made to reduce the country's dependency on expatriate professionals and experts in general, especially in the insurance industry. A principle was introduced to the effect that if there is no national counterpart being trained to take over from an expatriate manager or expert within a reasonable time span, then the said manager or expert would not have his working permit extended. 33/

40. The 1990 African Insurance Reassessment Workshop in Morocco recommended inter alia "that supervisory authorities should verify the honourability and competence of insurance managers."

Problems in insurance underwriting

41. In the area of underwriting, problems common to a number of developing countries include difficulties in the collection of premiums, inadequate rating systems, cash-flow underwriting, the practice of discounting and problems related to the level of commissions payable for acquisition. Another major problem is the lack of statistical data needed to establish a sound rating structure. A statistical data base would also be a good management tool.

Premium collection

42. The problem of premium collection has become serious in a number of countries. The preoccupation of many insurers with increasing their business volume led to insurance covers being sold to clients who were not able to make timely payment of their premium. The immediate consequence to the insurer was inadequate cash generation.

43. In Nigeria, the amount owed to the insurance companies by brokers, agents and policyholders as of 1988 was approximately 40 per cent of the annual premium of the market. 34/

44. In Cameroon, it is deemed that the amounts owed by clients and brokers would represent 70 per cent of the turnover. 35/

45. In Senegal, several companies are having difficulties caused by the non-payment of premiums, mainly in the agricultural sector. The increase of premium arrears is between 40 and 60 per cent. 36/

46. In Turkey, the collection of premium is a major problem in the insurance industry, with more than 45 per cent of the total premium overdue. This is creating tremendous cash flow problems for Turkish insurers. 37/

47. Extending grace periods for the payment of premium by agents is a method used by some underwriters to try to encourage agents/brokers to secure more business. Nonetheless, granting delays in premium settlement can be an unsound marketing strategy. 38/

48. The principle of no-premium-no-cover has already been in existence in a number of countries, and there is a trend for its extension.

49. Such a system was introduced in Kenya in 1988 and has had a remarkableeffect on the liquidity and cash-flow of companies operating in Kenya. The conclusions of the Reassessment Workshop on African Insurance in Morocco recommended the introduction of the concept of "no-premium-no-cover".

50. It is reported that the new insurance decree in Nigeria, taking effect in 1992, specifies "no-premium, no-cover".

51. In Peru, a new regulation requires payment of premiums within a maximum of 20 days, plus bank interest, for policies in local currency. Policies written in US dollars can be paid in six-monthly quotas after making a 50 per cent down payment. The measures are aimed at restoring liquidity to insurers and minimising the effects of inflation. 39/

52. In Morocco, following the decree of 10 November 1989, any premium or portion of a premium must be collected within a maximum of 30 days from its due date. This new premium payment requirement is designed to reduce to reasonable levels the sums owed to insurance companies by intermediaries. 40/

53. In Malaysia, with the introduction of the "cash before cover" principle, a cover note is issued only after premiums are collected. In this connection it may be pointed out that introduction of the principle of no-premium-no-cover may need to be supported by a set of guidelines on issues such as the point of time when the premium actually becomes payable and under which conditions it is allowed to be paid in instalments (e.g. Marine Hull and Construction All Risk insurance), and under which circumstances the determination of the premium depends upon inspection of the risk and consequently cannot be quoted immediately (e.g. multiple and complex risks).

Rating systems

54. Another major problem area in the insurance markets of certain developing countries is reported to be the rating system. Controlling the rates to be charged through tariff systems has prevailed for various reasons. Social considerations, such as protecting a particualr category of clients, have sometimes been the motivating factor. More important, however, has been the perception that individual companies may not have the expertise to set fair and adequate rates. Furthermore, in the absence of statistical data, they may not be in the position to set rates which would properly reflect risk exposure.

55. In the wake of liberalization and deregulation, some countries have been giving up the system of tariffs on the grounds that customers would derive benefits from more competitive rate-setting. Despite the envisaged opportunities for many markets arising from such a development, giving up tariff rating would have a number of problems. First, there is concern whether small and struggling companies would not damage the market by unduly undercutting rates merely to gain some ground, without taking the long-term implications of such a policy into account. Second, the absence of statistical data on loss experiences may make individual rating a subjective matter. Consequently, tariff rates for broad categories of risks based on overall market experience may be more appropriate. Third, deregulation may favour clients with large commercial risks to the disadvantage of individual clients with small and "mass" risks. Consumer movements in many developing countries are either non-existent or weak and the establishment of terms and conditions for "mass" risks may yet require some monitoring by the authorities in respect to both product content and premium.

56. In many countries, tariff rates have not been revised and updated, even insome extreme cases for as long as 20 years, particularly for compulsory classes of business such as motor third party insurance. Furthermore, compulsory insurance is more often perceived as an imposition or a tax rather than as a service. Thus, the public is very sensitive to variations in rates. Since the compulsory part of motor insurance constitutes a significant part of the total premium income, high-loss ratios in this department put a heavy strain on insurance companies. However, in some countries the insurance industry has been unable so far to rally sufficient support for an upward revision of tariffs, partly because of its inability to substantiate the basis of its proposals with sound and detailed arguments, and partly because profits were still made on the aggregate. It is sometimes contended that when an overall profit is still made for all classes combined and high acquisition costs are still incurred, low rates for certain classes imply that rates for other classes are high. The insurance industry has often been unwilling to adjust rates downwards in lines where results were favourable. It is obvious that in such situations a sectoral adjustment of the rating structure may have to take place sooner or later. This could be achieved through the introduction of a more competitive environment or through a well planned and calculated strategy of reviewing all sections of the tariff structure.

57. Nevertheless, in the context of the process of deregulation, many countries are considering the abolition of tariffs. In less developed insurance markets, it is particularly important that the interest of the small and individual client be kept in view. The increase in competition associated with privatization and liberalization policies may lead to a situation where insurance companies offer a wide variety of covers with marginal differences and varying prices, whose terms and conditions are difficult to compare for consumers who may not have sufficient experience in purchasing insurance and who would find it difficult to make a rational choice. It may therefore be advisable to develop unsophisticated simple covers with standardized features which would respond to the needs of a large number of clients. It will be easier to work out simpler and more straightforward loss assessment and claims settlement procedures for such covers. This would also speed up claims payments. Such covers would also simplify the task of supervisory authorities in monitoring the adequacy of the insurance services provided. All this would help in building up consumer confidence in insurance.

Enforcement of tariffs

58. In countries where tariffs and rating systems are applied, their enforcement is often a problem. The fact that in practice many breaches of tariff rates take place, and that it is difficult to enforce their strict observance, is often advanced as an argument for their abolition.

59. In Puerto Rico discounts of up to 70 per cent below the minimum tariff are being offered on property/casualty policies, openly breaking the law to maintain market shares. It is felt that the capacity of many companies to meet future obligations has been severely impaired by uneconomic rates. 41/

60. It is reported that in some African markets, there is a lot of rate-cutting, with the weak and so-called mushroom companies outdoing the bigger and better managed companies in the rate-cutting war. Since the mushroom companies have no intention of paying any claims, they have no difficulty in applying low and unrealistic premium rates, to the detriment of the insurance industry. 42/

61. In the markets of the ASEAN countries, "not so easily detectiblepractices" such as granting of higher commissions, no-claims discounts and even subsidisation of costs of selective overheads for agents or intermediaries have been noticed. Their purpose is to reward agents for securing larger shares of the market. 43/

Cash flow underwriting

62. In recent years a number of insurance markets in developing countries have suffered from reckless "cash flow underwriting". This takes the form of acquiring business for the sole purpose of deriving short-term benefits from the cash generated. This is often done by incurring disproportionately high aquisition costs, heavily undercutting premium rates and disregarding sound underwriting principles. This practice not only endangers the long-term viability of the insurer but also affects the insurance market as a whole. It often induces price wars which sounder and more responsible companies are sometimes forced to follow. 44/ The practice may also impair the building-up of sufficient reserves and thus impinges on the medium to long-term solvency of the companies involved.

63. In this context it should be recalled that part of the funds held by insurers consist of technical reserves which in a way belong to the policy holders, and returns derived from the investment of these funds would justifiably have to be passed on to them. This objective may be achieved by judiciously including an element of expected yield on technical reserves in the rating structure.

64. In Argentina, "low retention and high commissions have encouraged cash flow underwriting. A number of companies were retaining so little on loss-making lines of businesses, passing on costs to the state-owned monopoly reinsurer, that they were simply transferring problems." 45/

65. In Chile, fierce competition leading to a cut-throat price war over market shares has resulted in a number of companies having operating losses. However, underwriting losses are easily offset by good returns on the stock market. 46/

High acquisition costs

66. In several developing countries it was found that acquisition costs were too high.

67. In Pakistan, it has been argued that agency commissions should be limited to 10 per cent. 47/

68. In Tunisia, the allowed commission to agents soliciting motor insurance cannot exceed 8 per cent for passenger vehicles and 9 per cent for other motor land vehicles. Insurance companies are not allowed to pay more than 5 per cent of their net premium to agents as commissions. 48/

69. In Turkey, the Government fixed at 30 per cent the maximum commission on agents' registration fees and sharpened qualification criteria for agents. 49/

Statistical data base

70. Insurance is based on the theory of probability and the law of averages, which makes a sound statistical base vital for the operation of insurance companies. Even so, this key aspect has not been given sufficient importancein a number of developing countries. In several countries, efforts have been undertaken to collect statistics through insurers' associations, but the situation has been far from satisfactory.

71. The insurers associations of Malaysia, Singapore and the Philippines are trying to maintain a data base of motor statistics based on data from their respective members, but have found that some companies do not submit replies whilst in other cases the replies are so poorly completed that the statistics "are useless." 50/ In some cases efforts have been made to integrate the collection of statistics with the routine work of document preparation. Instead of preparing separate statements for statistics, the latter are picked up directly by the computer operator from copies of the original documents.

Problems in the area of claims

72. One of the causes for the poor image of the insurance industry is a general dissatisfaction with claims settlement. The expeditious and fair settlement of claims is one of the most important competitive tools available to insurers since the consumer's judgement of the quality of services rendered is primarily based on the ability to handle claims efficiently. In addition, delays in settlement of claims may increase the ultimate liability of insurers, inter alia due to the inflationary factor.

73. Delays in settlements may be caused by the insurer himself, due to a lack of expertise or skills in the company, insufficient staff in the claims department or by the overall deficiencies in the claims settlement system, such as a lack of co-operation from public agencies (e.g. police, fire department, etc.,) in providing corroborative evidence. The judiciary is often overburdened. The lack of expertise, low remuneration and an insufficient number of claims surveyors and loss assessors is another important factor. Ignorance and often illiteracy on the part of the client, coupled with failure to fully document claims, further complicate the situation.

74. Delays in settlement may also be unfair. The beneficiaries in developing countries normally do not have other resources on which they can depend until the claim amount is received. Moreover, interest is not paid on the claim amount for the period of delay. It may, however, be noted that in some countries courts have started awarding interest payments on the claim amount for delays.

75. While administrative inefficiences and lack of co-operation from public agencies are often the cause of delays in the settlement of claims, delays may also be due to cash flow problems or, in more serious cases, solvency problems in the company.

76. In the Philippines, "a new regulation is pending enactment which qualifies as a criminal act the failure or refusal of an insurance company to settle claims within the prescribed period." 51/

77. In Colombia, the new law of December 1990 stipulates inter alia "that claims must be paid or be objected to in "a serious and reasonable manner" within one month, and this obligation is unaffected by any reinsurance contract". 52/

78. In order to ensure consumer satisfaction it is necessary that systems areinstituted which permit a review of representations and the redressal of client grievances in respect to settlement of claims. It would be harmful for the reputation of the insurance industry if it allowed an impression to be formed that insurance companies try to save on claims, knowing that the insured will find it difficult to go to court and get the matter set right.

79. In the Philippines, the Insurance Commissioner called for the appointment of an insurance claims ombudsman to allow policy holders additional recourse against insurers, if they are dissatisfied with their claims settlement. 53/.

80. In Trinidad and Tobago, it was reported that the establishment of an insurance ombudsman is under consideration. This proposal was favoured by 70 per cent of the general insurers, but protested by 80 per cent of life insurers. 54/

Fraud and thefts

81. A problem faced by many insurance companies in settlement of claims is the increasing incidence of fraud and thefts.

82. In Liberia, fraudulent fire claims have caused many insurers to withdraw from this line, while those remaining are profiting by charging very high rates. 55/

83. In Rwanda, road transport is vulnerable to banditism. 56/ To prevent and combat fraud and theft, insurers in some countries are setting up prevention schemes and statistical collections are made on both losses and fraud.

84. In Malaysia, an industry-wide data base is currently being promoted by the Association of Insurers to curb the trend of rapidly deteriorating results, in part due to a growth in the number and size of fraudulent claims. To combat fraud, all insurers should take direct responsibility for detecting fraudulent claims. 57/

Loss assessment and survey

85. Loss assessors and surveyors play a pivotal role in the settlement of claims. By their acts of omission and commission they could be responsible for both delay and customer dissatisfaction. An increased level of professionalisation of this cadre may, therefore, be essential for the growth of the insurance sector. While basic insurance training has been more or less available in a number of developing countries, in many countries no training for loss assessors and surveyors is available.

Judicial procedures

86. Another problem prevalent in many countries is their overburdened judicial system. The experience in some countries has been that it can take a long time, in many cases up to 10 years, for a legal process to be completed. Some countries have tried to cope with the situation by increasing the capacities of the courts, and by instituting systems of arbitration for pending cases of compensation to motor accident victims.

87. In India, the institution of informal arbitration proceedings called LOK ADALAT (People's Court) has made it possible to settle a large number of pending cases and to substantially reduce the time between occurence of an accident and payment of compensation. This period has been reduced to no more than two to three years. This scheme has been supported by the judiciary.

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Chapter II

INSURANCE REGULATION AND SUPERVISION

A. Role of supervisory authorities

88. Insurance companies are an important part of the financial system in developing countries. It is therefore necessary to ensure their stability so that public confidence in the institutional financial structure of the country is maintained. Supervisory authorities, as the executive arm of the Government, have an important role in ensuring that insurance companies function in an orderly manner.

89. At the operational level, the primary responsibility of supervisory authorities is to protect the interest of the policyholders. Insurance is not only a commercial transaction but also has social aspects. Life insurance companies, for example, deal with long-term savings of individuals which need protection. In the non-life sector, it is necessary to ensure, as a matter of public policy, that policyholders and other beneficiaries (e.g. victims of road accidents) receive due compensation.

90. Supervisory authorities have a special role in respect to safeguarding the interests of consumers of products related to "mass risks". These consumers may not be in a position to evaluate the content of products and their pricing in the same manner as consumers of commercial covers. This problem is accentuated in developing countries by the fact that insurance awareness is low and information about "mass products" may not have been sufficiently dispersed.

91. Another aspect of the functioning of supervisory authorities in developing countries relates to the fact that insurance companies are mobilizers of savings and institutional investors. Insurance companies have large funds at their disposal, arising out of the policyholders' fund in life insurance and technical and free reserves in the non-life section. Their prudent deployment by way of investment is relevant not only from the point of view of the policyholders but also from the angle of the development of the economy. In many countries these funds constitute a significant part of total national investment. Insolvency in this sector, therefore, would have an adverse effect on the economy as a whole.

Deregulation and liberalization

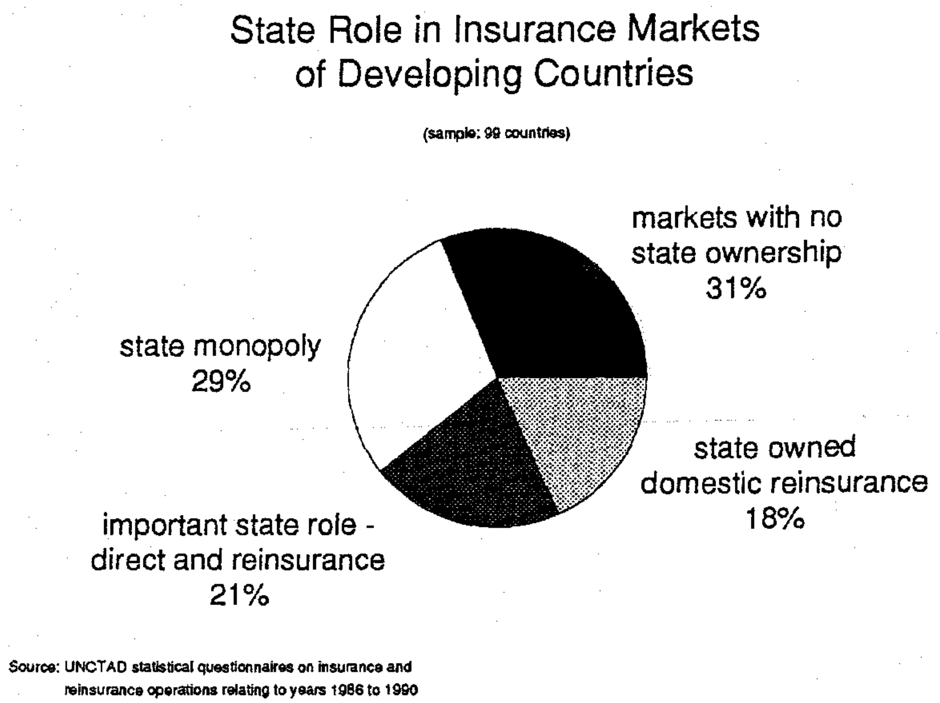
92. Apart from their traditional role of monitoring the solvency of insurance companies and their investment activities, the supervisory authorities may have to ensure that the principles deriving from the processes of deregulation, liberalization and opening of markets, such as the rules of establishment, national treatment, non-discrimination and transparency, are respected. They might also have the responsibility of preventing breaches of the rules of competition. It is to be noted that in the group negotiations on services within the Uruguay Round, one of the main concerns of many participants from both developing and developed countries was that Governments should be able to develop and maintain an effective and prudential regulatory system, whatever the commitments made towards liberalization. 1/ The Casablanca African Insurance Reassessment Workshop of October 1990 stated in this respect, *inter alia*, that "in the context of liberalization and privatisation, independent, strong and competent control authorities are needed to ensure the protection of consumers and that the rules governing the proper functioning of markets are respected."

93. The 8th Third World Insurance Congress (TWIC) held in New Delhi in February 1992 recommended, *inter alia*, that "sweeping reforms wherever applied, including the insurance sector, can only be successfully implemented with the establishment of a strong and well-administered prudential regulatory system". The introduction of liberalization reforms and the opening of insurance markets may face implementation difficulties if they are not accompanied by "prudent regulations" to be enforced by competent supervisory bodies. Otherwise, distortions and imbalances may appear. Such effective regulation and supervision should provide a stable environment for the development of a sound insurance market.

94. The structure of the market in a country would have a bearing on the nature and extent of supervision. If insurance is the monopoly of the state, supervision through a regulatory organisation will not be of the same

type as in the case of a market where the insurance sector is entirely in private hands. In a number of countries the state is playing an important role, in both direct insurance and reinsurance, through public sector companies, operating side by side with private sector companies. In other countries the direct insurance operations are in the private sector, but the state could have an influence on or a certain extent of control of the market through a state reinsurance company. Figure 1 gives an overview of state involvement in the insurance sector of developing countries.

Figure 1



B. Political backing for supervisory authorities

95. In this context it is often pointed out that the mere existence of complex laws and regulations does not necessarily bring about effective supervision. The supervising authorities should be backed by political support and should have sufficient resources at their disposal. In some cases even very sophisticated supervisory systems have failed to detect collapsing insurance companies. Yet they have played a prime role in managing crisis situations to prevent the insurance market as a whole being unduly shaken by the default of a few companies.

96. In Barbados, the Government has appointed an insurance supervisor, a post provided for but not filled since the inception of the new law in 1983, in a move which was welcomed by the industry. It is reported that Barbados wants to be pragmatic in meeting requirements to be competitive in respect of fiscal and infrastructural arrangements so as to preserve its good reputation as an international financial centre and not be seen as merely providing casual screening of applications, freedom from taxation or loose regulations and supervision. 2/

97. In Mexico, the new regulation meant to liberalize and open the country's industry has instituted a new regulatory body called the National Commission of Insurance and Bonds. 3/ The establishment of this new body is seen as part of a move towards more vigorous and effective regulation of the industry, and the overall supervisory framework is designed to provide less intrusive but more effective control. 4/

98. In Trinidad and Tobago, a technical team which reported to a special ministerial committee found that seven general insurers out of 28 failed to pass viability tests, confirming the view that the Insurance Supervisor's Department has been lax in enforcing the existing regulations in recent years. 5/ To improve the effectiveness of the Insurance Act, it was concluded that there should be an increased monitoring of insurance companies' operations. The Government moved to put much tougher rules in place, including:

- A higher minimum paid capital for general insurers;
- The cancellation of a company's registration if it remains technically insolvent for more than 30 days;
- Proof at the end of each financial year that companies have genuine assets to back their liabilities;
- Introduction of stiffer operating tests relating to expenses and liquidity. 6/

99. In Uruguay, a special committee is discussing a draft law which is expected to lead to the ending of the state monopoly in insurance and is part of a package aimed at reducing state monopoly throughout the economy. The proposals include: the establishment of an Insurance Supervisory Authority which would deliver authorisation to both new and existing companies; regulations governing requirements for solvency, technical reserves, management, capital, legal domicile and placement of reinsurance. 7/

100. In the Republic of Korea, in April 1989, the Insurance Supervisory Board was established for the efficient supervision of insurance companies, as the insurance business had been internationalized and deregulated. 8/

101. In Sierra Leone, the Commissioner of Insurance reported that the lack of power of the Commissioner's office has led to a general lack of discipline at all levels of the business and stated that his office needs strengthening through increased manpower, responsibilities and statutory functions.

C. Tariffs and rate setting

102. Monitoring the solvency of insurance companies is one of the prime concerns of supervisors. Its purpose is to protect the public interest. In this context, it is to be noted that supervisory authorities in some countries have shifted in recent years from the practice of checking rates and tariffs to a more global approach of formulating and monitoring reserves and solvency requirements. In these countries, it was thought that not allowing freedom in rating would restrict companies with a competitive edge from giving a lower rate or better terms to customers. In other words, removing restrictions in rate setting would lead to more advantageous terms and conditions of insurance. This represents a shift from ex-ante to ex-post scrutiny, and has two implications for insurance companies in developing countries. First, due to a freer régime of rates and conditions of insurance, competition might depress profit margins. As a consequence, a higher capital base and a careful reserve policy would be required to stay in business in the long run. Secondly, greater responsibility would be placed on the management of insurance companies. Both these trends can in fact be discerned. On the one hand, the capital and solvency requirements are being increased, and on the other greater attention is devoted to applying stricter criteria for determining the fitness of managers of insurance companies. Nevertheless, a large number of countries continue to maintain a tariff system and a role for supervisory authorities in standardising terms and conditions of policies and their pricing. While a freer system of pricing and conditions may ultimately bring more opportunities to consumers, it presumes their ability to differentiate objectively between products offered. Such conditions, however, may not prevail in many markets. It has therefore been argued that the availability of a limited range of unsophisticated covers tailored to the more basic needs as regards insurance protection would be a suitable approach in many developing countries.

D. Capital and solvency requirements

103. The introduction of higher standards for capital and reserve requirements might have an impact on the overall retention of business written, in that it might be possible to retain a larger share in the country. This in turn might have a positive influence in decreasing foreign exchange requirements for reinsurance.

104. In Brazil, a new accounting system, introduced in July 1989, requires a substantial increase in reserves. This will require companies to obtain additional assets to guarantee the increased reserves. 9/ In Colombia, the Law of 18 December 1990 has set new minimum capital requirements which might be revised annually in the first two months of each calendar year, although adjustments may not exceed the weighted average of the consumer price index. Requirements for technical reserves such as current risk reserves, mathematical reserves, reserves for outstanding losses, and reserves for loss ratio deviation, as well as their calculation, were also defined by the new law. On the other side, terms and conditions of policies no longer require prior approval by the authorities. They must, however, now be filed with the authorities, which might disallow badly worded policies or those quoting uncompetitive rates. 10/

105. In Chile, where the market was deregulated in the early 1980s, the reinsurance monopoly and tariffs have been abolished and the market has been opened to foreign capital. Consequently, the tasks of the supervisory authority were redefined. The supervisory authority now has to execute a strict follow-up on all matters related to an insurer's financial and economic stability. These include investment policies and compliance with minimum capital and solvency margins. 11/

106. In Mexico, a new law which ends minimum tariff rules will increase price competition. At the same time insurers will also be required to meet tough new minimum capital requirements and new rules on solvency requirements modelled on European Community standards . Insurance companies will be free to market their policies without explicit official approval. 12/

107. In Malaysia, Bank Negara, which has taken over the supervision of the insurance sector, is reviewing the financial solvency requirements of insurers which it feels have experienced some deterioration. The Bank is considering introducing criteria on a claims basis to complement the existing requirements to make insurers more selective in underwriting new risks. It is also considering the need for composite insurers to maintain separate solvency margins for each class of business. 13/

108. In Ghana, a new law is to be promulgated which specifies the capital requirements for setting up an insurance company. 14/

109. In Kenya, the Insurance Act was put into force in 1987. Its aim is to curb the lack of discipline in the insurance industry and to protect policy holders. All companies have to comply with minimum capital and solvency requirements. 15/ The Insurance Commission deleted from the registration list two insurance companies and five brokers after having screened the solvency margins of insurers, brokers and agents. 16/

110. In Namibia, the new insurance law requires the registration of insurers, brokers and reinsurers and sets minimum capital requirements, as well as deposits with the commissioner for each line of business. 17/

111. In Nigeria, a new decree is expected to increase tenfold the minimum paid-up capital for life and non-life operations in comparison with the previous amounts regulated under the 1976 Insurance Act. 18/

112. In Pakistan, where there is constant reviewing by the Government of compliance by insurance companies with the solvency criteria of the Insurance Act of 1938, cases are being prepared against seven insurers, of which three are leading companies; two have already had their licences cancelled and a similar fate awaits a third company. 19/

113. In Senegal, a new set of laws is in preparation which will toughen the regulation on the solvency of companies and reinforce sanctions against fraud. 20/

114. In Singapore, new solvency margins are to be introduced in 1993. Solvency margins for general insurers will be increased fivefold. 21/

115. In Thailand, plans exist to set up an Insurance Stabilization Fund to handle insolvency cases, and a threefold raise in the minimum solvency margin has been proposed to the Parliament, with the margin to be increased in proportion to the volume of premiums written. 22/

116. In the Philippines, a new law has been enacted (17 March 1992) which sets new minimum capital requirements for new joint ventures, new insurance and reinsurance companies. 23/

E. Investment regulations

117. Investments of insurance concerns must have the following three basic characteristics: they should be reasonably liquid, have a high standard of safety and provide a reasonable rate of return. Accordingly, in a number of countries, rules are stipulated for the investment of funds. In some countries the rules were formulated with the purpose of channelling investments into target development areas, and sometimes to cover, in part, the state budget deficit. It has been argued that this might be at the expense of the policyholders, and the case for wider investment opportunities has been advocated. In certain countries a relaxation of investment requirements has taken place. However, amounts have often been prescribed in terms of percentages of the total for various categories of investments. A portion of available funds can be invested in the financial market at the discretion of the insurer for the purpose of maximising his yield, but the basic criteria are nevertheless prescribed.

118. In Colombia, the new law (March 1991) sets new requirements for investment policy regarding technical reserves, 40 per cent of which have to be placed in specified instruments. 24/

119. In Mexico, the rules governing the investment of technical reserves have been liberalised. They now allow free investment of 70 per cent, while only 30 per cent must be invested in ways specificed by the Government (mainly state bonds). The 70 per cent "free" investments may be placed in some 30 authorised securities, including secured loans, positively yielding real estate and Petro bonds. 25/

120. In Senegal, a new law under preparation will propose a new approach towards investment in the light of the need for the insurance sector to play a stronger role in the economic development of the country. 26/

121. In Singapore, new investment regulations are to be introduced as of 1993, fixing maximum limits on investment placed in any one category and for investment in a related company, and a minimum level of liquidity in assets will be required. 27/

122. In Thailand, insurance companies received permission in 1989 to diversify investments into property development. 28/

123. In Turkey, the Government is considering regulations which would encourage insurers to increase their investments in the local capital markets. A government study recommends that insurers be required to invest at least 25 per cent of funds collected in the Istanbul Stock Exchange. 29/

F. Reporting and information requirements

124. The most important "tool" at the disposition of supervisory bodies is the timely receipt of information from insurance companies and its early analysis and assessment. The process of reporting to the supervisory authorities might also be a beneficial exercise for the management of the insurance company insofar as it provides an opportunity for introspective analysis. This would also enable comparisons to be made with other insurers in the same economic environment. It has been suggested that, when checking reports, the supervisory authority should watch for certain signs. 30/ These may be:

- A decrease in operating margins while the market share increases;
- An escalation of expenses without a measurable increase in business volume;
- The occurrence of an operating loss for two or more successive years;
- Major business shifts undertaken by large intermediaries;
- A consistent lack of underwriting profits;

- A high staff turnover; and

- A noticeable variation in outstanding claims provisions.

125. At an African Insurance Reassessment Workshop held in Casablanca in October 1990, the areas of competence of supervisory authorities were defined as follows:

- The control of the activities of all the players in the insurance sector, and the verification of the honourability and competence of insurance managers;

- The control of the books of accounts, in particular technical reserves, and capital and solvency margins;

- The on-the-spot control of insurance companies through the right to investigate on their premises;

- Acting as the privileged collector of information for the Government; and

- Building up an information base on the security of insurance and reinsurance companies and brokers.

126. It was reported that it was difficult for supervisors to ascertain the true state of affairs from a mere examination of returns. It was therefore recommended that, to be able to assess the reality of the situation and to understand the operational aspects, the supervisory authorities should keep in constant touch with the industry and have periodic meetings with its representatives. Spot inspections of the books and records of companies are regarded as an essential aspect of monitoring.

127. In Brazil, since 1 July 1989, insurance companies must comply with a new Chart of Accounts which follows United States standards. 31/

128. In Chile, each insurer, reinsurer and broker is under the control of the Supervisory Authority, where information on their performance can be obtained. 32/

129. In Malaysia, Bank Negara, the authority which is supervising insurance together with the Association of Certified Public Accountants, has finalized guidelines to set uniform accounting standards and a formal format for presenting the financial statements of life and non-life companies. The aim of this new format is to "ensure that the accounts reflect the true financial position of an insurer and provide a sufficent amount of disclosure." It will promote better information on their performance and enhance the effectiveness of the supervision of the insurance industry. 33/

G. Human resources

130. To be able to fulfill their role effectively, it is necessary that supervisory authorities have qualified staff. At a seminar on Human Resources Development in the Field of Insurance, held in Lisbon from 28 November to 5 December 1990, the training and education of staff in insurance supervisory authorities of developing countries was identified as an area of priority action. In the opening paper given at the 1992 TWIC conference, it was emphasized that "there is at present still a gap between the insurance industry and the Supervisory Authority in terms of the level of knowledge of the business. It is, however, the responsibility of Supervisors to gain information and knowledge comparable to what is available in the industry". 34/ Further, it has been argued that "if supervisory personnel was highly qualified both personally and professionally, it would usefully fill gaps in the legislation and become, especially in developing countries, one of the main instruments available to the State for promoting the national development of financial intermediaries." 35/ However, supervisory authorities in many developing countries encounter problems in attracting and retaining skilled personnel. It has therefore been suggested that careful attention be devoted to career prospects for personnel. Schemes such as "binding training programmes" have been implemented in Singapore and Malaysia, where training is paid by the

Government on condition that the trainee will have to serve in the department for a minimum period or reimburse the expenses, and this may provide an answer.

H. Dynamic role of supervisory authorities

131. Supervisors should have a dynamic approach and go beyond merely checking compliance with the law. They should extend their role to identifying the problems faced by the industry, and helping it to find solutions. Supervisory authorities should be perceived as helpful and positive. By virtue of closeness to the legislators, they might also be instrumental in improving the legislative framework. The active role played by the supervisory authority in Morocco might have helped the industry to increase its performance. The growth rate of its total premium ranked as the third highest worldwide during the period 1987-1989 and it was the only African country amongst the top ten. 36/ Amongst the measures adopted by the Moroccan Supervisory authorities, mention may be made of the following:

- Revision and updating of insurance legislation;

- Privatisation of two insurance and reinsurance companies;

- Fixing minimum capital requirements and exerting influence for a capital increase in other cases;

- Requiring companies to submit and comply with a "re-organisation plan" in well defined situations;

- Creating a "solidarity fund" to provide financial assistance to companies whose position has been weakened due to the fact that they are engaged in one or several categories of compulsory insurance whose premium rates are fixed by legislation;

- Warning, reprimanding and suspending managers who do not observe regulations;

- Working out a new scale of compensation for motor accident victims;

- Modifying the procedures to be followed for motor accident compensation claims;

- Revising motor insurance premium rates;

- Introducing premium collection norms;

- Easing taxation on life insurance, marine insurance and savings and capitalisation transactions. 37/

I. Auxiliary services

132. Supervisory authorities are also beginning to take an interest in what can be described as "auxiliary services" such as those provided by reinsurance brokers, agents, and loss assessors and surveyors. In some countries attempts are also being made to reduce acquisition costs considered to be excessive, and the commissions of brokers and agents and other intermediaries are under scrutiny.

133. In Kenya, the Commissioner has been looking at the solvency margins of insurers, brokers and agents, and has deleted the registration of two insurance companies and five brokers. 38/

134. In Namibia, a new insurance law requires the registration of insurers, brokers and reinsurers. Brokers have to purchase a fidelity guarantee bond to pay a deposit and purchase a professional liability insurance. 39/

135. In Tunisia, the allowed commission to agents soliciting mandatory motor business cannot exceed 8 per cent for passenger vehicles and 9 per cent for other vehicles. 40/

136. In Singapore, strict minimum requirements have been proposed for general insurance agents and brokers to improve the general standard of service through better product knowledge and proficiency, while observing a professional code of conduct when transacting business. 41/

137. In Turkey, to overcome the problem of bad premium collection, the Government has, besides other measures, fixed a maximum of 30 per cent for commissions, doubled the agents registration fee and sharpened qualifications criteria for agents. 42/

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Chapter III

LIFE INSURANCE

A. Introduction

138. Life insurance constitutes a significant segment of the world's insurance business. Table 2 shows the distribution of world premium between life and non-life. It constituted 52 per cent of total premium income in 1989 and has overtaken non-life insurance.

Table 2
Total world premium

Category	1985 % of total	1989 % of total
Non-life	55	48
Life	45	52
Total	100	100
=	(US$630.5 billion)	(US$1,210 billion)

Source: Reinsurance Market Report, 14 July 1992, p. 11.

139. The volume of life insurance business transacted in developing countries is low. Table 3 shows the market share of world insurance premiums.

Table 3
Market share of world life insurance premiums (percentage)

	1988	1990
Developing countries	3.68	4.79
of Africa	0.10	0.08
of Asia	3.29	4.39
of Latin America	0.29	0.32
Developed countries (a selected number)		
United States	28.71	29.09
Japan	34.76	28.74
EEC	20.68	24.79

Source: SIGMA, Zurich, Swiss Re, 4/1990 and 4/1992.

140. The share of life in the total insurance sector of developing countries differs widely. The statistical survey of 91 developing countries prepared by UNCTAD, which refers to the situation in developing countries between 1984 and 1986, shows that in 11 countries there was no life insurance sector, and in 54 countries the share of the life sector was between 0.1 per cent and 30 per cent (see table 4).

141. Life insurance is not merely a commercial activity, but has several other important aspects. It provides financial security to the insured individual and his or her dependants. Social security systems are either non-existent or insufficient in many developing countries. While this gap cannot be bridged easily, life insurance provides a certain solution. In many countries, instruments of savings are not sufficiently developed, and life insurance could provide a viable answer. Three aspects of the life insurance make it an apt method of saving. First, saving is on a regular and controlled basis, rather than sporadic and dependent upon a surplus being left after consumption. This makes it particularly suitable in developing countries, where the pressure on income is generally higher because of lower standards of living. Second, the savings element is closely linked with the

Table 4
Share of life business in total insurance business in developing countries
1984-1986

Countries surveyed Number	% of total	Share of life business in total business (%)
11	12	0
54	59	0.1 to 30
17	19	30 to 50
9	10	more than 50
91	100	

motivation to provide security to family members. And thirdly, life insurance is easy to understand, and its operation from the point of view of the individual is simple unlike other methods of savings. It suits well those in the middle and lower-income groups who are uninitiated in the intricacies of sophisticated personal investment instruments, and it is a method for individuals to save for old age. Furthermore, life insurance is a mechanism for mobilising the savings of individuals for long-term investment. Life insurance is thus an important financial institution in developing countries and could play a major role in the investment market. It is often one of the biggest investors in the housing sector.

B. Factors governing life insurance

142. The potential for the growth of life business in developing countries remains high. Several factors determine the level of supply and demand for life insurance and influence the growth of business actually registered. Some of these factors are discussed in what follows.

143. A study by the UNCTAD secretariat on the promotion of life insurance in developing countries noted that "the growth of life insurance business is inextricably interwoven with economic development. Economic development usually brings about increased personal savings" 1/. In the absence of a defined and uniform system of statistics to show incomes of individuals, growth in GDP is taken to represent the basic paramenter of demand for life insurance. Only when incomes of individuals are increasing, as reflected in growth of GDP, will more insurance be taken. An analysis of various markets clearly indicates that persons in countries with a high GDP per capita have high amounts of insurance per head, defined as the "density of insurance". But a given rate of increase in GDP may result in varying degrees of increase in life insurance. The ratio of percentage increase of insurance per point percentage increase in GDP, in other words the income elasticity of insurance, is defined as the "penetration of insurance". Table 5 gives the density of insurance and the penetration of insurance of a few developing countries in Africa, Asia and Latin America. For the sake of reference, the indices for some developed and some former Eastern European countries are also given.

Growth in incomes and their distribution

144. Apart from the fact that individual incomes may increase as a result of economic growth, their distribution in various segments of the population is important for the life sector. Life insurance business is likely to benefit most when the middle-income group has relatively higher gains than the high and low-income groups. However, no clear-cut model or comparative statistical analysis of this aspect, has been made. Nonetheless, while planning its strategies, the insurance sector should keep this in view.

Financial markets and fiscal concessions

145. For the growth of life business, not only must incomes increase and be suitably distributed, but financial markets must also be constituted in a manner which is conducive to savings. Increased confidence in life insurance as a savings instrument would be generated if opportunities existed to compare and judge a variety

of instruments. In this connection, it needs to be added that, for a comparison of returns on other savings instruments with those on life insurance, due account has to be taken of the tax advantages both for the

Table 5
Life insurance and penetration density: 1990

Country	Penetration*	Density**	Country	Penetration	Density
Africa:			Asia:		
Zimbabwe	3.34	20.84	Rep. of Korea	9.45	523.35
Kenya	0.48	1.58	Singapore	1.80	239.12
Morocco	0.34	3.93	Malaysia	1.37	32.68
Côte d'Ivoire	0.19	1.90	Philippines	1.19	7.38
Egypt	0.16	1.26	India	1.11	3.73
Cameroon	0.14	1.97	Thailand	0.97	13.72
Tunisia	0.13	2.04	Pakistan	0.44	1.53
Nigeria	0.12	0.28	Indonesia	0.23	1.34
Algeria	0.03	0.41	China	0.18	0.53
Lybian Arab Jamahiriya	0.01	1.11	Islamic Rep. of Iran	0.03	3.08
Latin America			Developed countries:		
Chile	1.77	33.80	Japan	6.42	1,645.45
Panama	1.22	24.93	United Kingdom	6.24	1,145.63
Mexico	0.42	11.06	United States	3.79	823.12
Dominican Rep.	0.40	3.25	France	3.09	692.44
Uruguay	0.39	7.72	Canada	2.77	601.74
Colombia	0.32	3.48	Germany	2.21	563.03
Brazil	0.18	2.13	Italy	0.66	132.93
Venezuela	0.11	2.48			
Argentina	0.09	2.89			
Some countries in transition:					
USSR (1990)	1.57	67.21			
Czechoslovakia	0.98	17.92			
Hungary	0.44	13.99			
Romania	0.35	3.65			
Poland	0.08	1.42			

* Premium income as percentage of GDP
** Premium in US$ per capita
Source: SIGMA, Swiss Re, 4/1992.

payment of premium and for the receipt of maturity or claim benefits. Further, saving through life insurance is regarded as safer because its funds are channeled into long-term investments which are generally less risky than those with high short-term expectations. This, of course, presumes that life insurance companies remain financially sound and do not fritter away savings of policyholders.

Life insurance and taxation

146. The subject of tax policy on life insurance in developing countries was considered in detail by a study undertaken by the UNCTAD secretariat in 1985, 2/ and various aspects namely approaches to the taxation of a life insurance company and to tax benefits for policy holders and beneficaries, both in respect of premium paid and the benefits received, were examined in detail. It emerged that "the tax policy adopted by Governments towards life insurance can have an important influence on the extent to which life insurance is successfully integrated into the society" (para. 3). At the same time, it is understandable that taxation on the life insurance sector "must be moulded" together with the country's economic policy (para. 4). It "cannot be designed in isolation from the structure of the existing tax system" (para. 25). As far as taxation of the insurance company is concerned, account has to be taken of the fact that "premiums and reserves are calculated on assumed future experience", and that "the actual experience and profits will emerge only after many years" (para. 22). As regards tax or fiscal concessions for policyholders for the premiums paid and for beneficaries on the proceeds of the policy, account has to be taken of incentives available through other savings instruments. It was pointed

out that each Government must decide "whether it should adopt a position of economic neutrality among the various savings institutions" (para. 33) so that the tax policy of the country is not the "cause of one product, service, or type of provider having an economic advantage over another in the market place". (para. 32)

147. In this connection, it is reported that in Thailand new tax concessions have been introduced allowing policyholders to double tax deduction on life premiums. 3/. In Morocco also tax advantages have been provided for life insurance to increase its attractiveness. 4/ In Benin tax incentives are being reviewed in order to make life insurance more accessible to families with lower incomes. 5/ On the other hand, it has been reported that a major reason inhibiting development of life business in French-speaking Africa is the lack of tax advantages for individuals on premium paid and the imposition of a tax on premiums received by a life insurer.

Life insurance and inflation

148. The rate of inflation has several serious implications for life insurance. From the company's point of view, it upsets its calculations, particularly those related to remedial administrative costs. 6/. For the insured the real value of the savings element of the policy is eroded. Since high rates of inflation are witnessed in a number of developing countries, life insurance companies have to be attentive to the situation and prepare for the changes that may be necessary in their strategies, particularly concerning products offered and their marketing. Since the actual rate of inflation that will take place is unpredictable, it is the perception in the minds of potential clients that really matters.

149. Certain implications, as well as the direction of change as a consequence of inflation, are apparent. Policies where the savings portion is periodically returned while the risk portion is kept up for the duration of the contract would be preferred by clients. A "three-stage policy" where a good portion of the savings accumulated are returned to the insured at three stages has proved to be popular in Pakistan. 7/ Those who require risk protection are likely to opt for long-term policies which have a very low savings element. Since these policies are low premium policies, the overall premium income of the company may be adversely affected.

150. New products may have to be devised. A flexible system, under which the sum insured is increased from time to time so that the real, i.e. deflated, value of the cover is maintained has been suggested. Premium will also be revised. Those who do not want the revision can stay with the old premium and sum insured. 8/ The indexation of life insurance policies has not been explored sufficiently, because of a variety of practical difficulties, one of them being whether the index used is accepted as reliable by the public. 9/ It is also possible to hedge against inflation by issuing policies in a hard currency or linking them with the price of gold or substituting the payments on maturity of the policy with commodities or real estate.

The social environment and life insurance

151. The level of literacy and the education system has an influence on life insurance. Those who are not exposed to modern economic knowledge may tend to prefer "sterile" forms of savings such as jewellery or gold. Ideological, cultural or religious reasons may impede development of life insurance. "Fatalism, local customs and traditions, reliance on help from the family ... and even religious beliefs"... may... "prevent people from providing for their family in case of death or even their own old age."10/

152. In North African Arab countries, life insurance is sometimes considered inappropriate on religious grounds and non-life insurance still represents the bulk of the market. 11/. In *Mauritania*, religious reasons are, inter alia, responsible for a low level of life insurance. It accounts for only 0.36 per cent of the total insurance business. Still, life insurance has been fixed as a development objective by the country's insurer SMAR. 12/ In the Islamic Republic of Iran, the Islamic contract of Mozarbeh has to be employed, which means the elimination of interest in accordance with Islamic principles. The contract postulates that someone will entrust his savings to another person who will use them for a commercial venture with the profits being divided as agreed at the outset. 13/ Further, the extent to which life insurance can be successfully promoted in a country depends on the stage of development of the country's infrastructure, in terms of communication, transportation, the legal system and the consumption habits of the population.

Constitution of the life insurance sector

153. A long-term outlook is necessary in life insurance, as it is a long-term business. The laws and regulations in many countries require that the surplus arising from better investment earnings, improvements in mortality and expenses being lower than presumed in premium calculation cannot be taken by the company as its own profit and has to be shared substantially with policyholders. Only a small part of the surplus may be kept by the company. Consequently, a substantial benefit to shareholders from the growth of the business takes time to manifest. Similarly, because of the availability of a large investment portfolio and a good cash flow associated with this line of business, downturns also take time to become visible.

154. By the same token, a larger capital is required to successfully manage a life insurance company than a non-life insurance company. A concentrated market is, therefore, conducive to the growth of life insurance. The requirement of a large capital base is in fact one reason why foreign insurance companies, with the backing of the large capital and resources of their corporate office, have been allowed to operate in a number of developing countries. This is also a major reason why a number of developing countries have constituted parastatal institutions for the life insurance sector.

155. It needs to be noted that competition between life insurance companies operating in a third world country is not confined to those licensed in the country. Competition from life insurance companies of some developed countries not established and unauthorized to operate in a given developing country exists due to the relative strength and stability of their foreign currencies; in spite of foreign currency restrictions that may exist in developing countries, there are often leaks in their systems that allow foreign-currency-denominated life insurance policies to be bought by their residents. This problem occurs particularly in countries that have a history of devaluations of their national currency.14/

156. Supervisory authorities in many developing countries are endeavouring to improve the capitalisation of life insurance companies in their country. This could be achieved by encouraging mergers and acquisitions, but most importantly by gradually increasing minimum capital requirements and by enhancing standards of valuation of policy reserves and solvency margins. The policy of not issuing new licences for life business to avoid the proliferation in the market of a large number of small companies has also been common in many countries.

157. On the other hand, the life insurance market in the Republic of Korea is opening up. In the three years preceding October 1990, 14 new domestic companies were licensed 15/. In Pakistan the Government has adopted a policy of deregulation and liberalization. A limited number of companies will be allowed in the life sector but not as composite companies, i.e. transacting both life and general lines. The private sector is of the view that the capital base requirements set out are excessive and protective of the public sector. Even so, two private insurers have applied for permission to start working life insurance lines and are reported to see a good perspective for their business. 16/

158. Another development, again arising from the need for substantial resources to successfully develop a life insurance account, is the entry of banks and other financial institutions into insurance-like business. Indeed, the barriers between banks and insurance companies are coming down. Life insurance companies deal with savings and investment, and so do many financial institutions. Thus, there is a synergy between their operations. So far this has happened mostly in the developed economies, but the trend may have repercussions in developing countries. It has been reported that in Malaysia, selling life insurance over bank counters is already gaining popularity. Distribution through the banking networks is significantly less costly than through the traditional agency force. The savings can be passed on to the clients in the form of cheaper premiums. 17/

Product development

159. Life insurers may consider adopting a "marketing" rather than a "sell what you have" approach. 18/ The products have to be constantly reviewed and "tailored" to meet the changing and varying needs of consumers. The information explosion has brought about a revolution in consumer aspirations, often making a diversification of the product line necessary. Specificities will differ from country to country, but generally speaking, the products offered should "not only provide the important ingredient of risk cover but also

incorporate a certain amount of flexibility, liquidity and offer returns which have some relevance and bearing to the rate of return available through other financial instruments." 19/ New approaches have to be devised.

160. It is reported that in Turkey life insurance is becoming an important alternative to savings, and new products, such as foreign-currency-denominated policies, are being introduced. 20/ In Singapore the life sector is considerably market-oriented and offers policies for very specific needs, such as "childrens' education" or "serious illness" policies. Innovations including living assurance (receiving benefits from a life cover should a specified disease occur), permanent health insurance, vanishing premium plan, (under which the policyholder stops payment of premium in a relatively short period, and the accrued bonus is used to finance further premium payments) and bond policy (a one-time premium payment purchases a number of bond units, which are invested and pay for a growing amount of life cover). In an increasingly competitive environment, research and development (R & D) is becoming important in satisfying customer demands. As a result of the dynamic approach adopted by the Singapore companies, coverage by life insurance improved from about 21 per cent of the population in 1986 to about 42 per cent in 1991. 21/

AIDS

161. The emergence of AIDS is a matter of great concern to life insurance companies, particularly in developing countries. According to the World Health Organisation's (WHO) figures of November 1991, so far there have been 366,000 reported cases of AIDS. WHO estimates that the total number of AIDS cases worldwide is around 1 million. 22/ The number of HIV-infected persons is much larger, and the estimate lies between 8 and 10 million. Of this the geographical spread is approximately as follows: 6 million in Africa, 2 million in the Americas, 0.5 million in Europe and more than 1 million in Asia and Oceania. The WHO estimates that by the year 2000 there will be 30-40 million HIV-infected persons. 23/

162. For life insurance, AIDS poses two problems. The first and immediate problem is the increase in mortality of persons already holding some kind of life policy, since claims will have to be honored in case of AIDS-related death. The second problem concerns the treatment of AIDS in future policies to be issued and raises questions of an ethical nature concerning the positions of the insurer, the insured and society in general. It will be inappropriate in the long run to take AIDS-related deaths as an increase in mortality, as this raises the question of equity between insured individuals.

163. AIDS undermines the adequacy of rates developed from current mortality tables. In Africa, principally the central, eastern and southern parts, and parts of the Caribbean, expected AIDS deaths will raise adult mortality rates by over 100 per cent. The infected individuals' mortality would be very high. For example, an infected 35 year old male can be expected to live 10 or 11 years. Of all infected persons, 45 per cent have developed symptoms after 9 years. It is likely that 7-8 years may pass between infection and symptoms, and during this period the individual has a full work capacity. 24/ The impact of AIDS on population growth is expected to be minimal, while a strong effect is expected on the mortality rates. 25/

164. The Caribbean is said to have the highest per capita number of AIDS cases in the world, and the resulting losses in the life business will inevitably have to be compensated from general insurance activities. In Barbados a US$4 million fund has been formed by a mutual life insurance company to meet anticipated AIDS-related death claims, in expectation of a significantly higher mortality rate. Barbados life insurers have started mandatory testing of applicants for life cover over B$200,000. In Guyana insurers have started to insert exclusion clauses into all life policies, which relieve them of any obligation to claims if the insured dies of AIDS. 26/

165. In Zimbabwe claims arising from declared AIDS deaths seem to be only a small portion of the total true AIDS claims. AIDS-related claims are in reality much higher, since for many people who die of AIDS and for whom claims are paid out, this fact is not put on their death certificates. When the mortality tables currently in use were constructed, AIDS was totally unknown and hence its effects on the insured population's mortality trend was not taken into account. This has resulted in large unexpected payments being made by life insurers for both life and disability products. Due to reasons of under-reporting and an inadequate statistical base, it is difficult to estimate the extent to which AIDS is affecting life portfolios. 27/

166. Concerning life insurance, the testing methods and information sought from applicants are often seen as violating the privacy and rights of the individual. The need to categorize the applicant in a risk group, in order to administer a proper cover and demand a premium viable for the workings of aninsurer, raises questions of discrimination. The issue of discrimination and privacy conflicts with the principle that low-risk individuals should not be subsidizing the premiums of high-risk individuals. Evading the occurrence of subsidization means taking into account two considerations of equity: equity among policyholders and the assignment of adequate premiums for corresponding risks, and equity in society as regards insurers - insurers cannot be expected to bear a burden disproportionate to their responsibilities, and they must share the burden on an equitable basis with the rest of society. 28/

167. The need for evaluation of risk for those applying for insurance is well recognised but in the context of AIDS is a sensitive issue. Any information obtained should be utilised with due care and respect for the privacy of the individual. It should not influence the client's social and economic position. The confidentiality of the medical report is of prime importance, because people will present themselves for testing only if they believe that no unauthorized disclosure will follow. 29/

168. Apart from adapting their workings to the new situation caused by AIDS, insurers should play an active role in its prevention through co-operation with all relevant medical and government authorities. Since insurers reach a large number of people in their everyday activities, they can make a productive contribution in the sense of awareness-building and education.

169. Antiselection is a significant problem. Individuals who know they have HIV or who belong to a high-risk group and seek insurance substantiate this problem. It has been found that the average life policy of an AIDS victim at the time of death has been in force for a significantly shorter period than policies of persons not infected by AIDS. Further, the average AIDS claim is higher than a non-AIDS claim. It is believed that group insurance is generally less subject to antiselection than personal insurance. 30/

170. In Zimbabwe the following measures are being considered in order to lessen the effect of AIDS on life portfolios:

(a) Increasing the group and basic individual life rate;

(b) Setting up an AIDS contingency fund;

(c) Moving more towards the marketing of investment contracts like pure endowments and reducing terms on life and endowment policies;

(d) Enforcing HIV testing for sums insured at $100,000 and above for individual life policies and $300,000 for group life;

(e) Re-modeling life contracts in such a way that proposers have to go for HIV testing (e.g. making the minimum term policy equal to US$100,000);

(f) Improving the training of life underwriters so that they maintain a strict but fair and consistent approach towards underwriting high-risk HIV cases by exercising extreme caution when accepting applicants who fall into any of the high risk categories. 31/

C. Areas of concern for life companies

171. The areas to which the managements of life insurance companies have to give particular attention have been summarized as: investment management competence, technical skills, marketing strategies, co-operation with theGovernment, responsiveness towards consumers and the product line. 32/ These and other related issues are discussed in general terms below.

Investment management

172. As trustees of savings of policyholders, life insurance companies have substantial amounts of money for investment. The aim is to maximise yield on these investments and minimise risk taking. In many countries parameters have been prescribed for investment of life insurance funds. Well developed and diversified investment opportunities do not exist in many countries, and investment options which will be safe and yet give a reasonable yield are not available. For example, it has been reported that in Senegal the main factor hindering a stronger development of life insurance is the insufficient investment opportunities for funds. The return on bank deposits is small and inadequate to stimulate growth of the life sector. 33/ Nevertheless, optimal results have to be obtained within the constraints of the given situation.

173. A great deal of investment skill and imaginativeness is required, particularly since a long-term view has to be taken. It is necessary to build up this expertise. Many insurance companies in developing countries have not paid sufficient attention to developing investment expertise and often manage their investments through the accounts department or by utilising the services of investment trusts. 34/

Actuaries

174. The services of actuaries are indispensable in life insurance. They are required for various purposes, namely for estimating the long-term implications of changing maturity rates, trends in investment earnings and expenses incurred, for interpreting the effects of changing market conditions, for product development, and most importantly, for calculating the surplus that results from operations (described as "valuation") and determining the solvency margin. These tasks cannot be achieved by accounting practices. However, an actuarial qualification is difficult to acquire, and the developing countries generally suffer from a lack of experienced actuaries. Often actuarial services have to be obtained from a different country, involving foreign exchange. Smaller and medium-size companies may have no choice but to engage an actuary on a consulting basis. The life insurance sector, however, should give thought to the problem. Persons can be trained up to middle-level actuarial knowledge, so that at least some of the routine and simple work can be done within the organisation itself. Perhaps diploma courses could be arranged for this purpose. Actuarial training could be offered by regional training institutes. Some of the important national institutes can also play a regional role in this training.

Interface with the Government

175. The interface between the life insurance sector and the Government and/or the supervisory authority is important. Governments and supervisory authorities play an important role in the conduct of life business in many ways. They set standards for the valuation of the life fund to determine the surplus and its distribution. Since life insurance represents the savings of individuals which have to be kept invested, guidelines for the investment of funds are often stipulated. Furthermore, in many developing countries a substantial part of investments must be made in government securities or bonds on the grounds that this safeguards the policyholders' savings. Life insurance is also greatly affected by fiscal policy in terms of the taxation of policyholders as well as the insurer. All this requires good mutual understanding.

Delivery system

176. There has to be an effective system for the delivery of life insurance products. It is to be noted that, unlike many lines of non-life insurance which are purchased to comply with the requirement of a credit institution or a law (third party motor insurance), life insurance has to be "sold". The marketing could be done either by company staff or by agents compensated through commission. It is reported that in francophone Africa it is mostly the staff of the company who do the marketing. 35/ However, in most other countries agents are responsible for selling life insurance. The problem with agents in many developing countries is that, for a variety of reasons, the qualifications of the people who take up this profession are poor. Most of them work part time, and the turnover is high. It has been stated that keeping the turnover rate of agents under control is the biggest challenge to the management. 36/ Most of them produce a low volume of business, and only a few contribute a reasonable amount. In general, a well placed human resources development strategy is needed for the selection, training, grooming, motivation and supervision of the intermediaries of life insurance.

177. "High pressure" selling is unproductive in the long run 37/. This factor alone is to a great extent responsible for the poor image of the life sector. The complaint is often made that the agent is interested primarily in booking the business and earning his commission, and does not provide after sales service. Sales not based on genuine needs also lead to a subsequent high lapse ratio, or conversely to a poor conservation ratio. Life insurance is a very personalised business 38/, and the delivery agent has to be well versed in financial and fiscal matters. He should be able to give proper advice to the prospective policyholder about taxation aspects and various other alternative savings instruments, and should be able to help in analysing the various options from a long-term point of view. He is often also responsible for collection of premium. He should also provide effective after sales services such as help to the client in completing formalities, e.g. for obtaining a loan on the cash value of the policy, and in the processing of claims.

178. Recognising the important role played by agents, the authorities in Singapore have issued minimum industry standards for their recruitment, training and management. The regulations cover minimum age, education and qualifications, and promotions. They also redefine commission scales and measures to prevent misrepresentation of the benefits of policies. 39/

179. An important aspect in the marketing of life insurance is that strict control has to be maintained on cost. This is necessary to keep up the attractiveness of life insurance as a savings media in comparison with other savings and investment instruments. In view of the weaknesses of the institution of agents as discussed above, this is not an easy task for a company to achieve on its own, since it operates in a competitive environment. The Association of Life Insurance Companies in Malaysia has done useful work in working out methods of controlling acquisition costs at the industry level.

Linkage with other agencies

180. Opportunities also exist in many developing countries for insurers to establish a link with units in mutual funds, credit card holders and institutions which provide housing mortgage loans. 40/ Pension-type retirement plans for employees of corporate bodies on a group basis have also been devised in many countries.

181. It has been observed that opportunities offered by various low-income groups have not been sufficiently explored. A standardised product can be marketed by establishing a linkage with other agencies. Since for a standardized product the personalised services of an intermediary may not be necessary, the cost can be reduced. Considerable work has been done in India in arranging low-cost insurance to salaried employees on a group basis.

Life insurance and the rural sector

182. The vast rural sector remains insufficiently explored. It is true that this sector is characterised by low income levels, high illiteracy rates and wide geographical spread, making it difficult to deliver the traditional and standard product. However, a group approach linked to a suitable agency, such as a mutual or a cooperative, a trade union, distributors of inputs such as seeds or fertiliser, or those who purchase the produce for processing, could be considered. Social and welfare organisations can help in constituting a group of clients. Amounts of cover can be kept low, and the policy benefits limited, covering primarily the risk factor. A flexibility in payment of annual premium, which often causes a problem because of the clients' fluctuating incomes, may be considered. When a reasonably large group is involved, pre-acceptance medical examination may be dispensed with. Non-medical insurance, whenever attempted, has shown good results. The premium tables could be established for tranches of age, say on a quinquennial basis. In the absence of birth certificates, a simple process of certification by a recognised but easily approachable authority may be stipulated. A simplification of administrative requirements would be helpful in cutting costs and reaching a broader range of middle and lower-income customers.

Mortality tables

183. An issue connected with improving life insurance products in developing countries is the need to develop mortality tables. Specific information is not available about countries which have developed their own mortality tables. Many developing countries utilise with some modification mortality tables compiled abroad.

While this is understandable in the initial stages, it should be possible to gradually build mortality tables, if necessary on a regional basis by sharing data. This would help establish a more realistic and credible premium structure. Such mortality tables based on experience for 1961 to 1964, 1970 to 1973 and 1975 to 1979 have been constructed in India. Mortality tables have also been constructed for Singapore, Malaysia, and Thailand for 1977-1983 under the auspices of the Commissioners of Insurance of ASEAN countries. 41/.

Sharing of surplus

184. Another issue is the sharing of surplus as determined by valuation. In many countries the statute or regulations require that a substantial part of the surplus, as much as 75 to 95 per cent, has to go back to policyholders. There are several methods of sharing the surplus with policyholders. In cases of with-profit policies, a cash bonus could be paid from year to year, or at designated intervals. In some countries, particularly India, the bonus is distributed at the time of death or maturity. For without-profit policies, premiums are revised in line with the current experience.

Notes

1/ "The promotion of life insurance in developing countries", UNCTAD document TD/B/C.3/177, para. 8, 1982.

2/ "Establishing life insurance tax policy in developing countries", UNCTAD document TD/B/C.3/193, 1985.

3/ World Insurance Report, No. 387, 11 May 1990, p. 4.

4/ Report submitted by the Mission of Morocco, Geneva, 1 August 1991.

5/ L'Argus, 26 April 1991, pp. 1270-1272

6/ Samee-ul-Hasan, "Life insurance in countries with high inflation", paper presented at Economic Cooperation Organisation, Istanbul, June 1991, p.5.

7/ Ibid.

8/ Ibid., p. 6.

9/ Ibid., p. 12.

10/ M. Shakerin and F. Jarfa, "Promotion of life insurance in developing countries with high inflation", paper presented at the 7th ECO Insurance Seminar, Istanbul, 5-6 June 1991.

11/ World Insurance Report, No. 354, 20 January 1989, p. 4.

12/ L'Argus, 9 June 1989, p.1588

13/ M. Shakerin and F. Jarfa, op. cit.

14/ Isagani de Castro, "The development of life insurance in third world countries", paper presented at 7th TWIC, Dakar, May 1990

15/ World Insurance Report, No. 372, 29 September 1989, and The Financial Times, 31 October 1990.

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21/ Asia Insurance Review, January-February 1991, p. 37.; Singapore Insurance Institute Bulletin, April-June 1991

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Chapter IV

MOTOR INSURANCE

A. Introduction

185. Motor insurance is an important branch of insurance in terms of premium volume in many developing countries. On average it represents more than one-third of non-life premiums. 1/ It is also a sensitive class of business, since it is compulsory in many countries and therefore affects and concerns a very large portion of the general population.

B. Importance of motor insurance

186. Motor insurance is particularly important to the insurer not only because of the volume of premium it generates, but also because it represents a major source of cash flow. Motor insurance premium income is steady, with no specific periodic or seasonal variations. Thus, a continuous cash flow is provided, allowing insurers to meet their normal obligations and providing opportunities for investment of funds on a comparative long-term basis. Another important feature of motor insurance is that a comparatively lower extent of reinsurance is required. The amount at risk per vehicle is small and the spread is good. Reinsurance is required primarily for third party claims arising out of bodily injury caused by accidents. Reinsurance is usually taken on an excess of loss basis. The limits are comparatively moderate and hence the cost of reinsurance is reasonable. Thus, the major part of the premiums generated can be retained. This is not normally the case in other lines of insurance business where substantial reinsurance may be required. 2/

C. Performance of motor insurance

187. On the other hand, unfavourable underwriting results are faced in motor insurance in a number of countries. The rise in the rate of accidents has generally surpassed the growth rate in the number of vehicles. Furthermore, the increase in accidents has been coupled with an augmentation in the severity of losses.

188. The causes for the growing number of accidents are numerous. They can be attributed to greater traffic density, particularly in urban areas, bad road conditions, inadequate traffic control, poor vehicle condition, inadequate maintenance, and inexperienced and sometimes careless driving. It has been reported that more than 230,000 people are killed every year in road accidents in developing countries and that accident rates in many countries are rising by more than 10 per cent a year. Similarly, it has been observed that for example in Bangkok, Thailand, 52 per cent of cars surveyed drove through traffic lights when they were red and in Sarabaya, Indonesia, less than one per cent of drivers surveyed stopped at pedestrian crossings. According to a recent inspection in New Delhi, India, nine out of ten buses had rear, brake or side lights out of order. 3/ Vehicles engaged in public transportation in developing countries are very often overloaded and insufficiently maintained. Other factors affecting loss ratios include the insufficiency of first aid and ambulance facilities, rising levels of court awards and mounting costs of auto repairs. More effective implementation of loss prevention practices involves relatively low costs and may offer significant potential for improvements in loss ratios, particularly when there are difficulties in modifying tariffs.

189. Reports from some countries in respect of motor insurance results are given below:

190. Chile: While motor insurance has experienced steady growth since the inception of a new law in 1986, the loss ratio has climbed to 75 per cent. When acquisition and management costs are added to the loss ratio, the motor line shows a negative underwriting result. 4/

191. Trinidad and Tobago: Practically no company underwriting motor business will make money (1989). 5/

192. India: In some categories of vehicles, loss ratios have climbed to 500 per cent. 6/ Republic of Korea: With loss ratios of 70.2 per cent and 65.9 per cent for the years 1988 and 1989 respectively, underwriting results in the motor sector are the worst of all branches. 7/

193. Malaysia: With the combined motor claims ratio rising to an estimated per cent in 1989, results are rapidly deteriorating. 8/

194. Côte d'Ivoire: Motor insurance takes up 45 per cent of the insurance market and has a loss ratio of 144 per cent. 9/

195. Egypt: The loss ratio for compulsory cover in the motor sector approaches 300 per cent. 10/

196. Zimbabwe: Several insurers have experienced underwriting deficits, and the loss ratios for buses have been exceptionally high. 11/

D. Inadequacy of tariffs

197. Motor insurance rates are generally subject to a tariff structure. Despite adverse claims experience, the rates are often not revised for long periods, or are inadequately revised. There are several reasons for this. First, motor insurance rates affect a large cross section of the population and therefore the issue is sensitive. Since the third party portion of motor insurance is compulsory and the level of compensation is a matter of public policy, the Government's direct or tacit consent has to be obtained when revising motor tariffs. Insurance companies have often not been able to put up a good case for a revision.

E. Risk classification

198. A low level of motor rates and the classification of vehicles into very broad categories which does not take the risk characteristics sufficiently into account may provide wrong signals to owners and drivers. There is little incentive for properly maintaining the vehicle, driving it safely, and adopting loss prevention measures. Very often, rating structures are not based on the characteristics of the owner or the driver, but on those of the vehicle. The age, occupation and earlier accident record of the owner or the driver is not taken into account most of the time . Even the vehicle itself, its use and condition or age are often not, or insufficiently, taken into consideration for the establishment of motor rates. The rates are usually based on a very broad classification of vehicles, for example the value and the horse power. In general, the client has considerable freedom in determining the amount for which his vehicle is insured. In view of the importance of the motor business in the total insurance business, it is important that, as markets attain maturity and sophistication, incentives and penalties are built into rating patterns.

199. Developments reported in a few countries are described below:

200. In Zambia the motor business succeeded in presenting a convincing case to the authorities and managed to obtain adjustments in rates in 1979, 1982, 1983 and 1985. On these occasions opportunities were taken to introduce several new ideas to reflect the hazards involved. As a result, the motor account, which had traditionally been in deficit, showed a profit. The new concepts introduced included:

- Physical inspection before commencement of insurance; requirement of an engineer's report for vehicles more than five years old;

- Introduction of the "average" clause, which reduces the claim amount in line with the proportion which the sum insured bears to the market value of the vehicle;

- Introduction of deductibles;

- Imposition of "area loading", varying from 12.5 per cent to 20 per cent depending upon the zone in which the vehicle normally moves, the capital city having the highest loading;

- Discounts if more than one vehicle is insured, if the person also drives a company vehicle, if the person accepts the restriction that the spouse will not drive, if anti-theft devices are fitted, and if the person is more than 40 years of age and has not been involved in any accident for four years;

- Introduction on a voluntary basis of a built-in personal accident cover and limited medical expenses if injury is sustained by the insured. 12/

201. Congo: The central problem is an old tariff which was introduced in 1962 and which had only one minor adjustment in 1984. 13/

202. Côte d'Ivoire: The tariff for compulsory motor insurance has not been revised since 1979. 14/

203. Malaysia: To render motor business viable, Bank Negara (the insurance control authority in Malaysia) has concentrated on 'a viable motor rating plan'. A better motor rating plan would take into account characteristics of vehicles and drivers when setting premium rates. 15/

204. Senegal: The market is unprofitable, as the auto tariff has been frozen for the past five years. 16/

205. Sri Lanka: In December 1989 the motor insurance tariff was increased for the first time in nearly 20 years. Third party policy was increased by 233 per cent. 17/

206. Tunisia: Suggestions have been made to dynamize the tariff system by introducing variable elements which will permit adjustments on the base tariff. The present system of uniformity, imposing the same tariff for different risks, needs to be differentiated. 18/

207. Turkey: The motor business in the past was burdened with a fixed low tariff generating inadequate premiums. 19/

208. The 1990 Reassessment Workshop of African Insurance Markets held in Morocco specifically recommended that, regarding the classes of business where tariffs are established by agreement of the authorities, the latter should take account of economic criteria.

F. Claims

209. The management of claims is affected by numerous and diverse problems.

210. Personnel: Many insurers attempt to improve their claims processing systems in order to both control claims costs and provide a more efficient service to their clients. This is usually done through improving the skills and performance of their personnel. In motor insurance, most claims are assessed by independent surveyors, with only few companies having their own in-house trained surveyors. Because these surveyors are not tied to any one insurer, delays and lack of application are often seen. Just as they have training schemes for their own personnel, insurers may consider setting up screening and training programmes for surveyors while still respecting the latters' independence. This would be to their mutual advantage and would also benefit insurance consumers.

211. Repairs and spare parts: In many developing countries the insured parties utilise makeshift repair shops to have their vehicles repaired. The advantage of such shops is that they charge less than the officially approved garages and carry out repairs quicker. The disadvantage is that the charges, although lower, are not standardized and a considerable amount of bargaining takes place. It is often difficult for the insurer to ascertain the actual amount the client has paid for the repair. Original manufacturers' spare parts are comparatively expensive in many developing countries. Very often the various parties involved allow the use of non-genuine parts. These are likely to be of inferior quality and the price may vary substantially. Often old and worn parts are used for repairs, making vehicles accident prone. The variable cost and quality of repairs and spare parts introduce an arbitrary element that complicates both a correct assessment of the claim and the appropriate establishment of indemnization. Such conditions are not conducive to professional underwriting.

212. Compensation for bodily injury: The settlement of claims for compensation of bodily injury due to road accidents has many problem areas. Hospitalization costs have been increasing. Accident rates in developing countries are high and a large number of claims have to be processed. Reports from the police often take a long time and are sometimes not sufficiently clear. The judicial process is slow. There are few standard norms as regards the level of compensation, and the amount of compensation often differs from one region to another.

213. Social implications: As pointed out, insurance companies frequently make a loss in their motor departments because of inadequate rates. It follows that when a claim is made they fight hard to avoid payment or at least to reduce the quantum. This has a public policy aspect since, although the cost of repairing the vehicle concerns only the owner, the compensation to the victims of road accidents affects the general public. The fact that a large number of victims are persons from low income groups further aggravates the problem. The authorities in developing countries should allow insurers at least an adjustment in the third party section of the premium rate so that the level of compensation is fair. This would also relieve insurers of the need to persistently and perpetually contest and challenge awards to accident victims. The legal process of determining compensation also deserves examination by the public authorities. A different problem is that in many developing countries the families of victims killed in car accidents do not present claims for compensation, taking the accident as a matter of fate. Severe hardship for the stricken families may be the consequence.

214. Theft and fraud: Satisfactory solutions to the insurance problems caused by theft and fraud require greater co-operation among the insurers themselves and between the insurers and their clients, the police department, the surveyors and the service and repair shops. Reports regarding several countries follow.

215. Argentina: A group of Argentine insurers have formed a data sharing system to exchange information on stolen cars. In 1990, insurers paid out more than $US200 million in car theft claims. 20/

216. Colombia: Auto theft continues to be a major problem for insurance firms. It is estimated that at least 11,000 vehicles are stolen annually in the country, some 3,000 of them covered by theft insurance. The relatively high level of auto insurance is due primarily to two factors. First, by law motorists now have to possess third party cover, and this provision is being strictly enforced. Second, an ever increasing number of motorists are today taking out comprehensive cover in view of the car-theft rate, which the police has been unable to reduce. 21/

217. Trinidad and Tobago: The sharp rise in thefts is making motor insurance a distinctively unattractive business. The Insurers' Association hopes that a data bank will assist them in keeping down the incidence of theft claims suspected of being fraudulent. Multiple claims for the same vehicle are being experienced by many motor insurers, but the Association of Insurers does not have the centralized tracking system to gather the necessary evidence. 22/

218. Pakistan: Some insurers have stopped writing comprehensive insurance for cars because of the rise in car theft. Representatives of insurance companies say that stolen vehicles readily appear on the open market while owners file claims. 23/ Theft of motor vehicles continues to increase with claims for 1990 reaching more than 6,500 cases. 24/

219. Malaysia: To curb the trend of rapidly deteriorating results, in part due to a growth in the number and size of fraudulent claims, it would be necessary to develop an industrywide data base. This idea is currently being promoted by the Association of Insurers. 25/. Also to combat fraud, all insurers should take direct responsibility in detecting fraudulent claims. 26/

G. Underwriting practices

220. Cash flow underwriting, the inability to control acquisition costs, cut-throat price wars for market shares and high inflation further deepen the disequilibirum between premiums and claims. In some countries measures have been introduced to ameliorate the situation.

221. Trinidad and Tobago: With companies writing business at low rates (due to fierce competition), inflation is bound to affect their ability to pay. 27/

222. India: A bonus-malus system and deductibles have been introduced. 28/

223. Republic of Korea: The motor sector grew by 50.5 per cent from 1989 to 1990, largely due to the increase in the number of vehicles and the introducion of a malus/bonus system. 29/

224. Singapore: The General Insurance Association of Singapore has barred three of its members from granting discounts of over 50 per cent to vehicle owners with no claims bonuses in order to maintain the transferability of no claims bonuses. 30/

225. Peru: The new regulations stipulate that rates are to be based on the technical principles of equity and sufficiency and on statistical information. 31/

226. Brazil: Companies are making efforts to improve productivity and risk selection, as they need to generate profits from underwriting and not from investments. 32/

H. Inflation

227. Argentina: The value of an insured property cannot be adjusted because there are no indexes that can predict price increases. For example, in the motor insurance branch, in 1989, policies were invoiced every four months, and a car's replacement value dating a month back could not be used a month later as a reference to estimate its total loss, since that value would have been less than 50 per cent of a similar car's actual price tag and premiums were of course hopelessly insufficient. 33/

228. Brazil: The differences between government indexation and the variation of effective costs has an impact on the company's cash flow, affecting mostly motor insurance. 34/

I. No-fault schemes and guarantee funds

229. In a number of developing countries the introduction of a partial or full "no-fault" system is seen as a remedy for the deficiencies of their system of settlement of third party claims. It is deemed that such a system would provide for quick indemnification, without debating the question of fault. This is a departure from the traditional tort liability system, where the burden of proof lies with the victim. In certain countries indemnization schemes for victims of traffic accidents have been introduced, thereby speeding up settlements and making them more equitable, although somewhat limiting compensation. Several reported developments follow.

230. Chile: A new law enacted in 1986 provided for two different types of insurance:

(a) A bodily injury insurance, where victims only have to declare that they were party to a traffic accident and name the insurance companies covering the parties to the accident in order to receive compensation. The compensation limits were set to enable companies to keep rates at reasonable levels.

(b) Regarding material damage, a third party coverage with the need of proof through judicial procedure was introduced. The new scheme is operating with acceptable levels of viability (64 per cent loss ratio). 35/

231. India: The General Insurance Corporation (GIC) has taken over the administration of the Solatium Fund Scheme from the Ministry of Surface Transport. The Fund provides compensation to victims of hit-and-run road accidents where the vehicle cannot be identified. 36/

232. The 1990 Reassessment Workshop of African Insurance Markets in Morocco recommended that:

- Limits to liability should be introduced, and "no-fault" systems considered;
- The establishment of guarantee funds for motor insurance should be studied.

233. The Gulf Cooperation Council (whose members are Saudi Arabia, Kuwait, Bahrain, United Arab Emirates, Qatar and Oman) has recommended the setting up of a guarantee fund for no-fault motor accident claims. 37/

J. Baremisation

234. In many African countries a "barème" scale for liability insurance in the motor business has been or is about to be introduced. It is to be used in court when awarding damages to victims of accidents or in direct payments to victims where no-fault systems have been adopted as is the case in Cameroon. 38/ The purpose of the "barème" scale is twofold. First, it ensures that the victim gets adequate and speedy compensation. Secondly, it limits excessive and varying court awards. The following countries have adopted or are due to adopt such a "barème": Algeria, Benin, Cameroon, Côte d'Ivoire, Mauritania, Morocco, Niger, Rwanda, Senegal, and Togo.

K. Simplification of policy wording

235. Several countries have taken steps to simplify policy wordings so that policies can be understood more easily by the general public. These measures are expected to improve the image and credibility of the insurance sector. A few country developments are described below.

236. Chile: Claim consciousness is still very low: only one-third of traffic accident victims have put through a claim for compensation. 39/

237. Malaysia: Insurers are contemplating introducing policies with simplified wording so as to make them understandable to everyone.

238. Peru: The new regulation mentions that terms and conditions of policies should be written in language best understood by the insured. 40/

L. Compulsory insurance

239. The trend of making third party motor insurance compulsory has continued. Obligatory third party liability for bodily injury from motor vehicles has been introduced or is under consideration in the following countries: Puerto Rico, Uruguay, Mozambique, Togo, Thailand, and Turkey.

240. In China since 31 May 1989 all vehicles owned by foreigners must be covered with third party auto liability insurance. 41/

241. In the Gulf region, the Gulf Cooperation Council (GCC) has recommended that compulsory insurance regulations should reach a unified standard within the GCC. 42/

M. International agreements

242. On the international scene a number of "coloured card" schemes have been operative. Under such schemes, loss or damage caused by a foreign vehicle is settled by local insurers which then have the right to seek reimbursement of their payments from the insurer who issued the international cover. Such schemes mainly function through a network of national bureaux representing the insurers issuing such international covers. Settlements between national bureaux are very often effected after all payments made for the respective nations are balanced out.

243. Argentina, Bolivia, Brazil, Chile, Paraguay and Peru have introduced a uniform third party liability policy for commercial vehicles. The agreement means that damage caused by a foreign vehicle will be paid in the country where the accident took place. 43/

244. In 1987 the African Preferential Trade Agreement (PTA) countries introduced a "yellow card" system for third party motor insurance. Claims settled by the country in which the accident occurs are later reimbursed by the country which issued the yellow card. 44/

245. On the other hand, the introduction of an "orange card" is beinghindered in the Arab countries by differences in the legal systems. 45/

246. A "brown card" system has been introduced in the Economic Community of West African States (ECOWAS). 46/

N. Multi-party multi-sectoral approaches

247. Solutions to problems of the motor insurance branch can be found only partially by the insurance sector itself. The problems arising in the settlement of claims require the involvement and participation of various, mostly public, agencies. These would include road and traffic departments, the police, the judiciary, health authorities, representatives of consumer associations, and the Government.

248. In a number of countries, "committees" comprising representatives of relevant public agencies and insurers have been set up (e.g. in Côte d'Ivoire and Malaysia), which have led to new regulations, new safety standards, road safety campaigns, and improvement of roads and health care systems. In Chile, for example, a new regulation has permitted hospitals to greatly improve their emergency services as they are now able to recover some of the costs incurred for treating traffic accident victims directly from the insurance companies. 47/

249. The 1990 Reassessment Workshop of African Insurance Markets in Morocco recommended that solutions to the problems of motor insurance have to be found partly outside the insurance sector, inter alia, through:

- The education of the public;
- Better roads and infrastructure;
- Better vehicle maintenance; and
- The enforcement of traffic regulations.

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Chapter V

FIRE INSURANCE

A. Introduction

250. Fire insurance business, which on average represents about 25 per cent 1/ of the total non-life business in developing countries, is an important line for insurers. This is particularly so since motor insurance produces losses for most companies in developing countries, while fire business is profitable, and thus provides a good cushion. To the extent that cross-subsidization takes place between profits of fire and losses of the motor section, fairness of rates for fire policyholders is impaired.

251. In Benin the fire branch has shown regular growth in both personal and commercial lines. It is a source of compensation for the loss-generating motor insurance sector. 2/

252. In Thailand fire insurance is subject to tariffs which are set by the Insurance Department. The advance in building quality and fire fighting techniques and the availability of water has caused a rise in profits. The Insurance Department is reviewing a probable cut in fire tariffs. 3/

B. Loss ratios

253. Loss ratios in the fire business are commonly lower than 40 per cent. An UNCTAD statistical survey shows that out of 87 countries, 61 had loss ratios in fire lower than 40 per cent. 4/ However, these statistics also show that events of a catastrophic nature may lead to a sudden rise in loss ratios. It may be noted that the primary impact of catastrophic losses, which is being discussed separately, is borne by the fire department since the risks of flooding, tornado, cyclone, volcanic eruption and earthquake are usually written as an extension of a basic fire policy. Substantial fluctuations in loss ratios also occur because in a number of countries the markets are small and do not provide a sufficient geographical spread of risks. Depending on the size of the market, a few major fires may turn a profit situation into one of severe loss.

254. In Chile fire loss ratios were 219 per cent in 1985 while only 63 and 84 per cent for 1984 and 1986 respectively.

255. In Mexico they were 169 per cent in 1985 while only 25 and and 9.5 per cent in 1984 and 1986 respectively.

256. In Fiji they were 644 per cent in 1985 while only 58 per cent in 1984 and 113 per cent in 1986. 5/

C. Insurance awareness

257. Lack of awareness of the benefits of insurance affects the fire sector most. Transport of goods is usually negotiated through the banking system and insurance is required. This supports marine insurance. In the motor section, third party insurance is usually compulsory, and insurance for damage to the vehicle is usually marketed along with it. In the fire section, insurance is required by the bank when it gives a loan to a commercial or industrial enterprise. However, the extent of insurance may be insufficient. It is also possible that the value insured has not been adjusted to take care of inflation, or of improvements made. The sum insured may be only to the extent of the loan availed. Further, the insurance may cover only the basic peril of fire and not extend to other insurable perils. It is generally believed that a large number or perhaps the majority of simple risks belonging to individuals, such as dwellings, shops and other small enterprises, and small sector and handicraft operations are without any insurance.

258. At a Reassessment Workshop of African Insurance Markets, it was suggested that some classes of fire risks should be made compulsory (as is the case in some Laender in Germany and Cantons in Switzerland) as a measure to improve risk consciousness and better protect the wealth of the country. Needless to say, while taking such a decision, the paying capacity of the public should be kept in mind.

D. Rating structure

259. Judging by the overall profitability of the fire business in developing countries, it would appear that premium rates are quite good. They may, however, hide a certain degree of arbitrary rate-setting. For example, the share of the rate for the basic cover of fire and other perils, particularly catastrophe perils, may not be properly allocated. There may also be inter se rate distortions between various categories of risks, particularly between commercial risks and "mass risks". It is possible that, for various reasons, particularly volume of business and effective lobbying, comparatively favourable rates and terms and conditions are given to the former, while the interests of the latter are overlooked.

260. Another weakness of the rating system for fire risks in developing countries is that incentives for risk improvement and loss prevention measures and penalties for bad features may not be well structured. For example, discounts for the installation of fire-fighting appliances, for the segregation of hazardous processes and materials, and for the subdivision of buildings to limit the size of a potential loss 6/ could be made more effective. In this connection, it is essential to note that together with a discount for fire-fighting facilities, it will be necessary to have systems, by way of periodical checks, to constantly control the servicability of the installation. Similarly, the imposition of a loading following discovery of a deficiency in the risk may be considered. Such a loading should be withdrawn when the deficiency is set right. High-rise buildings and complex risks require special rating. Since reinsurance on these risks is often substantial, the rate suggested by the reinsurer often has to be accepted. Nevertheless it would be advantageous for markets to pay greater attention to the technical aspects of risk evaluation and build up expertise and a capacity for proper rating of these risks as they grow.

261. The rating structure of fire and allied risks has not received the necessary attention in a number of developing countries. This could be partly because the business has been profitable on the whole, and partly because of a feeling among insurers that a closer examination may result in a downward adjustment of rates. A more important factor, however, is the lack of statistical data and expertise required for a systematic analysis of the characteristics of various categories of risks. The prevalent rates in a large number of countries are derived historically, with ad hoc modifications to meet pressing exigencies. It is, therefore, necessary that markets introduce, wherever this is not the case, a systematic collection of sufficiently detailed statistics of fire and allied risks. Existing rates may require review with the aim of making them fair and equitable. The establishment of a cadre of qualified and experienced engineers, if the size of the market warrants it, may also be considered. This would go a long way in building up and promoting a culture of loss prevention and risk management.

E. Loss surveyors and assessors

262. A problem from which most of the developing countries suffer relates to is the inadequate skills of surveyors and loss assessors, who tend to come to a conclusion about the loss by negotiating and bargaining with the policyholder, rather than technical and strict quantification. In programmes of insurance education, provision should be made for upgrading the skills of auxiliary services, such as those of surveyors.

F. Pooling arrangements

263. To have access to a larger number of risks, and to benefit from a better spread, a number of pooling arrangements have been set up within or between developing countries. The results have been generally profitable for participating companies. However, for various reasons, the scope of these pools has not sufficiently increased.

264. The African Fire Pool (AFP) has not succeeded in attaining its membership and premium income target. However, it is planning to attain US$3 million as premium income for 1993. Once this is achieved, the AFP will be able to consider the selective underwriting of facultative business. 7/

265. In the Republic of Korea all large industrial and commercial business could previously be insured only through the industrial fire pool shared until recently by 11 domestic companies. The advent of two American

companies joining the pool displeased the original members to such an extent that the major Korean insurers withdrew and the pool was dissolved. 8/

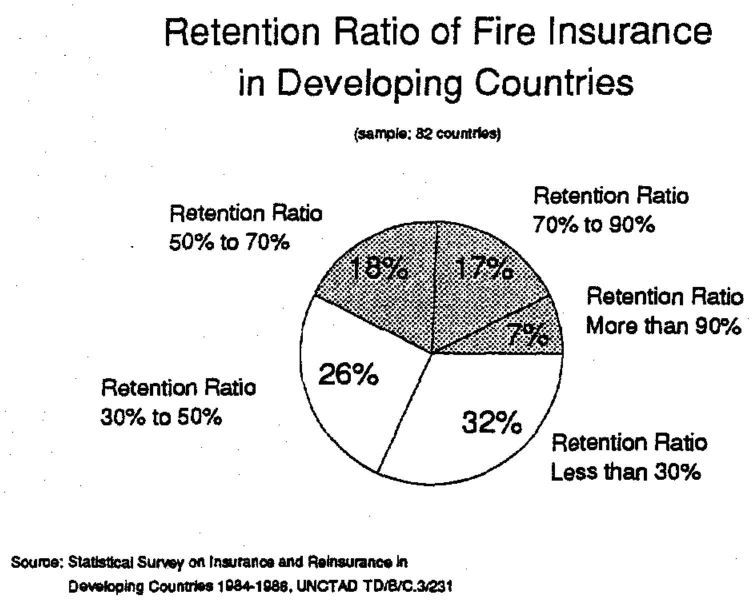
G. Reinsurance

266. An important feature of fire business in developing countries is that it is substantially reinsured. An UNCTAD statistical survey of 82 developing countries showed that 57 per cent of them retained less than 50 per cent of business underwritten, and 32 per cent retained less than 30 per cent (figure 2).

There are various reasons for this:

- The size of domestic markets;
- The retention capacity of companies with small capital and reserves in relation to the potentially high size of claims;
- The increase in the number of large risks in recent years;
- The complexities inherent in underwriting commercial and industrial risks;
- The fact that some risks have a high import content requiring foreign exchange for replacement in case of a loss, a problem which is eased by reinsurance abroad.

Figure 2



267. On adoption of an "open-door" policy by Viet Nam in 1988, the state insurer Baoviet is placing its facultative fire reinsurance in the London market. 9/

268. Various aspects of reinsurance of fire risks are considered in a separate chapter. Suffice it to say that retentions are fixed in a large number of developing countries on the basis of the amount insured. Depending upon the expertise available, fixing retentions on the basis of probable maximum loss (PML) may be considered. This would help in rationalizing retentions, inasfar as these would correspond more effectively to the potential of a loss. Since larger amounts could be kept in terms of the sums insured, overall retention will also improve. At the same time, it is necessary to be cautious, since a wrong application of PML underwriting may expose the net account of the company.

Notes

1/ "Statistical survey on insurance and reinsurance operations in developing countries (1984-1986)" (TD/B/C.3/231), February 1989, UNCTAD.

2/ L'Argus, 26 April 1991.

3/ Asia Insurance Review, March-April 1991.

4/ Ibid.

5/ Ibid.

6/ "Loss prevention in fire and marine cargo insurance", (TD/B/C.3/162), May 1980, UNCTAD.

7/ International Research Letter, September 1990.

8/ The International Broker, January 1991.

9/ World Insurance Corporate Report, No. 43, 11 May 1990, p.5.

Chapter VI

MARINE AND TRANSPORT INSURANCE

A. Introduction

269. The problems encountered in marine insurance include those caused by the cyclical nature of the business, safety of ships, infrastructural deficiencies in developing countries, the role of classification societies, maritime crimes and localisation of risks.

270. International marine insurance is a highly cyclical business. Soft market periods are followed by hard markets. The condition of the market is affected not only by variations in capacity - over-capacity leading to reduction of rates, more generous conditions and greater discounts - but also by the situation of the shipping sector. The shipping industry has been passing through a recession, and marine insurance markets have been soft. However, of late, the shipping industry has been doing better. Marine insurance rates are also hardening particularly in the hull department, and it is reported that for the first time in the past 20 years there are prospects for real growth. 1/ Nevertheless, certain segments of the market continue to experience adverse results.

B. Safety of ships

271. The safety of ships is of concern to the marine insurance sector, since it affects both the cargo and hull business. Losses both in terms of number of ships and their deadweight have been declining in the last few years (see table 6). Losses in terms of deadweight in 1990 amounted to less than a quarter of the 1986 figures. The number of ships lost is of course not the total picture of insurance claims since partial losses also occur. These give rise to both repair costs and general average claims on cargo.

272. It is worth noting that ships operating under flags of convenience have accounted for about 30 per cent of the world's ships lost. 2/

Table 6

Shipping tonnage lost 1986-1990

	1986	1987	1988	1989	1990
Number of ships lost	358	284	271	247	175
Thousand dwt	6,810	3,125	1,905	1,064	1,680
Percentage of world fleet	1.1	0.5	0.3	0.2	0.2

Source: Maritime Information Services Ltd., London, quoted in UNCTAD, Review of Maritime Transport 1990 (TD/B/C.4/340), p.82.

273. Risks have increased substantially over the years, inter alia for the following reasons:

(a) A greater number of ships are carrying oil and/or dangerous cargo. Approximately 35 per cent of the world's seaborne trade consists of this cargo. 3/ Accidents involving these vessels give rise to heavy claims.

(b) The size of ships has increased, particularly that of tankers. The number of ships over 100,000 GRT has grown to 498 ships. 4/ Large vessels increase the risk factor.

(c) The average age of many fleets has increased. Older ships are not getting replaced with new ones. Over 15 per cent of the world fleet is now 20 years old or more, and 73 per cent of the world tanker fleet is 10 years old or more. Out of the total losses of 258 ships in 1991, 192 ships were more than 15 years of age, accounting for 75 per cent cent of the losses, 5/ which indicates the increase in the risk factor with age.

(d) Resource squeezes due to frequent recessions in the shipping industry, particularly the last one, which lasted for nearly a decade, have resulted in a general fall in maintenance standards, with an obvious toll on safety.

(e) There has been a deterioration in operational standards and the quality of crews manning ships.

(f) There is a shortage of trained and experienced personnel and a lack of training facilities. According to a study carried out by the International Shipping Federation (ISF) and the Baltic and International Maritime Council (BIMCO), this shortage is likely to become progressively worse.

274. World maritime safety has grown along with the shipping industry. Most of the rules, regulations and standards related to safety are the outcome of maritime disasters with the attendant public criticism, liability claims and subsequent legislation. It is assumed that a ship constructed in accordance with the rules of an established classification society and maintained in classification and complying with the International Safety Conventions would constitute a good risk as far as insurance is concerned. However, in spite of a plethora of international regulations concerning safety and the protection of the environment, maritime disasters continue to occur.

Underwriting and classification societies

275. Traditionally, the underwriters approach the matter of maritime losses from a financial point of view, balancing claims (paid and outstanding) with premium charged. The quality of management of the fleet has not been given sufficient importance. At the last conference of the International Union of Marine Insurances (IUMI) held in Bern in September 1992, it was recommended that "in addition to analysing loss history, underwriters should seek to assess the technical standards of shipowners' vessels, the standard of its crew and of the owner's management". 6/

276. The working of classification societies has a close connection with marine insurance. The societies control the technical aspects of ship construction and maintenance. They inspect ships and issue reports pointing out defects and recommending steps to be taken. The shipowners are expected to take the necessary action to maintain the classification of ships. The underwriters accept the certificate of classification issued by societies and underwrite risks on this basis.

277. In recent years some marine underwriters have expressed dissatisfaction with the working of classification societies. It has been reported that for commercial considerations arising out of competition, classification societies have compromised on standards. 7/ For example, when a ship is required to be dry-docked for survey (and repairs) by a society, some other society agrees to continue the classification on the basis of a superficial survey and deferment of repairs. Some underwriters have, therefore, found it expedient to have independent surveys of ships, with reports submitted directly to themselves. Sometimes a "condition" survey, which is general in nature, and sometimes a "structural" survey, which is a comprehensive survey after dry-docking, is required by underwriters. While the underwriters are justified in taking such precautionary steps as they deem necessary, a duplication of function should be avoided. The infrastructure and expertise developed by the classification societies over the last two centuries has to be utilized.

278. Marine insurers may consider taking greater interest in the working of classification societies, so that the surveys done and certificates issued are more in line with the requirements of underwriting. In fact, it has been suggested that to restore confidence in the working of the societies, a thorough assessment of the entire structure under which the societies operate is necessary. 8/

279. A grading of ships in accordance with their condition may be of help to marine underwriters. At present a one-class notation is used by societies which continues throughout the life of the ship, irrespective of age and level of maintenance, as long as minimum standards are complied with. A graded class notation which takes into account age and condition of maintenance may be more relevant.

280. On their part, the classification societies have to improve their methods. Instead of non-exclusive (freelance) surveyors, the societies can use the services of other societies recognized by the International Association of Classification Societies (IACS) or the local classification society in an area where the particular society may not have proper representation. It has been reported that the IACS is evolving a code of conduct for its members and has issued a directive to them that they should implement a quality management system in their own organisations and should have that system audited and certified by its Quality Committee. Competition amongst various societies should not lead to sacrificing the quality of standards.

Problems of developing countries

281. About 21 per cent of the present world fleet belongs to developing countries. 9/ A number of developing countries are endeavouring to further expand, or in cases where they do not have one, to establish their own mercantile fleet. They encounter many problems, some of which are common to the shipping sector in general. Additionally, they face many difficulties because of lack of development of their economies. Some of these are:

(a) The lack of infrastructural facilities for implementation of safety standards. Many developing countries have virtually no maritime administrative machinery to service the fleet in terms of its safety requirements. Most of the developing countries have, therefore, remained perpetual importers of technology from the advanced maritime nations. They have to comply with the international regulations in order to trade, but they tend to follow the regulations as a maximum affordable rather than a minimum standard. They usually delegate powers of implementation of safety standards to classification societies or other organisations or persons, but have no mechanism to ensure the authenticity of surveys undertaken by these organisations or persons.

(b) A lack of dry-docking or repair facilities often leads to postponement of surveys to ascertain the safety standards of ships and carrying out of required repairs or renewal. Sometimes temporary repairs are carried out which may not be effective.

(c) Only a few developing countries have classification societies of their own. They are Brazil, China, Cuba, Democratic Peoples' Republic of Korea, India, Indonesia, Islamic Republic of Iran, Mexico, Republic of Korea, and Turkey. Only the societies of China and the Republic of Korea have been admitted as members of the IACS. India has been admitted as an associate member. 10/ In the interest of development of their shipping sector, major maritime developing countries may consider having their own classification societies. The marine insurance sector would be able to coordinate better with a national society. This would also provide the nucleus for growth of shipbuilding, ship repair and other marine ancilliary services.

(d) With a worldwide shortage of trained and experienced maritime personnel, developing countries find it more difficult to man their fleets effectively. Inability to pay according to international standards, and lack of tax concessions for maritime personnel in many developing countries hamper efforts to attract the best talent.

C. Multi-modal transport regime

282. Insurance companies are interested in the terms of contracts for carriage of goods, as this affects their eventual liability. With the containerization of cargo, the cargo proceeds from the point of origin to the point of final destination without any checking. Similarly, the cargo could be carried on a road vehicle which could roll on and off a ferry without any discharge when the mode of transportation is changed. Under such a system it is natural for one and the same operator to undertake responsibility for the entire transport. The United Nations Convention on International Multimodal Transport of Goods, 1980 (the MT Convention), adopted in May 1980 with the participation of 84 states, including 51 developing countries, is intended to create a measure of uniformity in multimodal transport. The Convention requires 30 contracting parties to enter into force. As of October 1992, it had as contracting parties Chile, Malawi, Mexico, Rwanda, Senegal and Zambia. One of the reasons for the delay in more countries becoming contracting parties has been that as long as the United Nations

Convention on the Carriage of Goods at Sea (Hamburg Rules) is not in force, there is no point in bringing the MT Convention into force, as this would create too big a gap between the liability under the Convention and that under the Hague Rules or the Hague-Visby Rules. By October 1991, the required number of 20 countries had become contracting parties to the Hamburg Rules by definitive signature ratification or accession. 11/ The Convention thus entered into force on 1 November 1992 in all trades from or to a contracting party. Meanwhile, new rules, called the UNCTAD/ICC Rules on Multimodal Transport Documents, were finalized in April 1991. Being based on the existing unimodal liability régimes, these Rules would facilitate multimodal transport, and parties are free to use them if they so wish. These Rules are intended to avoid a multiplicity of different régimes governing such transportation and to provide a private transport contract with a uniform legal régime. 12/

D. Maritime crime and fraud

283. Maritime crimes continue to grow in complexity and sophistication. The alarming factor is that the majority of crimes today are committed by "organised gangs/syndicates" as opposed to the relatively ordinary criminals of the past. It has to be recognized that liability for all maritime crimes does not fall on insurers. For example, in documentary frauds where the cargo does not exist, there is no insurable interest and the loss is outside the scope of the insurance contract. However, a claim is nonetheless made on the insurer by the party which has suffered the loss, and the insurer has to go through the process of detail enquiries, investigations and often extremely costly legal proceedings to establish that liability does not attach to it. At a general level, the function of the insurer is to protect the buyer or the seller of the goods under contracts of international trade, and it is expected of him that he will guide and advise his clients in matters related to imports and exports. It is, therefore, necessary for insurers to understand the ramifications of maritime crime. The frauds that are encountered can be classified as those relating to documentation, charter party, deviation and piracy. 13/

Documentary frauds

284. Oil frauds: Since 1989, offers for the sale of crude oil ex. Nigeria have victimised hundreds of buyers. In a typical example, oil is offered at a discounted rate (up to US$6 below the market price). The buyer is asked to open a letter of credit which is encashable after the vessel reaches its destination. The sellers prepare false documents and copy these to the buyer. The buyer is then asked for an advance sum of US$250,000 (typical amount) to cover "port expenses" of the vessel. The buyer pays this amount to the seller and awaits the vessel's arrival at the discharge port. In reality, the shipment belongs to another buyer and the victim discovers this only after the vessel reaches its destination. Despite warnings in the press, this type of fraud continues.

285. Cigarettes: Since the middle of 1990 the sale of non-existent cigarettes of a certain brand has been on the increase. Unscrupulous sellers offer container loads of surplus cigarettes at discounted rates. Sellers cash the letters of credit by presenting false documents. In some instances, reputable agencies had issued 'pre-shipment inspection certificates' by examining the goods in warehouses. The actual containers when shipped were empty. The insurance policies in many instances were genuine. Worldwide, dozens of innocent buyers have lost hundreds of millions of dollars.

286. Other types: Lately, fraudsters have targeted Commonwealth of Independent States (CIS) countries. In a recent case, a company from one of the CIS countries was cheated of US$2.5 million when it paid for a shipment of non-existent sugar. Lack of commercial know-how may have been instrumental in this fraud. The offer for the sale of the sugar had said "price - c & f $265 from a South American port to any port in the world".

Charter party frauds

287. These reached a peak in the mid-1980s. In a typical case a time charterer having collected the freight would abscond leaving the cargo owners and the carrier to resolve the matter. The cargo interests ended up paying double freight for the vessel to complete the voyage. Fortunately these frauds have declined and there has been only one reported case since 1990.

Deviation

288. In the 1980s over 30 vessels illegally deviated into Lebanon and sold cargo. In most instances, the cargo was virtually lost and the cargo insurers had to suffer considerable losses. In some cases, it has been possible to recover the cargo through quick action. The last such recovery was in December 1990 for a cargo of aluminum worth US$8 million. This was achieved with the support of the Lebanese Government. Since then there have been no further illegal deviations into Lebanon.

Piracy

289. This has emerged as a real problem, particularly in South-East Asia, as described below.

290. Short-term seizure: Vessels underway are boarded by armed pirates in the Malacca Straits and the Philippine Channel. The attackers rob the crew of their personal effects and the ship's cash. There were over 160 reported attacks in 1991. The actual figure is likely to be more.

291. Long-term seizure: Vessels underway loaded with cargo are boarded by armed pirates who overpower the crew and force them to anchor at remote locations. The entire cargoes are offloaded into barges before the vessels are released. These attacks usually happen at night in the Gulf of Thailand and the South China sea. There have been six reported incidents since 1989. In one of the latest cases the chief officer of the vessel was murdered and thrown overboard.

292. Permanent seizure: A vessel underway or at anchor is boarded by armed pirates, not so much for the cargo but to hijack the vessel and trade with it. The crew is landed or simply thrown overboard. The vessel is then given a false identity and effectively becomes a 'phantom ship'. From this point she is used to load legitimate cargo after which she deviates into an unscheduled port. The cargo is sold to unsuspecting buyers. The name of the vessel is once again changed and the thefts continue.

Scuttling

293. Another area of concern to marine underwriters is the scuttling (intentional sinking) of an over-insured vessel, which benefits the shipowner in his claim for the loss from the hull insurer for more than the vessel is worth, or the scuttling of a vessel with over-insured or non-existent cargo which, in addition to the hull claim, enables the cargo owner similarly to gain in his claim from the cargo insurer for the excess over the real value or for the entire claim in the case of non-existent cargo. Variations of the above scenarios are numerous. For example, instead of involving the connivance of the assured as in the latter case, the shipowner can use scuttling as a means of hiding the fact that he has stolen the cargo and sold it clandestinely before the sinking, which can also be classified as a deviation fraud. In such cases the shipowner profits from the overvaluation of the hull on the insurance policy as well as from the proceeds of the theft. In order for the insurer to avoid paying such claims (assuming a prima facie case has been made by the assured for loss from an insured peril), he must prove that the vessel was intentionally sunk, as well as the complicity of the assured in the act, which is often factually a difficult task, in that evidence is frequently unavilable and, in some national legal systems, legally difficult to establish as well. Another variation of the scuttling scenario is to arrange an entirely bogus disappearance, whereby the vessel later "reappears" under the guise of a new name and nationality. 14/

294. Yet another type of fraud in marine insurance relates to an intentional overstatement as to the size of an insured consignment. As a result of the overstatement, a claim can be made by the consignee against insurers for alleged non-delivery of what was, in fact, the non-existent part of the consignment. Such frauds have often occurred in connection with an arranged over-invoicing by an accommodating seller at the behest of a buyer wishing to obtain excess foreign currency from the central bank of his home country which has imposed currency exchange controls. 15/

295. Marine insurers of developing countries often suffer losses from maritime crime and fraud due to inexperience and/or lack of information and the manner in which trade is conducted in their country. If the company is small, the underwriter might not thoroughly check the shipping documents, the antecedent of the trading parties, and the status of the vessel. It is also possible that the requirement of immediate notification

of loss or damage is not enforced. The underwriter may not have access to or make full use of the internationally available information about ships, their owners, charters, corporate history, etc. Expertise may also be lacking in respect of the follow-up action to be taken once a suspicion has arisen. The insured may also not be well organised or fully familiar with the intricacies of international trade. It has to be realised that the international criminal often has much experience and, in any case, the advantage of pre-planning. Infrastructural support from other related agencies may also be lacking. For example, the shore authorities may be slack. The land enforcement agencies may not be prompt in pursuing a reported case. It has even been reported that in many cases the victim vessel, when caught in an incident, merely informs the owner's headquarter or its agent, but fails to report the crime to the shore law enforcement agencies, pleading that communication has broken down. 16/ Most importantly, there is insufficient co-ordination. There is no agency or focal point where all incidences of maritime crime are reported and expertise developed to take remedial action.

296. The insurance sector in India has constituted a system of verification of ships bringing full-vessel-load imports and of all ships carrying exports. Verification of part-load vessels for imports has not been found practical. On receiving an application, three aspects are examined: first, operational aspects, such as who has issued the bill of lading and on whose behalf it has been executed, and who is the operator, charterer or owner of the vessel; second, financial aspects, such as the financial standing of and bank report on the parties involved; and thirdly, the standing of the ship, such as the year built, classification status, and whether any mandatory survey is pending. If the application does not meet with the required standards, a penal rate is charged in addition to the usual marine insurance rate. This has helped in reducing considerably the incidence of maritime fraud. 17/

E. Loss prevention

297. Loss prevention has an important role to play in marine insurance. The IUMI issued a brochure entitled "Cargo loss prevention recommendations in 1974" 18/. Many of these recommendations are still valid for a large number of developing countries. Two studies entitled "Loss prevention in fire and marine insurances", and "Cargo loss prevention: suggestion for a domestic policy in developing countries" have been made by the UNCTAD secretariat. 19/

298. A large number of marine insurance losses occur in developing countries at the port. The inadequate facilities at ports is a matter of overall infrastructural deficiency, but the insurance sector can voice its concern and help create the necessary atmosphere for improvement of the situation.

299. Various steps can also be taken by the trade to minimise or prevent losses. A Colloquium on the future of marine insurance in Africa held in Douala in May 1989 recommended the following concerning loss prevention:

"That shippers and insurers should take the following steps to improve loss experience:

a. Individual insurers and their national/subregional associations to:

- Estimate total costs of different types of loss and establish priorities for remedial action;

- Co-operate with shippers in tackling major problem areas, including lobbying of Governments to ensure support in promoting procedural and security improvements;

- Produce simple loss prevention leaflets for handing to policyholders when cover is taken out, explaining assureds' obligations;

- Agree on packaging or preparation standards to be accepted in conjunction with shippers' associations;

- Combine in employing surveyors in ports to perform pre-discharge surveys and to supervise unloading of key cargoes.

b. Individual shippers and their sectoral associations to:

- Estimate quantity, frequency and cost of various losses affecting them (isolating place of loss such as ship, port and inland);
- Estimate cost of preventing given types of losses and the likely savings;
- Assess proportions of losses borne by insurers and assureds;
- Assess possibilities of joint funding and joint preventing action between insurers and assureds;
- Concentrate on a few specific problem areas at one time; initially on low cost and no-cost measures;
- Draw the attention of port authorities in conjunction with other transport and handling auxillaries to take appropriate measures to improve security and protection of goods;
- Encourage if possible importers and exporters' associations to lease port facilities under their direct control with autonomous theft and weather protection;
- Identify and avoid the use of operators with poor records;
- Discuss at association level and individually with insurers a system of premiums tailored to assured's own record (this implies remaining with same insurer);
- Request shippers' councils to disseminate existing information on packaging, preparation and handling methods and to organize research where specific information not yet available;
- Agree non-standard packaging in advance with insurers or agree general packaging standards with insurers' associations;
- Prepare simple loss prevention guidelines and information through relevant associations and all available media;
- Organize selective pre-shipment inspection where problems are suspected in the country of origin;
- Organize regular, pre-discharge surveys in conjunction with insurers;
- Exchange confidential information on poor operators within sub-region, split costs of research between countries (or split tasks), exchange information on own experience."

F. Localisation of risks

300. Following the UNCTAD resolutions of 1972 and 1975 on the subject of marine cargo insurance, several developing countries have enacted rules and regulations for the localisation of marine cargo insurance on imports. These rules have however, encountered some problems in their application. An UNCTAD report of November 1989 noted that "the provisions have been circumvented for all practical purposes through dubious business practices which increase the cost of important goods". 20/ The utility of localisation of insurance on imported cargo is being increasingly questioned.

301. In Thailand, measures are being considered to stimulate exporters to take out local cargo insurance instead of selling on a "free on board" basis. This would stimulate the domestic insurance business and reduce foreign currency outflow. 21/

302. In Africa, despite attempts to increase local cargo insurance, importers continue to buy all-risks cover in foreign markets while buying only minimum protection locally. The existence of this double insurance is primarily a result of the lack of confidence in domestic insurers. 22/

303. In Benin the domestic insurance of imports has been compulsory since 1983 and this has kept this insurance branch alive despite the reduction of the national maritime vessel fleet. 23/

304. Togo has instituted a law in 1987 by which imports are to be insured locally, in accordance with resolution 9 (VII) adopted in 1975 by the Committee on Invisibles and Financing related to Trade (CIFT) meeting on Insurance. 24/

G. Loss assessors and adjustors

305. A major problem encountered by many developing countries in respect to marine insurance is their lack of experienced and qualified loss assessors and loss adjustors. The result can be that marine insurance rates for shipment to the respective country become more expensive. Training persons in this profession in developing countries may be identified as a matter of priority.

H. Burden of proof

306. With respect to the handling of losses, amendments made by Chile to the commercial code may bring major changes in how losses will be adjusted in the country:

- The burden of proof is softened, and the insured will only need to come up with a presumption on the cause of the loss and indicate the events "that presumably caused the loss".

- While insurance should not be a means of profit for the insured, the amount insured can be as high as the amount that could reasonably be obtained by the insured from the sale of the goods. 25/

I. Landlocked countries

307. During the period under review some landlocked countries, such as Malawi and Zimbabwe, continued to have difficulties finding insurance for their exports and imports which have to transit through insecure regions disrupted by war and unrest. This seriously affects the trading potential of these countries. 26/

308. Apart from the issue of passage through troubled areas, landlocked countries generally face many difficulties regarding insurance of their imports and exports. These can be summarised as follows:

- The insurance sector in the country may not be sufficiently developed, and heavy reliance may have to be placed on insurance or substantial reinsurance outside the country of both imports and exports;

- Since the volume of business is small, and unbalanced inasfar as there is disequilibrium between total premium income and the occasional high value of a few shipments, rates, terms and conditions of insurance or reinsurance are likely to be high;

- There have to be transshipments; in addition to transshipment at the port of entry, there may be transshipments at the national border. This considerably increases risk;

- The country through which the goods have to pass often insists on customs verification for its own security, and unpacking and repacking may be required. This, again, increases the risk and poses problems for insurers of survey at a foreign destination.

J. Aviation insurance

309. In the area of aviation insurance carriers of some developing countries have found pooling arrangements useful. Fleets can be insured or reinsured in the international markets together in one slip on a pool basis. If it is felt more convenient to insure them separately, a pool can be formed on the basis of an agreed cession by each of the airlines out of their reinsurance placement. Examples of this are the African Aviation Pool or the facility set up by I.A.T.A., the Airline Mutual Insurance open to I.A.T.A. members and established in Bermuda. The Airline Mutual Insurance set up by I.A.T.A. deserves special notice, since many major airlines, both from developed and developing markets, are members.

K. Inland transit

310. Marine insurers in developing countries also encounter heavy losses on insurance of goods transported by road. In many developing countries the railways are not able to bear the growing load, and in spite of shortage of petroleum-based fuel, road traffic is important. From the insurance point of view, the roads are in poor condition, vehicles are often defective, and breakdowns are frequent. Trucks often do not have a metal container, and goods are merely loosely covered by plastic or some other material. There are many stoppages on the way. Incidences of pilferage, theft and robbery are common.

311. A special feature in many developing countries is that to promote employment and enterpreneurship, individuals have been given loans by financial institutions to acquire and run trucks for inland transportation. These individuals, in fact, become one-truck operators and are owner-cum-driver. From the insurance point of view, there is a problem in fixing liability on them for negligence. Insurance companies, therefore, often find that they are unable to make recovery for the carrier's liability from these transporters.

Notes

1/ Lee Coppack, ReActions, September 1991, p. 113.

2/ Lloyd's Register, Statistical Tables 1991, table 5, p. 53.

3/ Ibid., table 2, pp. 10-16.

4/ Ibid., table 26, p. 5.

5/ Ibid., table 11, p. 26.

6/ Hans Teije Anonsen, quoted by Gavin Souter, "Charting a course in marine insurance", Business Insurance, 21 September 1992.

7/ Mark E. Brockbank, "The crisis in the marine insurance market", paper presented at the Seminar on Marine Insurance and Average, Genoa, June 1992, p. 10.

8/ Ibid., p. 11.

9/ UNCTAD, Review of Maritime Transport, 1991 (TD/B/CN.4/8), 1992.

10/ H.K, Taneja, correspondence. 16 October 1992.

11/ UNCTAD, Review of Maritime Transport, 1990. UNCTAD, (TD/B/C.3/340), September 1991.

12/ UNCTAD/ICC Rules for Multimodal Transport Documents, p.2.

13/ The various instances of maritime crime cited in this section have been provided by Jayant Abhyanker, International Maritime Bureau, correspondence of 14 September 1992.

14/ UNCTAD, "Review and analysis of possible resources to minimise the occurrence of maritime fraud and piracy" (TD/B/C.4/AC.4/2), September 1983, para. 32. page 9.

15/ Ibid., para. 33.

16/ International Maritime Bureau, Piracy: A need for Cooperation, June 1992, p.2.

17/ P.S. Swaminathan, correspondence, 28 October 1992.

18/ Third edition (1974).

19/ UNCTAD, "Loss prevention in fire and marine cargo insurance" (TD/B/C.3/162 and Suppl. 1).

20/ UNCTAD, "Insurance in developing countries: review of developments in 1986-1988", (TD/B/C.3/229), para. 67.

21/ World Insurance Report, No. 387, 11 May 1990, p.3.

22/ World Insurance Report, No.364, 9 June 1989, pp. 2-3.

23/ L'Argus, 26 April 1992.

24/ Report of the Director of Insurance of Togo, 5 October 1991.

25/ Insurance Research Letter, April 1989, p. 78.

26/ Insurance Research Letter, April-May 1991.

Chapter VII

EXPORT CREDIT, POLITICAL RISK AND OTHER INSURANCES

A. Export credit insurance

312. Export credit insurance has evolved out of uncertainties relating to international trade, particularly due to problems arising out of foreign legal jurisdiction, political changes and currency exchange difficulties faced by many developing countries. The banking sector has been unable to bear the various risks, and many developed countries have established institutions to support their exports, for example ECGD in the United Kingdom and OPIC (Overseas Private Investment Corporation - a government agency with an excess of loss protection with Lloyds) in the United States of America.

313. Export of manufactured goods from developing countries is increasing. The volume of South-South trade, although small in comparison with world trade, is also growing. Large numbers of risks are involved. While these vary according to the specificities of a given situation, broadly they can be grouped along the following lines:

- The creditworthiness report being imprecise or wrong;
- Embargo, where the contract cannot be performed due to the cancellation or non-renewal of import licence of the importing party;
- Inability to enforce a contract in a foreign country;
- Sudden currency devaluation;
- Non-receipt of payments in spite of letters of credit, due to foreign
- Exchange problems in the country to which exports have been made;
- The unilateral termination of a contract by a buyer even when the buyer has no contractual right to do so;
- The failure or refusal of a buyer or contractor to perform their contractual obligations;
- The unfair rejection of goods by a buyer on or prior to delivery;
- The non-delivery of pre-financed goods by a foreign exporter;
- Non-performance of barter and counter-trade contracts by a party which had entered in a contract.

B. Political risk concerning assets in a foreign country

314. Although relatively modest, developing countries do sometimes make investments in other countries, either neighbouring or in the region. Often mobile assets are located in a foreign country, for example by a construction company. Risks of confiscation, expropriation and nationalisation of assets by a foreign Government are encountered.

C. Role of state institutions

315. A limited degree of commercially oriented insurance for both export credit and political risks is available in the international markets, particularly at Lloyds of London. However, this is usually insufficient for the needs of developing countries. It is possible that, with the expansion of international trade, resulting from

more liberalised trading conditions and the continuing process of economic integration and globalisation of financial markets, a more structured private political insurance market will emerge.1/

316. For the present, state institutions set up in many developing countries to promote their exports and foreign investments are playing a primary role in respect of export credit and political risk institutions.

317. It has been reported that new covers in the non-life field in Chile include export credit and other credit covers. 2/

D. Terrorism cover

318. Risks of damage to property due to strikes, riots and civil commotion are covered as extended perils under fire insurance of properties (SRCC endorsement). However, when the magnitude of the breach of the public peace is such that it is a matter of an uprising against the state, SRCC endorsement would not cover the risk. Such a situation was faced in Sri Lanka in 1988 when widespread disturbances took place and the total damage to property came to nearly US$230 million. The international reinsurance market took the view that the losses were not covered under the original policies, and hence not covered by reinsurance. Consequently, a separate fund was set up in Sri Lanka to cover the risk of terrorism. A separate premium is payable to this fund by all those who purchase property insurance. It is reported that the fund has grown over the years, and currently the risk continues to be covered, but without payment of any premium.

319. Acts of terrorism have also taken place in India. A special insurance to cover the risk has been devised in the market.

E. Kidnapping

320. Kidnapping cases have increased in recent years in Pakistan. In 1989 more than 508 cases were reported. To meet the situation, insurance companies have devised a cover. Underwriting is on a selection basis. 3/

F. Public and general liability

321. The practice of claiming compensation from someone who is responsible for causing injury or damage is not yet common in developing countries, except for accidents caused by vehicles. This is a sizeable portfolio for insurance companies in developed countries. Consciousness, however, is growing. In particular, after the chemical gas disaster in Bhopal, India, in 1984, it was realised that a system should be evolved for payment of compensation to persons affected by industrial disasters. A law was passed in India in 1991 requiring all manufacturers of chemical and hazardous material to have public liability insurance. The insurance sector has designed appropriate policy wordings and rating structure.4/

G. Product and liability

322. Developed countries import many items from developing countries. This provides an opportunity for many countries to increase their exports. However, the importing developed countries often require that the manufacturer provides product liability insurance, should an accident occur in their country causing bodily harm. For example, product liability insurance is sought for import of vehicle tyres. Some developing countries, for example, India and the Republic of Korea, have, therefore, developed product liability insurance to support their exports.

H. High-technology-related risks

323. With the establishment of nuclear-based plants, new initiatives are required to be taken by the insurance sector to cover the increasingly sophisticated risks.

324. In India, an insurance pool to cover the risks relating to the new nuclear activities of the country has been established by five local companies. This pool will cover liability and damages. India is the twenty-eighth country to establish such a pool and will participate in the reinsurance coverage of other countries. 5/

325. In the Republic of Korea, the management of the Korea Energy Insurance Pool, set up in 1971 mainly to provide property and liability insurance protection to the nuclear energy industry, was returned to Korean Re in 1989.6/

Notes

1/ SIGMA, Swiss Reinsurance Company: "Political risk and export credit insurance", July 1990.
2/ World Insurance Report, 8 June 1990.
3/ Best's Review, 1991.
4/ The Review, January 1991, p. 46.
5/ L'Argus, 25 August 1989.
6/ Asian Insurance Review, January-February 1991.

Chapter VIII

OFFSHORE AND CAPTIVE INSURANCE MARKETS

A. Introduction

326. There has been hesitation in developing countries with regard to providing domicile for captive and offshore companies. Similarly, these countries have been reluctant to allow domestic enterprises to form captive and offshore insurance companies, which are generally seen as bypassing the economic mainstream of the country. However, due to a more liberalised international environment and to globalisation, a number of developing countries, in addition to the traditional captives centres, have recently established or are about to establish offshore and/or captive centres. The purpose is to tap international insurance business by providing an attractive legislatory environment and good facilities and infrastructure. Tax concessions on profits and investment income, higher tax-free reserving, liberal incorporation requirements as well as lean supervision and regulation may be provided.

327. Yearly premiums collected by captives are estimated at approximately US$10 billion. 1/ Nine per cent of the world's commercial insurance premiums are collected by captives 2/ and 35 per cent of the world's industrial insurance is provided by captives. 3/

B. Advantages

328. Captive insurance companies are set up by parent companies, usually large transnational companies, with several advantages in view. They are seen as a mechanism to lower insurance costs since control can be exercised on premiums and cost of operations. Covers can be better tailored to meet the specific needs of the founding enterprise, and captives can thus be part of a risk management strategy. Profits from insurance operations can be kept within the enterprise group. Through the creation of a captive, the parent company has access to reinsurance markets whose resources, prices and expertise it can tap. Control can be exercised over the extent and cost of reinsurance, and advantages can be derived from the cash flow arising from insurance operations. The relatively liberal regulatory tax environment in offshore centres makes it possible to channel funds into national and international investment instruments that yield relatively high returns. Another incentive for establishing and using captives is in fact the possibility of minimising taxes for transnational corporations. The establishment and utilisation of captives in insurance is likely to be stimulated by the process of deregulation and privatisation.

C. Location of offshore and captive companies

329. When looking for a location to establish a captive or an offshore insurance company, the founder usually seeks the following characteristics:

- Double taxation treaties and taxation arrangements with as many countries as possible, especially with countries with developed financial markets;
- A politically stable environment;
- Adequate infrastructure, including availability of financial services and a good telecommunications system;
- Qualified personnel and administrative services;
- A flexible and efficient regulatory body;
- A precedence by way of some captives and/or offshore companies being already established in the location, and

- Legislative competitiveness, especially regarding the level of taxation on profits, reserves and investment income.

330. It is reported that "today there are more than 20 international offshore financial centres for setting up captives. Worldwide, the number of captives is in the vicinity of 3,000; one hundred are domiciled in Asia, where several new centres have been or are to be established." 4/

D. Country developments

331. Malaysia has established an offshore financial centre on the island of Labuan. The offshore centre should cater for all aspects of insurance activities, i.e. providing for insurance, reinsurance, broking, underwriting and administrative services. However, offshore insurers operating from Labuan cannot write Malaysian domestic business, though they will be permitted to underwrite reinsurance of Malaysian business. 5/ Labuan, as a part of Malaysia, will reap the benefits of the existing double taxation agreements in force with 31 countries, of which as many as 20 have tax-sparing clauses built into them. 6/

332. Puerto Rico, eyeing the rewards of becoming a captive domicile like Bermuda and the Cayman Islands, is considering legislation that would make it more attractive for captive insurers and reinsurers. 7/

333. Singapore is trying to attract American and European multinationals to set up a second captive operation or a regional captive in Singapore. 8/

334. The Australian authorities are considering legislation that would nullify the tax privileges enjoyed by Australian captives in Singapore. Singapore proposed considering an increase in its corporate tax for offshore business from 10 per cent to 25 per cent, but this would still undercut the Australian tax while creating problems for offshore companies of other origins. 9/

335. Barbados is trying to extend its network of double taxation treaties in order to maintain and enhance its attractiveness as a captive domicile. This move comes after the Congress of the United States of America voted in 1988 to stop tax concessions to offshore United States companies in Barbados once the current tax treaty expires at the end of 1989. 10/

336. As regards Bermuda, the United States-Bermuda Tax Treaty provides tax exemption to insureds for policies issued by a Bermuda insurer. However, the rules of the procedure have been modified and a tax refund may now be claimed only if the Bermuda insurer was registered in the Bermuda Register of Companies as resident for the whole period for which the refund is sought. Additionally, the risk covered must have been reinsured with a person also entitled to the benefits of the treaty. 11/

Notes

1/ Captive Insurance Company Report, January 1992.
2/ Captive Insurance Company Report, October 1991.
3/ The Review, May 1989, p.21.
4/ Asia Insurance Review, March-April 1991, p. 10.
5/ World Insurance Report, No. 393, 3 August 1990, p. 7.
6/ The Review, November 1991, pp. 49-51.
7/ World Insurance Report, No. 362, 12 May 1989, p.5.
8/ Asia Insurance Review, Sept.-Oct. 1991
9/ World Insurance Report, No. 387, 11 May 1990, p. 8.
10/ World Insurance Report, No. 366, 7 July 1989, p. 8.
11/ World Insurance Report, No. 361, 28 April 1989, p. 8.

Chapter IX

NATURAL CATASTROPHES

A. Introduction

337. Large or mega losses have attracted considerable attention recently. With wide-body aircraft in operation, aviation insurance losses have assumed importance. Similarly, the operation of very large vessels has given rise to big casualties for the waterborne traffic sector, and with increasing road congestion, accidents on roads have also resulted in much loss of life. Large industrial plants and high-rise buildings with high values have also suffered accidents. Accidents in the oil sector have also resulted in major losses. Most importantly, natural catastrophes, to be clearly distinguished from man-made catastrophes, have caused large-scale damage.

B. Natural catastrophes

338. Insurance companies are affected, since catastrophe losses have serious consequences for their business. The term "natural catastrophe" is defined as a loss event caused by natural phenomena such as earthquakes, hurricanes, typhoons, tornados, windstorms, heavy rain, heavy snow, volcanic eruptions, severe drought and locust storms, usually involving a large number of individual losses. These events are characterised by a high loss potential and far-reaching economic and social effects. "Apart from population development, climate development may also have a decisive influence on the frequency and extent of damage of natural catastrophes. The greenhouse effect, i.e. the global warming of the earth as a result of changes in the earth's atmosphere regarding carbon dioxide, nitric oxide and CFCs or chlorofluorocarbons, are brought up in many discussions as causes of the increasing frequency of natural catastrophes. Some indicators seem to support this argument: it is relatively certain today that hurricanes developing in Central America in the next few years will be pushed further and further northwards due to the warming of the earth's atmosphere. However, the generally increasing frequency of such events cannot yet be adequately supported by evidence. In addition, a comparison of the climate development over several decades or even centuries makes the temperature changes measured in recent years relative. The current position in discussions could be roughly summarised as follows: the greenhouse effect will very probably have important consequences for the earth in general and the insurance industry in particular over the next few years and decades. When, where, and to what extent these consequences will manifest themselves cannot, however, be evaluated conclusively as yet." 1/

C. Economic losses

339. Evidence shows that there has been an increasing trend in the frequency of natural catastrophes. Studies show that the economic consequences of the damage caused has sharply escalated. This occurs as a result of an enhanced level of economic activities and geographic concentration of values in most countries of the world, coupled with an increased frequency of catastrophic events. According to one estimate, 14 catastrophes occurred in the 1960s, each with an economic loss in the region of US$100 million. The number rose to 70 in the 1980s, which means an increase by a factor of five within three decades. 2/ The continuous growth of the world population, along with ageneral improvement in living standards and the urbanization process, contribute to the ever-increasing economic consequences of natural catastrophes.

340. Two additional factors of consequence are global migrations and industrial development. Recently migrations have occurred to coastal regions which generally suffer a higher exposure to natural catastrophes. Industries also emerge or relocate to regions with higher catastrophic risks in search of new and cheaper resources. 3/

D. Insured losses

341. Not all properties that are damaged and destroyed are insured. Assessments differ about the extent of insurance taken. According to one estimate, even in the highly earthquake-prone area of California, only 25 per cent of houseowners and householders buy earthquake insurance. 4/ The extent of insurance in less

catastrophe-prone areas and in less prosperous countries, particularly developing countries, can be easily imagined.

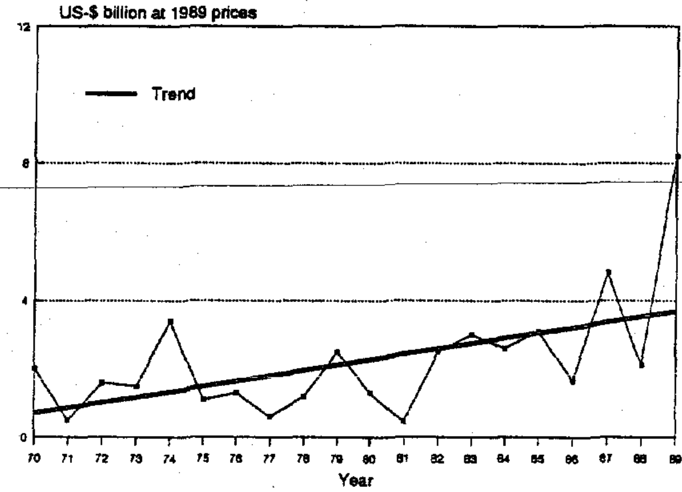
342. There are several reasons for properties susceptible to natural catastrophes being uninsured. It is true that today a greater number of people and properties are insured and, in addition, are better insured, but insurance is still far from being universal in its reach. 5/ Memories are short, and people tend to forget the widespread damage a catastrophe can cause. The perception of the premium rate also differs. From the insured's perspective, only a very nominal additional premium should be charged to include perils associated with catastrophe in normal property insurance (in most markets, the perils in question are insured as an extension of standard cover), in view of his perception that such an event does not occur very often. On the other hand, insurers wish to have adequate premium, not only to cover claims payments but to build a reserve for super catastrophes. From their point of view, extended coverage is often given to industries at a very low cost, and personal lines do not have sufficient loading either. There are marketing problems in increasing the rate. The sales organisation often does not take sufficient interest in explaining and selling the extension for catastrophic risks.

343. Insurance companies are also hesitant or reluctant to enlarge their commitment to catastrophe risks. They are afraid of anti-selection. Persons who are exposed to catastrophic risks may be the only ones who choose to have insurance and sufficient spread is often not achieved. Furthermore, accumulation poses a big problem for companies. Many of the companies writing this class of business are small with a limited capital base. They wish to avoid exposing their net results to violent fluctuations. Since catastrophe strikes only once in a while, savings or profits of a claims-free year have to be accumulated in a fund to meet liability when a severe event occurs. The tax authorities, however, are reluctant to allow such funding as tax deductible and insist on treating the savings of the year as profit in the usual manner. In Colombia, Mexico, Norway, New Zealand and Sweden, limited tax facility is allowed for the creation of a fund to meet catastrophic losses. 6/ It is interesting to note that in Japan "the practice to cover earthquake peril started as extended coverage endorsement of fire insurance only in commercial lines in 1957. There was no earthquake coverage in personal line fields because private insurers did not wish to take such risks on the pretext of the uninsurability of earthquake peril which can cause catastrophic loss, the unpredictable nature of its occurrence and possible occurrence at specific earthquake-prone areas". 7/

344. Although insured damage forms only a small part of the devastation caused by catastrophes, it has caused very high loss burdens in recent years (figure 3).

Figure 3

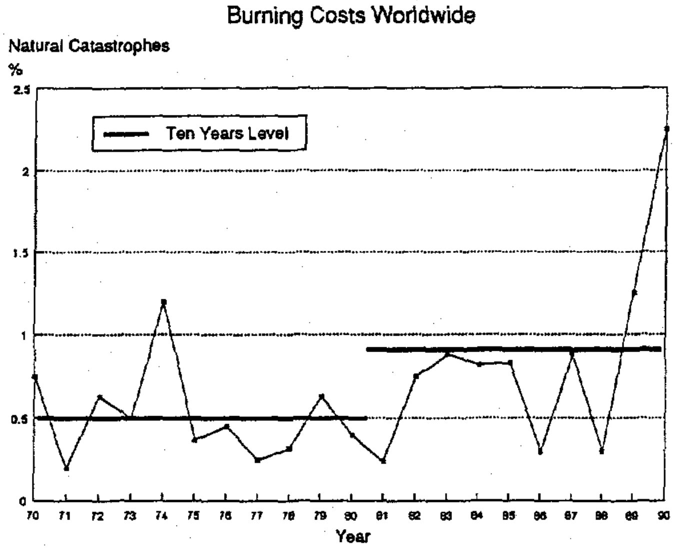
Insured Damage by Natural Catastrophes



Source: Sigma, Swiss Re. 6/90, p. 9.

345. The burning costs for natural catastrophe losses increased in the 1980s in comparison with the 1970s. In the 1980s a new level was established at around 1.0 per cent of the world non-life premium income, which is twice the figure experienced in the 1970s. The peak years of 1989 and 1990 saw burning costs climbing to 1.5 and 2.3 per cent respectively and only three years in the 1980s were below the 0.5 per cent mark. Burning costs in the 1970s oscillated around 0.5 per cent with a peak of 1.2 per cent in 1974. (figure 4).

Figure 4



Source: Sigma, March 1991, quoted by W. Jacobi, "Catastrophe", Reinsurance, December 1991, p. 16.

346. In terms of amounts, until recently it was estimated that the insurance industry must count on an average annual burden from natural catastrophes of about US$5 billion. 8/ However, the figures have gone up further. In 1989 major catastrophe losses totalled US$9 billion, and in 1990 they approached the figure of US$11 billion. 9/ The results in 1992 are likely to deteriorate further, with hurricane "Andrew" having hit the states of Florida and Louisiana in the United States of America.

E. Reinsurance and natural catastrophes

347. Reinsurance plays an important role in the insurance system. Reinsurers are partners of insurance companies in providing cover to individual clients. Without their support, the insurance companies would find it difficult to face the large losses caused by catastrophic events. In fact, insurers have shared a substantial part of the losses caused by natural catastrophes. In the earthquake in Mexico City in 1985, reinsurers shouldered 97 per cent of the losses. The situation was much the same in the aftermath of hurricane "Gilbert" in Jamaica in 1988 and of hurricane "Hugo" in Puerto Rico in 1989.10/

348. The reinsurance market for catastrophic risks is also not very large and keeps fluctuating. The single largest catastrophe reinsurance placement is believed to be the New Zealand earthquake programme of approximately US$570 million. 11/ The recent catastrophic losses have resulted in a significant loss of capacity in the retrocession market. The market began shrinking as early as 1987, continued to do so in 1988 and 1989 and faced a crisis in 1990.12/ There has been a total collapse of capacity in the second tier retrocession or "spiral" market. 13/

349. The profitability of the international reinsurance market has been greatly eroded in recent years, and catastrophe losses are largely held responsibile. The top 100 companies showed a combined ratio of 111 per cent for 1989, as compared to 108 per cent in 1988. A combined ratio of 115 to 120 per cent is estimated for 1990. In the United States of America, combined ratios for all reinsurers developed from 103 to 107 to 106 per cent respectively during 1988, 1989 and 1990. 14/

F. Recent trends in reinsurance

350. Insurance companies realize that reinsurance protection against catastrophic events is a necessity. In fact, companies are seeking protection in greater measure than in earlier periods. However, the reinsurance market has hardened.

351. The conditions required by reinsurers differ from market to market, depending upon its proneness to catastrophic losses, limits of cover sought and past experiences. The following are some of the important measures which have been suggested:

352. (a) Much greater information than in the past; in fact, a very detailed London Market Questionnaire has been evolved. In particular, the transparency of exposures has to be ensured. This will enable reinsurers to adjust the capacity available to them to the needs of the market and avoid capacity being superfluously committed. Within CRESTA (an organisation of insurers, reinsurers, brokers and risk managers founded in 1977), the topics of windstorm and flood exposures have gained momentum. A set of forms has been developed for various countries in order to monitor the aggregates from natural perils per postal zone or even smaller regions in the case of floodcovers. A loss report form has also been developed which shows actual losses against sums insured for buildings, contents and loss of profit. This enables more accurate assessment of (Probable Maximum Loss) PML and burning costs per region; 15/

353. (b) Efforts to market catastrophe risks in newer areas and regions, particularly those which are not apparently exposed, or where the return period is long; a better spread will go a long way in solving the problems of both insurance companies and reinsurers;

354. (c) Avoidance of long-term contracts; if this is not possible, a right to review rates should be included in the contract;

355. (d) Improvement of the claims handling system; natural catastrophe losses come in a bunch, and there is social or government pressure to expedite a large number of claims so that the rehabilitation and reconstruction process can be speeded up. Under these circumstances the surveyors and loss assessors cannot go through the process of detailed scrutiny. Markets, therefore, have to evolve guidelines for processing these claims in anticipation. In particular, a tendency to claim for earlier minor damages in the claim arising out of a catastrophe has to be guarded against (for example, cracks in a building which have developed over the years as part of wear and tear and aging, are attributed to earthquake damage);

356. (e) More precisely defined wordings, for example what constitutes a windstorm, and what kind of accumulation of water is to be regarded as a flood;

357. (f) Imposition of co-insurance by the insured, and judicious introduction of deductibles and franchise. In extreme cases, resort may be had in the "ultima ratio" to exclude certain hazards altogether;

358. (g) Restricting indemnity; the case of Japan is cited in this connection, where limits both in terms of maximum amounts and percentage of sum insured are observed; 16/

359. (h) Increase in premium rates for insurance of risks which can be catastrophic in nature in the region, for example increase in earthquake rates in earthquake-prone areas, increase in windstorm and related perils rates in areas which are susceptible for these events, etc.;

360. (i) Separation of premium charged for natural perils from the main cover, which is not the case in many markets. This will enable insurers to judge the adequacy of the premium, and will also enable the compilation of proper statistics;

361. (j) Increase in the rate payable by the insurance company to the reinsurer, which in the case of excess of loss arrangements (and catastrophe risks are usually protected by such non-proportional reinsurance) is not based on the rate charged to insurers, but is applied to the total premium of the company in that line of

business. It has been stated that "catastrophe reinsurance as a product has been underpriced for many years...."; 17/

362. (k) Limitation of reinsurers' liability. In Excess of Loss arrangements this is set by the event limit. In proportional reinsurance, on the other hand, the reinsurer is liable (up to a defined extent) on all policies issued by the insurer, and it has, therefore, been suggested that a cession limit be observed. This would indirectly imply limiting the number of policies or the amounts which an insurance company can write against natural perils;

363. (l) Adoption of risk management practices and loss promotion systems; while natural catastrophes are unavoidable, there is still insufficient awareness, particularly in developing countries, that losses due to such events can be better faced, and reduced, through better understanding of the risks. It is realised that specific action is beyond the purview of the insurance sector, and it is suggested that a strong message be projected to the public and Governments and a "lobby" be created for improvement of building codes, coastal and flood defences and cities' drainage systems.

364. The programme set forth by the United Nations in connection with the International Decade for Natural Disaster Reduction includes:

- The mapping of hazard zones;
- The assessment of loss potentials resulting from different catastrophe scenarios;
- Land-use regulations/restrictions;
- Standardization of building codes;
- Standardization of loss information;
- Development of forecast and warning services;
- The improvement of public information, awareness, and motivation. 18/

G. Implications of suggestions made

365. Many of the suggestions are well conceived, and it is obvious that in their actual observance allowances will be made for regional and market variations. Some of the ideas are too costly to be implemented in totality, and for others the process can only be gradual and adoption will take time.

366. Natural catastrophic losses have become a focus of concern for the insurance and reinsurance sector. Two points made in this connection, despite their limitations, nonetheless have a certain justification. First, although supporting statistics of premium income generated and losses incurred are not available region-wise, there are indications to the effect that a substantial part of insured natural catastrophic losses have emanated from OECD countries. According to an estimate, 78 per cent of total registered insured damage was caused in these countries. 19/ Secondly, although large losses have been faced, the reinsurance world still serves its purpose well. It is true that the operating ratios often surpass the 100 per cent level, but substantial investment income is derived from earnings on technical reserves and other savings made from insurance operations in the past.

367. The increase of insured catastrophic losses in recent years has put reinsurers in a position to envisage the hardening of terms for catastrophe risk reinsurance and/or to diversify their portfolios by extending business into regions less susceptible to natural catastrophe.

368. Distinctions can be made here between markets and regions which are exposed to natural catastrophes and have had substantial insured losses, and those which are better situated. From the point of view of the first category of markets, a hardening of reinsurance terms will unduly strain the capacities of regional insurers, weaken their insurance sectors and may result in a reduction of whatever natural catastrophic risks they have been able to bring under the insurance system.

369. On behalf of the second category of markets faced with the hardening of reinsurance terms for catastrophic risk, it is argued that they can hardly make sacrifices when their own situation is far from strong and when considerable effort is still needed to consolidate their own position. These markets can, in fact, take advantage of the new competitive situation since their business may be eagerly sought by reinsurers attempting to diversify their portfolios.

370. Keeping in mind the regional disequilibrium of insured catastrophic losses and the possible hardening of reinsurance terms, developing countries may find themselves in a difficult situation. On one hand, it is true that generally speaking premium rates charged for catastrophe risks in many developing countries have been low. It is also realised that in international reinsurance business, a narrow country or regional view may not be appropriate and it is in the very nature of insurance and reinsurance that during periods when no catastrophe occurs in a given country, premiums arising from that country are partly needed to pay catastrophe claims in other regions. On the other hand, however, making insurance and reinsurance of catastrophe risks in developing countries costlier will not solve the problem, since their share in the totals is modest. In any case, a diversification of portfolio by catastrophe reinsurers may prove to be mutually beneficial and supportive of the insurance sector in developing countries in the long run.

H. Reinsurance in developing countries

371. The position of reinsurance companies in developing countries deserves to be noted. They are, by and large, small and were established in the last decade or so. They have served a useful regional role and continue to encourage greater retention of risks within the region. They have to play a role in reinsuring natural catastrophe risks of the region within the capacity available to them. It is, however, beyond their scope to venture into international catastrophe reinsurance business. The lure of plentiful business should not induce them to venture into something where stakes are high, instead of concentrating on their own business which is profitable.

I. Role of governments

372. It is understandable that the insurance sector increasingly wants to extend its scope of activities, not only for the sake of expansion of turnover but also to be able to play a greater economic role in society. But as far as losses arising due to natural catastrophe are concerned, it is widely recognised that the involvement of the state is inescapable.

373. It has been argued that, from a conceptual point of view, there are severe limitations on commercial insurance mechanisms, meant primarily for relatively frequent small losses, in terms of effectively and profitably relating to catastrophic losses, since these do not satisfy the following criteria:

(a) The insured event has to occur with a certain regularity, in a certain period of time;

(b) The sustained damage must be measurable; it must be possible to calculate the probability of occurrence and the degree of damage;

(c) The risks must be spread geographically;

(d) The amount of damage must be limited. 20/

374. From a practical point of view, it has been noticed that insurance is able to cover only a fraction of the economic damage and Governments, even in advanced market economies, have to provide direct compensation for natural disasters. Losses caused by major catastrophes can reach such tremendous amounts that it is doubtful if the whole world insurance sector together is strong enough to absorb the totality of the risks. 21/ In fact, with the possibility of a further rise in catastrophic losses and the hardening of the reinsurance market, the role of the insurance sector may if anything diminish.

J. Catastrophes caused by drought and locust in Africa

375. Catastrophes due to drought, which occur in many African and in particular the Sahel region countries, deserve a special mention. Climatic changes, overgrazing, receding forest and other man-made causes are among the reasons. Locust invasions can also attain catastrophic dimensions. The low level of income prevailing in the Sahel countries, most of which belong to the group of least developed countries, means that the possibilities of private insurance range from narrow to insignificant, especially as the affected population is mostly nomadic. The lack of any reliable statistics, the increasing frequency and severity of droughts, the insufficient knowledge on causes, and the absence of measures for effective prevention and reduction of drought-related risks, together with the inability and unwillingness of the affected population to pay premiums, means that they are considered uninsurable. Efforts to extend the insurance system must be made, but no significant contribution from commercial insurance can be expected. For the Sahel region, it has been proposed that the organs and institutions dealing with drought prevention and relief, for example the intergovernmental Permanent Interstate Committee for Dought Control in the Sahel, which is financed by both member States and donor countries, should look into the possibility of creating a support fund whose contributions come exclusively from government and international aid funds. As regards the indemnization of farmers hit by drought, possibilities exist today to survey via satellite the losses in sum in order to avoid the cumbersome and costly evaluation of each individual loss. It can be further suggested that Governments and the international community - which are called upon to help the endangered populations overcome the effects of drought or locust infestation each time there is an emergency - might consider setting up a fund which would come to the help of the affected populations quickly and in an organized way. This would avoid delays in delivering aid to the stricken populations, as certain structures would already be in place. It would also avoid the time-consuming mobilization of funds via ad hoc appeals. 22/

K. Interface between insurance and government relief

376. The insurance sector and the government department in charge of catastrophe relief programmes should fully explore possibilities for mutual co-operation. Attention should be paid to areas of overlap and to where a commercialisation of existing public security mechanisms may bring greater financial discipline and accountability.

377. In Israel, according to the Law for the Compensation of Those Hurt by Natural Disaster, the sum which has been or will be paid as per the insurance cover will be deducted from the government relief scheme.

378. In the Islamic Republic of Iran the Relief Fund for Damaged Agricultural Units, which provides catastrophic aid to affected farmers, excludes products and perils covered through the Agricultural Products Insurance Fund.

379. In France farmers who have taken basic cover are entitled to receive aid from the National Guarantee Fund for Agricultural Calamities. The Fund is financed by the Government and the compensation varies from between 25 and 28 per cent, if the farmer has fire and allied perils insurance on his buildings and premises, to 35 per cent if he has hail insurance on his crops. The application for compensation has to be routed through the farmer's commercial insurer and thereby requires him to purchase available commercial cover. Such a policy stimulates the spread of insurance.

380. It is difficult to propose such conditions to farmers in developing countries in view of the level of development of both agriculture and the insurance sector.

Notes

1/ SIGMA, Swiss Re., 6/1990, p. 29.

2/ B. Koye, "Catastrophic risk insurance", presented at the 8th TWIC, New Delhi, February 1992.

3/ Ibid.

4/ R. Palm, "Earthquake insurance: Some findings from home owner study", Institute of Behavioral Sciences, University of Colorado, Boulder, 1990.

5/ A. Munkhammar and R. Themptander, "Catastrophe insurance", The Geneva Papers on Risk and Insurance, No.31, April 1984.

6/ Ibid.

7/ Y. Morimiya, "Demand for natural disaster insurance", The Geneva Papers on Risk and Insurance, No. 32, July 1984, p. 275.

8/ B. Koye, op. cit.

9/ John S. Greig, "The effects of the recent world catastrophes on reinsurance capacity - A broker's perspective", presented at the 1st Singapore International Reinsurance Conference, Singapore, 6-9 October 1991.

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11/ John S. Greig, op. cit., p. 1

12/ O. Serge and A. Claude, "A climate change", The Review, April 1992, pp. 19 ff.

13/ John S. Greig, op. cit., p. 4

14/ Walter Jakobi, "Catastrophe - on a slow boat to recovery", Reinsurance, January 1992, p. 12.

15/ Walter Jacobi, op. cit., p. 22.

16/ Y. Morimiya, op. cit., p. 277-278.

17/ John S. Greig, op. cit., p.4.

18/ B. Koye, op. cit.,

19/ SIGMA, Swiss Re., 6/1990, p. 14

20/ B. Koye, op. cit.

21/ A. Munkhammar and R. Themptander, op. cit., p. 133

22/ Ahmadou Kourouma, "L'Assurance des risques catastrophiques: La secheresse et le péril acridien", paper presented at the 7th TWIC, Dakar, Senegal, 21-25 May 1990.

Chapter X

REINSURANCE

A. International reinsurance markets

Introduction

381. Although, during the period under review, the fundamentals of international reinsurance did not change significantly, 1/ the insurance markets of developing countries were subject to considerable strain in the field of reinsurance. The problems of developing countries in the sphere of reinsurance were, to some extent, a reflection and a consequence of continuing underwriting losses which reinsurance companies, in both developing and developed countries, continue to incur.

Underwriting performance

382. Table 7 shows the operating results of some reinsurers. The unprofitability of operations in the last few years of several syndicates of Lloyd's of London, which remains an important reinsurance market, has received wide publicity. Losses of Lloyd's amounted to L2.063 billion (US$3.85 billion) in 1989, the largest in the 304 year history of the institution. 2/ This came on top of a loss of US$983.7 million in 1988, while a loss of US$2.12 billion is expected for 1990 and of US$1.4 billion for 1991 (preliminary estimates). A total of US$8.6 billion in losses is expected for the underwriting years from 1988 through 1991. 3/

383. Several factors are responsible for the underwriting losses of international reinsurance business. First, the major direct insurance markets of the world continue to produce underwriting losses and this gets reflected in the underwriting results of reinsurers. The United States of America, Canada, Japan, Germany, France, Italy, the Netherlands and Switzerland accounted for some 80 per cent of worldwide non-life premium income. These markets, with the exception of Germany, all produced underwriting losses over a long period (see table 2). The unprofitability of direct markets adversely affects reinsurance business. Second, the composition of insurance portfolios has changed. With the emergence of a greater number of large risks, the share of medium and small risks has decreased. Third, a non-proportional basis for reinsurance has been adopted by several companies in different markets, and the results of this form of reinsurance tend to be more volatile. 4/ And fourth, there are indications that the impact of major losses - both as a result of natural calamities and man-made major losses - is increasing. 5/

Investment income and profitability

384. It is significant to note that underwriting losses do not mean unprofitability in overall operations. Most insurance and reinsurance companies have a sizable investment income arising not only from free reserves but also from technical reserves, which are funds held for pending liabilities, and current cash-flow. Table 9 shows the profitability of the non-life sector as measured by pre-tax return on equity. Nevertheless, a reinsurer does not participate in the investment income of the ceding company and is concerned only with the underwriting results of the business.

385. While specific conditions within the market differ from one class of business to another, generally "soft" conditions prevailed up to the end of 1990. Over-capacity has been one of the reasons. However, a hardening of the market is reported of late. The reinsurance market is cyclical and it is felt that a turning point has come. The leaders of the market cannot but be influenced by their global experience, as also by the cost of their own protection based on their overall results. It has been reported that, due to the loss experience of recent years, "rates were hardening, sizes of deductibles were back to healthier levels and there was a more prudent approach to the acceptance of risks." 6/ It is reported that rate increases are likely to be maintained and in fact accelerate in 1993 and beyond.

Table 7
Underwriting and operating results of selected professional reinsurers

Company/ year	Underwriting results as % of net premium	Investment income as % of net premium	Pre-tax operating profits
Egypt Re (91)	-20.96	22.38	+
Munich Re (91)	-11.52	19.13	+
Swiss Re (90)	- 8.64	15.82	+
Royal Re (90)	-25.00	10.36	-
Singapore Re (90)	-9.00	20.25	+
Malaysia Nat (91)	-2.60	18.36	+
Cigna Re (91)	-6.10	13.21	+
Korean Re (91)	-16.00	13.50	-
ARIG Re (91)	-44.16	32.60	-
ASIAN Re (90)	-15.50	16.98	+

Source: Asian Reinsurance Corporation, Bangkok.

Table 8
Underwriting results as percentage of premiums
(Average over the period 1975-1989)

COUNTRY	
United States of America	- 7.5 per cent
Canada	- 6.8 per cent
Japan	- 0.5 per cent
Germany	+ 0.8 per cent
France	- 11.0 per cent
Italy	- 10.8 per cent
Netherlands	- 3.9 per cent
Switzerland	- 8.2 per cent
United Kingdom	n.a.

Source: SIGMA, Swiss Re, 6/91, pp. 3 and 22-26.

Table 9

Continent	Pre-tax return on equity 1987	1990
Asia	18.6%	14.1%
Europe	8.9%	8.3%
North America	13.4%	8.2%
Aggregate	10.9%	8.5%

Source: Alan Levin, "Reinsurance market report", 14 July, 1992, p. 13.

Condition of the market

386. The soft conditions affected developing countries as both buyers and sellers of reinsurance. On the whole, it was possible to place reinsurance without much difficulty and on relatively advantageous terms. As sellers of reinsurance, on the other hand, soft conditions did not help reinsurers of developing countries to expand their business. Under the hardened market conditions, developing countries as buyers of reinsurance are experiencing a situation where terms of reinsurance have gone up substantially, or are likely to go up steeply. In some cases, covers could not be fully placed. As sellers of reinsurance, the full benefits of the hardening market could not be obtained by reinsurers from developing countries, since standards of security required by

international markets have in the meantime gone up, and many find themselves marginalised. Various aspects of reinsurance of developing countries, as buyers and sellers, are discussed below.

B. Developing countries as buyers of reinsurance

Introduction

387. The demand for international reinsurance from developing countries remains high. There are several reasons for this. Often there is a "structural imbalance" between volume of premiums of a given class of business and liabilities reinsured per risk, or even by accummulation. 7/ This necessitates substantial reinsurance. Further, a high rate of inflation, a phenomena prevalent in many developing countries, means an erosion in real retention capabilities. Retentions are fixed in terms of nominal monetary amounts and not revised pari passu with the rate of inflation. However, the most important reason why insurance companies rely heavily on reinsurance is that their capital is low and free reserves have not been built up. This manifests itself in the form of a low retention capacity. Insurance companies cannot, under these conditions, afford to retain more of their own risks because of the possible consequences of fluctuations in underwriting results. In spite of the use of sophisticated models based on the law of averages, in insurance it is difficult to assess future fluctuations precisely, since other variable factors intervene. Furthermore, insurance companies in developing countries by and large do not have the advantage of a cushion from a large investment income derived from reserves built up over decades, and therefore have to be very cautious not to incur underwriting losses. The advent of catastrophes, both natural and man-made, is a big threat to them. The fact that motor insurance, which is a substantial part of the business underwritten, continues to remain unprofitable due to non-revision of rates and other reasons also restricts the building up of reserves. Opportunities to earn sufficiently on existing reserves are curtailed in many countries due to the imposition of compulsory investment requirements and the non-existence of diversified and well-developed investment markets.

Risk assessment and PML underwriting

388. An imbalance also exists between the high sophistication of many of the large risks and the technical know-how available locally. Not having adequate command of technical details of complex risks leads an insurer to reinsure these heavily. For determination of the extent of reinsurance required on a risk, it is necessary to adopt the PML (Probable Maximum Loss) underwriting principle. This is based on the consideration that a risk is not likely to be totally destroyed by occurrence of a peril, say fire. If it can be determined that a risk is likely to be destroyed to the extent of one-third on any given occasion, three times the amount can be retained in monetary terms. In the absence of proper determination of PML, inappropriate reinsurances could be placed. If the PML is fixed on the high side, the amount retained by an insurer will be comparatively low and a higher extent of reinsurance will have to be sought than would be the case if it is fixed at a low level. But a low PML exposes the net account of the company.

389. However, the proper determination of the PML of various risks requires a high level of expertise and experience. This is generally lacking in developing countries. A few markets, notably insurance companies in India, have a large cadre of qualified engineers employed to assess their own PML. In many countries, the concerned international reinsurer or the broker on his behalf arranges an inspection and determination of the PML of complex risks. This works satisfactorily, but means that expertise is not built up in the local market. In many other developing countries, the PML concept is not followed at all. A gradual development of expertise to determine the PML could go a long way in increasing the retention capacity of many insurance markets.

Reinsurance placements and markets

390. Reinsurance placements of insurance companies can very broadly be grouped into proportional, faculative and non-proportional. Proportional basis is the traditional and classical method of reinsurance. A large number of insurance companies in developing (as well as in developed) countries have proportional reinsurance as the base of their arrangements. The main advantage is that the company is able to retain its own risks for amounts it can determine. Facultative reinsurance is sought for peak risks, particularly when the risk is large and the exposure high, but the spread (in terms of number of risks and/or premium income in that category) is insufficient. Both proportional and facultative reinsurance, however, entail substantial administrative

work. Furthermore, proportional reinsurance often "imposes for the insurer an obligation to cede more business than strictly desired and it does not necessarily provide an absolute limit to the ceding companies' exposure in the event of a loss". 8/ When a company grows in size and attains financial strength, it may increase its retention and obtain non-proportional reinsurance in the form of a "working" excess of loss, or an excess of loss for protection of the net retained amounts, or for catastrophe exposures.

391. A general classification of the markets where those three broad categories of reinsurances can be placed is helpful in understanding the problems of developing countries, although a caveat must be entered to the effect that in actual practice the boundaries are not always clear and often overlap. Proportional reinsurance on major lines of fire and marine business, which in the case of of developing countries is usually profitable, can be exchanged on a reciprocal basis - matching in premium and in profitability over a period - with other insurance companies on a global basis, either through brokers or contacts established directly. However, reciprocalexchange presumes a well-balanced treaty and reasonably stable results. With the deterioration of underwriting results on their direct business, the United Kingdom insurance sector has almost gone out of this market. 9/ Some insurers with good results in Europe are still able to maintain a reciprocal trading relationship. Japan, with its profitable results on direct business, is an important trading market for reciprocal business with many countries.

392. It is worth noting that since results of exchanged or traded business tend to fluctuate, insurance companies of developing countries often place their proportional business without obtaining reciprocity. Instead, additional commissions in lieu of reciprocity are obtained. But while such practices give a short-term advantage to the concerned companies, the capacity of the local market is not built up, except when the arrangement is with a reinsurer in the country or in the region.

393. The advantage of facultative reinsurance is that the risks and their rates are known. Facultative business emanating from developing countries is generally profitable. To the extent that capacities of other companies in the market are not already exhausted through co-insurance, facultative business should be first given to them. National and regional reinsurers also can, and in fact do, play an active role in this area. Both Africa Re and Asian Re are developing acceptance of facultative business from their region. International reinsurance markets also seek out this business. While reciprocity cannot be expected, often informal arrangements are made whereby the recipient would give some business in return. The other broad category of reinsurance placement is the non-proportional cover requirement, either for protection of the net account, for large risks or for accumulation against catastrophe exposure. A part of proportional business which is unbalanced, particularly relating to natural catastrophe perils such as earthquakes, is also often placed on a non-reciprocal basis. This business is placed in the international reinsurance markets and reciprocity is not a decisive factor.

Problems of reinsurance placements by developing countries

394. A few of the weaknesses of the reinsurance placements of developing countries can be noted. International reinsurance is sought mostly on fire (and allied perils), marine and aviation risks. Although the direct premium rates on property risks are generally good in a number of countries - and this to a large extent explains the overall satisfactory profitability of insurance companies in developing countries, in spite of losses in the motor department - the dismantling of tariffs and the entry of brokers, consultants and advisors in the markets of many developing countries has led to an erosion of premium rates. Many of the property risks in the industrial sector and ocean-going vessels of developing country flags are also aging, and become "heavier risks" year by year. 10/ Maintenance of property is often inadequate, and loss prevention systems are not strictly enforced. Loss assessment systems are often deficient. Administratively, documentation and the timely rendering of accounts is weak, partly because modern information technology has not as yet been fully integrated into the working of insurance companies. International reinsurers have also drawn attention to the fact that the interest rate given on deposits held by ceding companies is often far lower than what is actually earned by them. Most importantly, there is often an undue delay in settlement of balances due to reinsurers, sometimes because completion of stipulated procedures takes time, and in other cases as a result of foreign exchange problems of the country. In many countries, procedures have been enforced for remittances, and often these are time consuming. In other cases Governments, faced with a shortage of hard currency, are obliged to determine priorites for its allocation. Payments for reinsurance are oftenlow on such lists, and this imposes a very heavy burden on reinsurance transactions. Delays in settlement of balances and the possibility of devaluation in the

intervening period influence profitability, and reinsurance rates can be affected. 11/ A cost has to be paid for exchange risks and political uncertainties.

395. The authorities responsible for releasing foreign exchange for reinsurance placements have to realise that payment of premium due to reinsurers need not represent outflow of foreign exchange. The incoming commissions and claims paid by the foreign reinsurers have to be taken into account. The ultimate drain of foreign exchange is represented by the net balance after adjustment of commissions and claims received, and profit commission. This is actually the cost of the protection provided. This can be minimised by timely remittance of premiums due to reinsurers.

Fronting arrangements

396. Note must also be taken of the practice followed by some companies in developing countries of acting as a risk-broker rather than a risk-taker by retaining minimal shares of their risks and reinsuring the rest at terms which leave an assured profit, since their own costs are lower than the commissions earned. It has been suggested that branches of foreign insurance companies usually adopt this strategy. Such a practice is also encouraged by those who have withdrawn from the market as direct insurers but still wish to participate in domestic risks through reinsurance. 12/ In any case, such fronting arrangements, although understandable from the point of view of a small company, are not a suitable strategy to pursue, as they jeopardise long-term growth prospects. They prevent the building up of capacity and expertise and are not, therefore, in the legitimate interests of developing country insurance markets.

Retention capacity

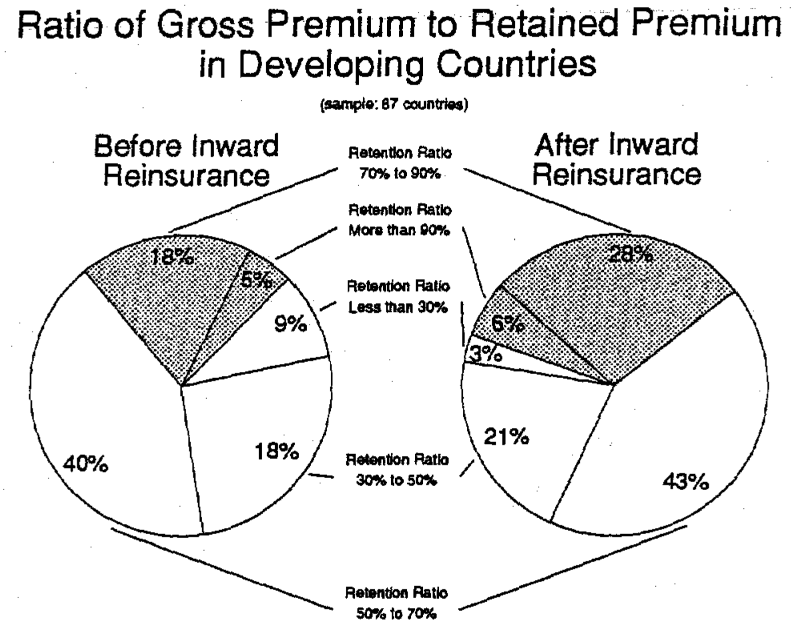
397. An analysis of statistics compiled by the UNCTAD secretariat on insurance and reinsurance in developing countries (see figure 5) reveals the position of retained premium before and after receipt of inward reinsurance. Out of a sample of 87 countries, retention before inward reinsurance was below 30 percent in 9 per cent of countries. The number of countries in this category declined to 3 per cent after inward reinsurance. At the other end of the spectrum, the number of countries which retained more than 90 per cent improved only marginally from 5 per cent to 6 per cent, before and after inward reinsurance respectively. The most significant variation was in the aggregate group of countries that retained more than 70 per cent (shadow area in figure 5). This category of countries increased to 34 per cent after inward reinsurance from 23 per cent before inward reinsurance.

398. Increasing the retention capacity of insurance markets in developing countries has been a much discussed matter. It is, however, being increasingly realised that a general increase in retention is linked to restructuring of markets. If financially stronger companies could emerge either as a consequence of mergers and acquisitions or through improving the capital and solvency margin requirements of insurance companies by way of government policy, the retention capacity of markets would improve. A large number of undercapitalised companies may require more reinsurance, and could be an important cause of the low retention capacity of many markets. In contrast, a smaller number of adequately capitalised companies would lead to much higher retention. Mere exhortation to the effect that companies of developing countries should increase retention does not work. Apart from the question of the overall increase in retention level of a market, considerable scope exists for increasing retentions selectively and adjusting them inter se between various risks. For this purpose, the portfolio will have to be examined in depth to determine the loss profile of categories of risks and to ascertain which are the risks a greater share of which can be retained without exposing the net account of the company. This exercise would require both an adequate statistical basis and a good technical knowledge of underwriting to determine the characteristics of the risks under consideration. Another aspect which needs to be taken into account in deciding reinsurance is the currency which would be required for the reinstatement of damages. Generally speaking, for risks whose repair or replacement does not require imported goods or services, a higher amount of local reinsurance may be placed, either with other domestic insurance companies or domesticreinsurers. For example, personal accident or motor third party risks can be reinsured locally as far as possible. On the other hand, foreign reinsurance of marine cargo and hull, aviation and high-technology plants would provide hard currency for restitution should a claim arise.

Reinsurance security

399. Security of reinsurers has assumed importance in recent times, as insurers have not always been able to collect claims and other dues from their reinsurers. This has been due either to the failure of some reinsurers, or to disputes between the ceding company and the reinsurer over some technical or legalistic aspects of the contract. As far as the financial viability of reinsurers is concerned, there is no substitute for proper checking. Reinsurance brokers have strengthened their security departments, and many maintain lists of reinsurers of acceptable security for placing business on behalf of their client insurance companies. Nonetheless, the ceding company has to remain vigilant about the security of its reinsurer, since the analysis made by the broker is only a service and does not engage his responsibility. Services offered by specialised institutions which do security analyses of insurance and reinsurance companies on a worldwide basis are available and should be better utilized. The growing concern with the security of reinsurers has favoured the prominent professional reinsurers whose financial stability is known to be beyond doubt.

Figure 5



Source: Statistical Survey on Insurance and Reinsurance in Developing Countries 1984-1986; UNCTAD TD/B/C.3/231

400. An aspect of security which needs to be noted is that the quality of the business offered for reinsurance and the terms of reinsurance sought also have a bearing on the security that can be obtained. If the business to be reinsured is of inferior quality and a very cheap and bargain rate is being sought, the security is likely to be inferior.

Early receipt of dues from reinsurers

401. Quick receipt of reinsurance claims is of prime importance to insurers in developing countries. They may not be in a position to finance claim payments to direct clients. London has been well-known for taking an accommodative view in interpretation of reinsurance contracts and for speedy payment of claims. This in fact has been one of their important marketing strengths. European reinsurers have also been understanding and enjoy an unimpeachable record of willingness and speed as regards settlement of claims. It is, however, reported that of late a more formalistic approach is being taken in various markets. This puts a strain on the insurance sector of developing countries, especially since the wording of reinsurance contracts is proposed by the reinsurer.

Continuity

402. It is understandable that various reinsurers have to be approached to obtain competitive terms. At the same time, the continuity of a relationship is an important aspect in building long-term confidence and mutual trust among insurers and reinsurers. This goes a long way in helping ceding companies when a difficulty arises. As a general rule, therefore, continuity should be an important consideration in choosing a reinsurer.

Attractiveness of reinsurance business from developing countries

403. In spite of many weaknesses in the reinsurance placed by developing countries, it is generally regarded as profitable and is therefore sought after. Reasons for the general profitability of reinsurance ceded are manifold. Direct insurance companies in many developing countries often benefit from monopolistic or oligopolistic conditions. The rates on the classes of business which are reinsured are good, either due to tariff régimes or because of a lack of competition. The values to be insured are also usually lower and the accumulation of risks less pronounced than in industrialised countries. All this leads to making insurance and reinsurance business of developing countries reasonably profitable. Furthermore, the important players in the international reinsurance markets endeavour to diversify their commitments beyond the reinsurance business available in developed countries, which typically has a long-tail and heavy exposure. This business is available mostly in developing countries.

Effect of hardening markets on developing countries

404. However, the recent hardening of the international reinsurance markets is causing some concern to buyers of reinsurance from developing countries. It is feared that reinsurance terms for their risks might be increased due to overall underwriting losses in the international market, in spite of the fact that the major losses have occurred elsewhere. It has been reported that this has in fact happened in some classes of oil and energy business, where the terms have been affected by losses incurred by reinsurers in other geographical areas. Experience tends to show that when there is a trend towards upward revision of terms and conditions, the burden falls less heavily on major markets, since these cannot be alienated nor can important accounts be risked due to cash-flow considerations. In this respect smaller markets are more vulnerable and suffer more. 13/

Importance of international reinsurance markets for developing countries

405. London has traditionally been the centre of international reinsurance. However, the problems of Lloyds has meant some setbacks. The number of syndicates diminished from 354 in 1991 to 275 in 1992, and it is believed that it will go down further in 1993. 14/ Nevertheless, capacity has not gone down to the same extent. It has been estimated that it diminished only from L11 billion in 1991 to L10 billion in 1992 and is expected to fall not more than 10 per cent in 1993. Lloyds continues to be important both for capacity and for providing a "lead". The establishment of the London Underwriting Centre is expected to considerably strengthen the British market. Professional reinsurers from continental Europe are also important players in the international market and, in fact, have been gaining in importance. They support reinsurance programmes of many countries and also play a significant role in providing technical assistance and training to developing countries. It may be mentioned in this connection that apart from the obvious commercial interests, a close relationship and mutual trust prevails between the insurance sector of developing countries and the international reinsurance markets. It is, in fact, widely acknowledged that reinsurers play a vital and significant role in the development of domestic markets of developing countries. A trend which needs to be noted in this connection is that a requirement is sometimes imposed (when the risk is not of such a high exposure that reinsurance in a widespread market is unavoidable), both by the London and the European markets, to the effect that a sizeable share of reinsurance must be placed in their market. Reinsurers justify this on the grounds of the increasing cost of handling and processing proposals, and for the support services provided. This, seen from the point of view of buyers of reinsurance in developing countries, restricts their options and the development of contacts with a more varied market.

406. The reinsurance market of the United States of America has not played a significant role in developing countries in Asia and Africa, in spite of its size and the sophistication of its institutions. One reason advanced for this is the prevalence of a very detailed formalistic and contractual system of reinsurance in that country.

There is, however, a growing awareness of the issue and a desire on the part of American reinsurers to enter the markets, and offices have recently been established in Hong Kong and Singapore for developing reinsurance business in the region. Reinsurers from the United States of America are quite active in many Latin American countries.

Mechanism of reinsurance placements

407. The mechanism of reinsurance placements in the international market, or more appropriately the route to be followed for placements, has been specified in many developing countries, usually by the respective supervisory authorities. In some countries, all reinsurance has to be channelled through the national reinsurance company. This has been the case in Brazil, Uruguay, and Algeria. It was considered that dealing with international markets requires special skills, and the interests of the market would be best served by pooling reinsurance placements in one place. In certain other developing countries, all foreign reinsurance placements must be shown to the national reinsurance company, which has a right of first refusal. This was the case until recently in Pakistan. In still other countries, as in Ghana, a small percentage of international placements has to be given to the national reinsurance company, so that it is able to scrutinise the terms on which business is being reinsured. Another situation which exists is where there is freedom to place business in the international market (after compulsory cessions to the national reinsurance company have been made), but this can be done only through companies or intermediaries approved or registered by the supervisory authority. This is the case in Egypt. However, proposals for enlistment are sponsored by insurers and the reinsurer in the market, and to this extent there is sufficient flexibility. In Chile, the reinsurers are required to register with the supervisory authority, providing it with full information and a bond in its favour. This measure replaces the earlier situation where the national reinsurer had a monopoly on all reinsurance. In Bangladesh, the private insurance companies have voluntarily decided that they will entrust the Sadharan Bima Corporation with all their international placements, since separately they are too small to obtain satisfactory terms.

Brokers for reinsurance placements

408. In dealings with large professional reinsurers the services of brokers are not necessary. The former offer many advantages, such as a large capacity, continuity of relationship and technical advice. However, a company in a developing country may wish to diversify its reinsurance placements and obtain the benefit of competition by going to, or seeking quotations from, other players in the international markets. In that case intermediation by a broker may become necessary. Both small and large brokers have their positive aspects. However, it is worth noting that during the last few years, several domestic brokers have started working in developing countries. Although they obviously are not as prominent as international brokers, many of them have developed expertise and connections beyond their national boundaries. To what extent they are able to provide a satisfactory level of service is a commercial judgement. Utilisation of their services could in the long run strengthen the markets of the developing countries. To improve their position it is necessary that they involve themselves with technical aspects of the business, and not rely merely on the connections established with various companies.

C. Developing countries as suppliers of reinsurance

Reinsurance acceptance

409. A distinction can be made between reinsurance accepted by direct companies and that accepted by professional reinsurers in developing countries. Furthermore, a worthwhile distinction can be made in terms of reinsurance originating from direct markets (domestic or regional or some foreign markets with similarity of results) and that originating in the international reinsurance markets.

Direct companies and reinsurance acceptance

410. Direct writing companies accept reinsurance business essentially for two reasons. First, they are seeking to improve the spread of risks, which is a crucial aspect of insurance operations. Their own portfolio may not provide the desired extent of spread, and a diversification (or mix) can be achieved through an exchange of business. This is likely to produce more stable underwriting results. Second, only the net premium income is

seen by the shareholders, clients and the general public (the net premium being the total premium underwritten minus reinsurance ceded plus reinsurance accepted). Since a substantial amount of the premium is ceded to reinsurers, the acceptance of inward reinsurance is necessary to restore somewhat the size of a company's operations.

411. The direct writing companies accept reinsurance under these two compulsions. As has already been noted, when a direct writing company has a reinsurance treaty which has produced a profit over a period of years, reciprocal exchange is sometimes negotiated. The profitability can be adjusted through several mechanisms, such as volume of business exchanged, commission terms, profit commission and terms of deposit. If the treaty of a company is unprofitable, the opportunity for a mutually satisfactory reinsurance exchange may not exist, and the business will have to be placed non-reciprocally on the best possible terms.

412. It is generally agreed that non-proportional international reinsurance business may not be the type of business best suited to direct writing companies in developing countries, except when they have grown in size and financial strength and have acquired the necessary expertise so that acceptance of such business can be taken up as a specialised and additional activity. Profit may emerge over a period, but extreme caution is necessary in entering this business, since without experience there is every possibility of its turning out to be a loss rather than a profit centre.

Brokers for inward business

413. The role of brokers in placing reinsurance business of developing countries has been already discussed. Their services are also necessary for negotiating and facilitating inward business. Brokers established in the developing countries can be used, since, due to better familiarity with and closeness to the area, they may be able to arrange a better exchange. However, the reinsurer, as the seller of reinsurance, will have to pay the brokerage, and to the extent he can develop reinsurance connections directly, the cost can be saved.

Reinsurers of developing countries

414. Developing country reinsurers have come into existence, usually as public enterprises, to meet the aspirations of emerging markets with regard to retaining a greater portion of the domestic premium within the country and building up reinsurance expertise. It would appear that, at least for a large number, their capacity remains under-utilised. A study by Africa Re of 16 reinsurance companies reveals that, judging by the international norm of a netpremium of about three times the shareholders' funds, the potential capacity of 14 of them has not been fully utilised. For example, Africa Re writes business equivalent to only 40 per cent of its potential. 15/ A number of privately owned national reinsurance companies allied to regulations to increase national retentions have been established in several Latin American countries in recent years, and have generally done well.

Compulsory cessions

415. For most of the reinsurance companies in developing countries, compulsory cession, often prescribed by law but in certain cases agreed by the market, is the mainstay of their business. It gives them a base. Some examples of compulsory cessions are: 10 per cent of fire risks to the Insurance Corporation of Barbados in Barbados; 10 per cent to Caisse Nationale de Réassurance in Cameroon; 30 per cent to Egypt Re in Egypt; 10 per cent to Fiji Reinsurance Corporation in Fiji; 20 per cent to Ghana Re in Ghana; 20 per cent to General Insurance Corporation in India; 25 per cent (and an additional 25 per cent of all treaties) to Kenya Re in Kenya; 10 per cent to Caisse Nationale des Assurances et de Réassurance in Mali; 10 per cent to Société Centrale de Réassurance in Morocco; 20 per cent (and an additional 25 per cent of all treaties) to Nigeria Re in Nigeria; 30 per cent to Pakistan Insurance Corporation in Pakistan; 10 per cent to National Reinsurance Corporation in the Philippines; 15 per cent (fire and marine only) to National Insurance Corporation in Sri Lanka; 5 per cent (except marine hull) to Thai Re in Thailand; and 25 per cent to Milli Re in Turkey.

416. In addition to compulsory cessions to national institutions, some markets also require obligatory cessions to regional reinsurers. For example, companies in member countries are required to give 5 per cent of their treaties to Africa Re. Asian Re obtains, as obligatory cessions from markets of member countries, 5 per cent

of the reinsurance business placed abroad or US$500,000, whichever is less. It is reported that that ZEP Re which is a new regional reinsurer set up by the PTA countries in Africa, is to get 10 per cent of treaty from companies in member countries.

417. In some markets, although there are no compulsory cessions to a reinsurer, it has been stipulated that a specified percentage of business must be retained in the market. In the Dominican Republic 30 per cent of all reinsurance must be placed with "authorised insurers and reinsurers"; 75 per cent of the capacity should be retained in the local market in Indonesia; and 15 per cent of all business written by foreign companies must be ceded to domestic insurers in Oman. The Nigeria Re in Nigeria has to be given the right of first refusal of all reinsurance business placed outside the country. In Pakistan 25 per cent of all foreign reinsurance has to be offered to Pakistan Insurance Corporation.

418. Although data on the profitabilty of the compulsory cessions received as compared to other business written are not available, it is presumed that, since the direct business is profitable, the compulsory cessions would also produce a reasonable profit. In this connection, periodic review and adjustment of commission (and profit commission) terms on compulsory cessions given to national and regional reinsurance companies should be considered, so that while a reasonable profit is left, the interests of direct writing companies are safeguarded.

419. A substantial part of the business received by reinsurers through compulsory cessions is usually retroceeded to the ceding companies, and tothis extent they perform the function of a national pool. This increases the total retention of the market. However, a few issues have to be kept in view in the interest of the companies making the compulsory cessions. First, direct writing companies may be required to make obligatory cessions to several organisations - national, subregional and regional reinsurers - and this may have a cascading effect. Second, the extent of retrocession to the ceding companies should be maximised. Only a limited purpose is served if the reinsurer retroceeds a substantial part of the business to international reinsurance markets. And thirdly, while an overriding commission to cover administration and other expenses is justifiable, it should be modest.

Development of business of reinsurers in developing countries

420. Reinsurance companies which receive compulsory cessions realise that, while such arrangements were necessary in the formative years of their operations, dependence on them has to be scaled down and alternative sources of business developed. Consequently, many reinsurers in developing countries are taking steps to build up other business. Some reinsurance companies, like Tunis Re in Tunisia, are able to operate without any compulsory cessions. In the Republic of Korea compulsory cessions to Korea Re were abolished as from April 1990. The compulsory cessions received by Milli Re in Turkey are proposed to be phased out over a 10-year period. Apart from the question of reducing compulsory cessions, in recent years it has been contended that it would be fairer to ceding companies to gradually shift from a quota share basis to a share in treaties placed. The quota share arrangements may have been a simpler method in earlier stages, but it deprives the ceding company of the opportunity of retaining simple risks up to its capacity.

421. In keeping with the trend towards deregulation and liberalization, some changes have taken place in reinsurance markets, particularly in Latin America. In Argentina, Chile and Peru the requirement of routing all reinsurance through the national reinsurer has now been withdrawn. The requirement of retaining all life and 90 per cent of non-life business in the local market in Colombia has also been lifted. In this context it may be noted that Brazil and Argentina cede very little into the international market because they have only a small catastrophe exposure. The average reinsurance from other Latin American countries is about 25 per cent. 16/

422. The task of developing reinsurance business other than compulsory cessions is not easy and there are limitations. As in the case of direct writing companies, the capital base of reinsurance companies in most cases is also small, which makes their acceptance limits low. Since they do not have substantial investment income they cannot be venturesome. Profitable businesses, other than what they are already getting from the national or neighbouring markets, is not easy to obtain, since it is already placed against reciprocity or as a sweetener together with other unbalanced business in the international reinsurance market. It is difficult to have it released. Furthermore, after having given obligatory cessions, the direct companies themselves want some diversification and are reluctant to give further business to the national reinsurer. Additionally, there is also the problem of

catastrophic exposure - both man-made and natural - and too much business from a limited geographical area is not attractive. Furthermore, since such reinsurers are anchored in a country or a region, they cannot stay out of some of the unbalanced and exposed business of the area. All this makes for difficult tight-rope walking.

423. Since national and regional reinsurers are a part of the international reinsurance market, they have to take part in international reinsurance business. Premium volume has to be gradullay built up, and since there are limitations on developing local or regional business, the net has to be cast widely. Contacts have to be developed in the international markets, since the intricacies of the trade can be learned only by participating in it. Geographical diversification and a better spread has to be achieved, particularly if the territory where the reinsurer is established is catastrophe-prone.

424. On the other hand, the available international business is likely to be risky. Also, since it may have passed through a few hands and overhead commissions are kept at each stage, the profit margin is eroded. The reinsurance companies in developing countries, therefore, have to be extremely careful, selective, and cautious in underwriting inward business. In particular, they should not lend their resources to constitute what has been described in insurance circles as "innocent capacity", or a dumping ground for highly exposed business. At the First Singapore International Conference held in Singapore in October 1991, it was suggested that international reinsurance is such a complex and difficult business that it requires substantial capital and reserves to underwrite and that reinsurers from developing countries would be better off concentrating on finding niche markets in their own regions by developing a certain specialisation.

425. Inward business accepted has often produced losses for reinsurance companies in developing countries. For example, in the Republic of Korea, in 1988 the loss ratio on inward business was 116 per cent as against 51 per cent on reinsurance business ceded abroad, and in 1989 the ratios were 107 per cent and 103 per cent respectively. 17/ For Egypt Re of Egypt the inward acceptance in 1989 produced a loss ratio of 92.4 per cent, as against 23.5 per cent for reinsurance ceded. 18/.

426. There also have been cases of failure. The account of INdeR in Argentina is being run off as a result of a severe financial crisis. Similarly, RMCA (Reinsurance Management Corporation of Asia) in Singapore is also being run off. It has further been reported that Mauritius Re in Mauritius, Philippine Re, Eastern General Re and Reinsurance Corporation of the Orient in the Philippines did not succeed. A substantial volume of retrocession business accepted from international markets is given as the primary reason for their problems. In fact, it has been maintained that "many if not all financial failures of third world reinsurers have been caused by underwriting losses from risks accepted from Europe and North America". 19/

Facultative business

427. An area which needs to receive special attention from reinsurers in developing countries is the facultative reinsurance business. Here the risks are known, control can be exercised and selection of risks is possible. It is true that the capacity of reinsurers in developing countries in accepting large facultative lines is limited, and the direct writing company may prefer to entrust the placement to a reinsurer who can provide sufficient capacity. However, it should be possible to find a workable solution to this difficulty, for example, by the reinsurance company playing the role of intermediary for international placement of large facultative lines.

Currency management in reinsurance

428. The depreciation or devaluation of currencies of developing countries has significance for reinsurance transactions, since reinsurance is usually in the currency of the ceding company (reinsurance on aircraft and oil-rigs is a notable exception). As sellers of reinsurance, reinsurers in developing countries are in a difficult situation. Since the risks reinsured are located in a foreign country, premiums are received and claims have to be paid in that country's currency. If the currency of the reinsurer has depreciated or devalued between receipt of the premium and payment of the claim, a much larger amount in the local currency is required to meet liability. Since the accounts of the reinsurer are kept in local currency, he suffers an "exchange loss". The reverse side is that when reinsurance is bought in the international market, the reinsurer in the foreign country (usually with a harder currency) has to pay out a much smaller amount in his own currency for payment of claims to the ceding company, if depreciation or devaluation of his currency has taken place. This in fact is an

additional factor which makes reinsurance emanating from developing countries attractive to the international markets. In view of the implications of exchange rate fluctuations, proper "currency management" is an important aspect of reinsurance business in developing countries.

Co-operation amongst reinsurers

429. The benefits of greater co-operation and exchange of business among reinsurers of developing countries have often been emphasized. Numerous subregional and regional pools, as well as the two regional reinsurers, Africa Re and Asian Re, are proof of the importance given to such co-operation. A few subregional reinsurance companies have also been established. Mention may be made of CICA Re in the francophone countries of Africa, ZEP Re in the Preferential Trade Area (PTA) for Eastern and Southern Africa, Arab Re in Arab countries, Arab Union Re in the Syrian Arab Republic and the Libyan Arab Jamahiriya, private sector Nuevo Mundo in Panama and Asean Re in the ASEAN region in Asia.

430. As regards pools, mention may be made of the Africa Aviation Pool and the Africa Oil and Energy Pool managed by Africa Re, the Fire Pool of East Africa managed by Kenya Re, the Africa Fire Pool managed by CICA Re, the Third World Pool managed by Nigeria Re, the WAICA Pool of West Africa, the Pool de Co-reassurance des pays sans littoral, by the four West African landlocked countries, namely Burkina Faso, Chad, Mali and Niger, the Arab Fire, Marine and Aviation Pools managed by Arab Re, and the Pool managed by Trin Re in Port of Spain, Trinidad. The Eco Pool, formed between the Islamic Republic of Iran, Pakistan and Turkey is also managed by Milli Re. The FAIR Pool is an important interregional pool and is managed by Milli Re.

D. Bilateral reinsurance exchanges

431. Increased bilateral exchanges among insurers and reinsurers of developing countries are another way to supplement efforts aimed at increasing retention of business. Their business may often match and have similar characteristics. While bilateral exchanges have not received much attention and support, they are in fact taking place on a substantial scale. It has been estimated that in Africa alone, the aggregate of bilateral exchanges runs into very substantial amounts and far exceeds the sums involved in formal and institutionalised exchanges. 20/ The advantage is that these exchanges arecommercially oriented, flexible, voluntary and do not entail expenses needed for running formally established organisations.

432. Very often administrative and psychological factors have hindered the further expantion of bilateral exchange of reinsurance business. Not enough information is exchanged about the characteristics of the markets or the nature of the risks. Problems of communication and of travel restrictions due to foreign currency shortages add to the problems. In this connection it has been pointed out that "we tend to distrust each other to the extent that the average African, Asian or other third world insurance or reinsurance official would prefer to place his business in the international markets rather than with any of his colleagues in the developing markets even where the necessary capacity exists ...". 21/ It has been further maintained that "African companies do not seem to be keen to exchange business with each other. When they do, the story goes that African reinsurers are paid last, after all others. So many have been discouraged from accepting African business altogether in order not to maximize their uncollectible account. Is it not possible to treat each other as other international reinsurers and settle balances in the same manner - not sooner, not later?" 22/

433. In view of the great potential for bilateral exchange, three African Reinsurance Exchange Meetings have been arranged, sponsored by UNDP, UNCTAD and the AIO, in Cairo, Egypt (1988), Harare, Zimbabwe (1990), and Tunis, Tunisia (1992). Arranged before the renewal season, their aim was to encourage business among African insurers and reinsurers and to ease somewhat the problems arising from the lack of foreign exchange. Further, the spread of risks would be improved, ultimately leading to more stable results.

434. Since inability to settle balances due to each other because of exchange control regulations is stated to be one of the main hurdles in expansion of such exchanges, the AIO and Africa Re have been working on the concept of an African Reinsurance Clearing House, which should provide a mechanism for settling balances between trading partners. Hard currencies would only be needed for settling the final balances. In this way an important stumbling block would be removed. However, a study undertaken by an AIO sub-committee found

that the existing clearing facilities (for example of ECOWAS and the PTA) were not really suitable for insurance and reinsurance transactions. To adjust those mechanisms would require political support by the highest authorities of participating countries and possibly involve legislation on their respective modalities. The sub-committee concluded that this would be a time-consuming and costly exercise whose chances of success would be by no means certain. Thus the implementation of the idea has been suspended for the time being. 23/

435. While a clearing house remains the industry's ultimate objective, the sub-committee recommended that one should not wait for its realization but should go ahead with bilateral exchanges. It decided that the facilities enjoyed by Africa Re in the matter of transfer of funds from one country to another should be utilised more efficiently to promote exchange of business. For the last few years, Africa Re has already been underwriting an Auto-Fac slip line on behalf of over 40 African companies, and it has been decided to enlarge the scope of this arrangement. Presently, the member companies provide a capacity of about US$6 million, and with the US$1.5 million capacity of Africa Re, a total capacity of US$7.5 million is achieved. The business is retroceded to the participating companies after the necessary reinsurance for protection of the portfolio. To this extent the arrangement works as a pool. The premium underwritten has grown to around US$4.5 million in the last few years, and the net underwriting surplus has been around 15 per cent of premium underwritten. This surplus ultimately goes to the member companies.

436. At the African Reinsurance Exchange Meeting held in Tunis in October 1992, it was further decided that, with the aim of accelerating bilateral exchange between African professional reinsurers and insurers, an "African Reinsurance Exchange" be constituted, again with Africa Re as the nucleus and the manager. Member companies of the African Insurance Organisation (AIO) will be eligible for membership. Designated shares of treaties and facultative business on risks of the African region will be ceded in priority to cessions outside the continent. The business accepted by the Exchange will be retroceded to members on the basis of the volume of business of their cessions and capacity. Retrocessions received would have to be fully retained for the net account of that member. All participants would make an initial deposit in convertible funds. The Exchange would retain for each member and to their credit 25 per cent of the disclosed net surplus (on the basis of a five-year accounting) of the closed year until such time as the amount so retained equals 50 per cent of the member's underwriting capacity in the Exchange. A Technical Committee would supervise various aspects of membership and operations.

437. The efforts made by Mahgreb countries are worth mentioning. Since 1987, they have an annual meeting for the exchange of business in the framework of the Rendez-vous de Carthage, which takes place around the middle of October. Only Mahgreb countries and brokers participate. It is reported that this regular event has resulted in increased exchange of business amongst participating companies.

E. Advances made in reinsurance markets of developing countries

438. There have been some positive developments in reinsurance markets of developing countries. In this respect mention may be made of the initiatives taken in some countries to establish themselves as reinsurance centres for their region or continent. This applies in particular to Singapore, which is rapidly developing itself as the reinsurance centre of Asia. With 31 reinsurance companies, Singapore has in fact the highest number of reinsurers operating in Asia. Pointing out that Singapore's reinsurers were enjoying good international acceptance, Singapore's Insurance Commissioner has indicated that future plans are aimed at approaching the level of the London market in terms of quality and service. Branch offices are encouraged to upgrade their operations and become locally incorporated. Hong Kong has been an important reinsurance centre for a long time. The likely effects of change in 1997 are not clear as yet. Bombay in India is also trying to develop connections with insurers and reinsurers in developing countries. A number of brokers with international infrastructure have emerged. Seoul in the Republic of Korea is also emerging as an important player in the Asian markets.

439. In Africa, Lagos in Nigeria has been establishing itself as a reinsurance centre, hosting the headquarters of four professional reinsurance companies, including Africa Re, and several leading direct insurance companies with international connections. Tunisia is another centre of importance, with Best Re, ARIG and MGFA being in the market, apart from Tunisia Re. Kenya is reported to be developing into an insurance and reinsurance centre for eastern and central Africa. It hosts the Eastern African Regional Office of the African Reinsurance

Corporation, as well as ZEP Re, the reinsurance company established by PTA countries. Some reinsurance companies from developingcountries have been establishing branches in London and other major locations of interest.

F. Country developments

440. Some of the developments regarding reinsurance in individual countries are described below.

African countries

441. Gabon: A new reinsurance company, the Société Gabonaise de Réassurance (Gabon Ré) has been founded in Libreville, Gabon. The leading shareholder is the French Union des Assurances de Paris (UAP), owning 30 per cent of the shares. The Government holds 2 per cent. Other shareholders include reinsurers and insurance companies from France, Germany, the United Kingdom and the United States, and private citizens. Gabon Ré will receive a voluntary 20 per cent of all the treaties on the Gabon market, and exchanges will be sought within Francophone Africa. Gabon Ré has no intention of writing international business in the near future. 24/

442. Namibia: The Ministry of Finance intends to keep the Namibian insurance market open and competitive. Foreign reinsurers may register or incorporate. It is deemed that the Namibian market is too small to insist on the incorporation of reinsurers, and for this reason a minimal capital requirement was set for registration of foreign reinsurers to prevent the proliferation of reinsurers in such a small market. 25/

443. Nigeria: It was reported that companies in the market owe around US$25 million to the Nigeria Reinsurance Corporation. Nigeria Re has taken many of them to court and hopes for a prompt settlement, as this would enhance the recycling of services to other insurers. 26/

444. Sierra Leone: The Sierra Leone Reinsurance Co. was to be established by the end of 1991. The objectives are a reduction of the outflow of foreign currency and encouragement of reciprocal exchange of business with international reinsurers. 27/

445. In Zambia, where no professional reinsurer is active, the Zambia State Insurance Corporation (ZSIC) exchanges business with neighbouring reinsurers. In this way efforts are made to contribute to an increase in premium retention on the African continent. Even though the insurance business was liberalised with effect from January 1991, all reinsurance will be handled by ZSIC. 28/

446. The insurance industry in Zimbabwe is reported not to view the establishment of a regional reinsurance company of PTA member countries too positively. It has been observed that since Zimbabwe is the strongest insurance market in the group, it might end up subsidizing the reinsurance markets in other PTA countries. 29/

Asian countries

447. Asian insurance markets have been the object of considerable interest on the part of reinsurers due to their generally good growth potential, in particular in the Pacific Rim countries. While a wide spectrum of classes and types of reinsurance contracts is ceded to reinsurers from Asian countries, fire and related property lines remain the predominant classes of business ceded by Asian insurers of Southeast Asia. This is followed by marine, cargoand hull insurance. Concerning the kind of reinsurance vehicles utilized by Asian companies, the great majority reinsures on proportional basis rather excess of loss. The placement of proportional business is reported to be evenly split between reinsurance brokers and direct writers, whereas the excess of loss account relies much more heavily on brokers. The countries and territories which have a higher exposure to catastrophes, such as the Philippines, Taiwan Province of China and Hong Kong, employ catastrophe excess of loss reinsurance. "On the other hand, where there is little, if any, concern for catastrophe exposure, there is more reliance on proportional treaties and per risk excess of loss covers to protect against large unusual shock losses. This for example is the case in Singapore and Malaysia." 30/ The same source also points out that the profitability to reinsurers writing Asian reinsurance business varies by class. Property, marine and motor results emanating from Thailand, Malaysia and Singapore have recently been reported to be profitable. The results from

Taiwan Province of China, the Philippines and Indonesia have not been so favourable, due in part to several large fire losses.

448. "International reinsurers expect more demand for reinsurance and more sophisticated insurance products and services as the economies of Asian nations develop. Insurance relating to trade will certainly continue to grow as well as liability accounts. The property and related business will require more reinsurance protection particularly for large construction projects which will result in further facultative reinsurance activity and ultimately a growth in treaty protection with large fixed property classes." 31/

449. China, unlike other Asian countries, retains most of its business. In 1989 the gross premium income was approximately US$2.1 billion, of which only US$70 million ceded abroad and spread over a very large number of insurance and reinsurance companies. 32/

450. In Fiji, 10 per cent of all risks covered by local companies are ceded to Fiji Reinsurance - a joint venture involving the Government (20 per cent), the local insurance industry (60 per cent) and foreign insurance interests (20 per cent), up to a maximum of F$600,000 per individual risk in all insurance classes except aviation. The company, in turn, absorbs up to F$250,000 of these risks and obtains excess of loss cover offshore for any additional exposure. 33/

451. In the Republic of Korea, the insurance market has recored substantial growth in the past decade. Although in April 1990 the compulsory cession system was phased out, international reinsurers do not see their premiums increase quickly due to the strong role played by the Korean Reinsurance Company and because local capacity must be fully utilized before business can be ceded abroad. But while the amounts ceded from the Republic of Korea have been growing, recent results have been disappointing to overseas reinsurers, particularly from the catastrophe and per risk excess of loss account, which in 1990 produced several large risk losses, in addition to flood losses resulting from typhoons. 34/

Latin American countries

452. Reinsurance in the Latin American countries has been decisively marked by privatisation and liberalisation policies.

453. Developments in Argentina and Brazil in the area of reinsurance are discussed in a separate document on liberalization and privatization.

454. In Colombia, a new circular concerning reinsurance placements abroad stipulates that the office of the Superintendent itself will now authorize such placements. It will no longer act as advisor to the foreign exchange office in this matter. 35/ A registration system is to be set up for reinsurers and reinsurance brokers to enable the Superintendent to judge the quality of support obtained by domestic companies. This will imply that foreign insurance and reinsurance companies must have a general agent in Colombia and send their financial statements regularly. 36/

455. In Mexico, a general register of foreign insurers is to be established. Companies are required to be solvent and well established in their country of operation to be included in this register. The Secretary of Finance will continue to maintain a register of foreign insurers of good standing, solvent and with stability in their market of operations. 37/

456. Peru liberalized its reinsurance market in March 1991. Since then, insurance companies have been free to contract insurance domestically or abroad. The reinsurance should be placed with duly registered national or foreign reinsurance companies (before, all business relating to domestic reinsurance was to be contracted exclusively through Reaseguradora Peruana). Insurance and reinsurance companies are authorized to form national reinsurance systems. They should, however, disclose all necessary information to the office of the Superintendent. Reinsurance contracts in force in the country or abroad on the date of issue of this legislation could remain in force up until the end of the time period of the last policy assigned to those contracts. 38/ Meanwhile, Reaseguradora Peruana has been offered for sale.

Notes

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2/ Asia Insurance Review, July-August 1992, p. 30.

3/ Business Insurance, 31 August 1992.

4/ John Lock, "World reinsurance and its future prospects", paper presented at the First Singapore International Reinsurance Conference, Singapore, 1991, p. 4.

5/ SIGMA, Swiss Re. June 1990, p. 9

6 John Greig, quoted in World Insurance Congress, "Signs of upturn in the insurance market," Asia Insurance Review, July-August 1992, p. 30.

7/ Patrick Peugeot, "Don't underrate African business", paper presented at 14th African Insurance Congress, 1987.

8/ John Lock, op. cit., p. 4

9/ "Reinsurance - London and Third World opinions", Insurance Institute of London, 1981, p. 47.

10/ Herbert N. Haag, "How to meet challenges facing the Afro-Asian insurance market", paper presented at the 11th FAIR meeting, Pyongyang, Democratic People's Republic of Korea, 1989, p. 9.

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12/ "Reinsurance - London and Third World opinions", op. cit. p. 18.

13/ M.S. Wijenaike, "An experiment in regional co-operation", Insurance Review, Special EAIC issue, September 1991, p. 86.

14/ Carol Boland, "Down, but not out", ReActions, September 1992, p. 23.

15/ Eyessus Zafu, "The future of national reinsurance institutions in Afro-Asian markets", paper presented at 12th FAIR Conference, Addis Ababa, 14-15 September 1992.

16/ Reinsurance Market Report, 20 October 1992.

17/ World Insurance Report, No. 376, 24 November 1989.

18/ William Olotch, "The role of national, sub-regional and regional reinsurance organisations", paper presented at AIO Conference, Nairobi, Kenya, 1992, p. 4-5.

19/ Isagani de Castro, "Reinsurance for the nineties", paper presented at 8th Third World Congress, New Delhi, 1992, p. 3.

20/ Yoseph Aseffa, paper presented at the UNCTAD/AIO Reinsurance Exchange Meeting in Harare, Zimbabwe, October 1990, p. 4.

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22/ Yoseph Aseffa, op.cit., p. 4.

23/ Eyessus W. Zafu, "The future of national reinsurance institutions in Afro-Asian markets".

24/ World Insurance Corporate Report, No. 13, 3 March 1989, p. 3.

25/ World Insurance Report, No. 395, 31 August 1990, p. 4.

26/ Insurance Research Letter, August 1990.

27/ World Insurance Corporate Report, No. 76, 13 September 1991, p.3.

28/ World Insurance Report, No. 403, 18 January 1991, p. 7.

29/ World Insurance Report, No. 377, 8 December 1989, p. 7.

30/ Piccione, Tal, "The Asian reinsurance markets", paper delivered at the International Insurance Council in New York and published in The Reinsurance Market Report, December 1991.

31/ Ibid.

32/ Ibid.

33/ Best's Review, March 1989, p. 85.

34/ World Insurance Report, No. 376, 24 November 1989, p. 6.

35/ Insurance Research Letter, November 1991.

36/ Insurance Research Letter, October 1991.

37/ Insurance Research Letter, February and May 1990.

38/ Insurance Research Letter, July 1991.

Chapter XI

CO-OPERATION AMONG DEVELOPING COUNTRIES IN INSURANCE

A. Introduction

457. Insurance is based on the law of large numbers. However, two basic requirements for the law of large numbers to operate effectively, namely a portfolio with a sufficient number of risks with similar characteristics and a geographical spread, often cannot be obtained within the limitations of a company's business, and indeed within the national boundaries of a country. Co-insurance and reinsurance have, therefore, become an inseparable part of the insurance system. These practices have lent an international character to insurance.

B. Co-operative Insurance Mechanisms

458. Since the 1960s and 1970s the insurance sector has established a number of forums to facilitate co-operation and concertation amongst various insurance markets of developing countries. Their geographical scope varies from interregional to regional and subregional. Some facilities are meant for insurance supervisory authorities, others are of interest to insurers and reinsurers, while most forums are for the benefit of both. The regional and subregional organisations, whose purpose is to foster an exchange of information among members, to define areas for co-operation, to chart common approaches, and to encourage new contacts, play a pivotal role. The African Insurance Organisation (AIO) for Africa, the East Asian Insurance Conference (EAIC) for East Asia, the Federacion Interamericana de Empresas de Seguros (FIDES) for Latin America and the General Arab Insurance Federation (GAIF) for Arab countries have launched numerous initiatives leading to greater co-operation. Mechanisms on an interregional basis or involving the whole of the third world, such as TWIC (Third World Insurance Congress) and FAIR (the Federation of Afro-Asian Insurers and Reinsurers) further widen the scope of regional consultations. The respective regional, subregional or interregional associations organize regular meetings in one of their member countries. As regards the most universal of these organisations, TWIC, the meetings take place alternatively in each developing continent. The meetings are attended by a great number of insurers, reinsurers, brokers, and other insurance-related trades from developing as well as developed countries. Conference interactions have led to exchange of business among them, encouraged the establishment of regional pools and supported the work of regional and subregional reinsurance corporations.

459. As regards co-operation among supervisory authorities, Latin America and Africa both have a regional association of insurance commissioners. The Association of African Supervisory Authorities is the most recent co-operative arrangement of supervisors and was established in 1989 during the AIO Conference in Yaoundé, Cameroon. A subregional association in Asia is the Association of ASEAN Insurance Commissioners. The Association of Insurance Supervisory Authorities of Developing Countries (AISDAC) was established at the second TWIC Congress in Buenos Aires, and is an interregional association for all developing countries. The exchange of information and experience on insurance legislation and efforts to harmonize it, supervision and training have been identified by these associations as key areas of co-operation.

460. Reinsurance is another area of co-operation among developing countries. Possibilities of bilateral exchange of business between insurance companies in developing countries and co-operation between various subregional, regional and interregional reinsurance companies in developing countreis have been noted in the chapter on reinsurance. Co-operation in the field of agricultural insurance in developing countries can also play a significant role in promoting effective schemes which would be of relevance to the rural areas. At the New Delhi meeting of TWIC held in February 1992, it was resolved that associations be formed on a subregional and regional basis to promote agricultural insurance among member countries, on the model of ALASA (Latin American Agricultural Insurance Association), formed in 1985 as a consequence of recommendations made at the meeting of TWIC held in Casablanca. The AIO and FAIR have also formed standing committees on agricultural insurance.

461. An important area of co-operation amongst various insurance markets is training of technical and managerial personnel. This may include sharing the regional institutions, such as IIA, WAII and IAA in Africa,

the IIAP in Asia, ISTS in Latin America and the Academy of Insurance for Central America and the Caribbean. It is true that in recent years many national insurance training facilities have been established, but these are mainly devoted to the teaching of basic insurance principles. Active regional co-operation would allow for more sophisticated training activities which, because of their cost and number of persons concerned, may be beyond the reach of individual developing countries.

462. Co-operation efforts in respect of training, in particular involving the regional training institutions, have faced heavy financing problems. The approach has been to depend upon contributions from Governments. However, in a time of increasing public deficits, it is difficult for Governments to sustain such institutions, especially when the immediate benefits are confined to the insurance trade. The managers of insurance concerns have to realize the vital importance of trained personnel for their companies and be prepared to raise the necessary finance. The structure of such institutions should be as cost-efficient as possible, since they compete with facilities offered in developed and other developing countries.

463. It has been recognised that sufficient coordination between various training institutes in developing countries is lacking. At a meeting in Lisbon, organized by UNCTAD in 1990, ideas for the establishment of an international network of insurance training institutions were therefore advanced. The main purpose of such a network would be to help disseminate information on the curricula and training courses provided by the various centres, and offer data on admission possibilities, grants and traineeships for foreign students. The network should also provide training for trainers, give technical assistance and organize regional courses. Regional training institutions would play a pivotal role in it.

464. At the same time, national training institutes could play a more prominent role in arranging higher-level training on a regional basis. Workshops could be arranged for key managers of several countries where intricate case studies are analyzed and discussed and where these managers would get guidance on how to deal with complex questions. Experience and ideas regarding curricula development could be exchanged, learning material could be swapped, copied and improved, and teachers from developing countries who give courses in a specialty area could lecture at several national institutes in special high-intensity training programmes.

C. Economic Integration

465. Two developments in recent years in respect of international co-operation in the area of trade need to be noted. First, in multilateral negotiations under the aegis of GATT, insurance has been included in the negotiations on services. The aim of these negotiations is to liberalize "international trade and place it on a secure basis, thereby contributing to economic growth, development and welfare of the world's peoples". 1/ Second, there is the concept of economic integration between countries which "focus on the creation of preferential regional trading arrangements or common markets" 2/.

466. It should be mentioned that the above two developments do not conflict. Under the GATT concept of liberalization, countries are free to form trading blocs and establish privileged trading arrangements as long as there is no increase in barriers to trading with outside countries.

467. The experiences of countries promoting integration show an increase in efficiency among members of the group resulting from increased competition and decreased trading costs that occur when trade barriers are eliminated.

468. The degree of closeness within a group of countries aiming at economic integration can range from co-operation to complete integration. Four levels of integration may be identified:

- The free trade area, where customs tariffs are abolished between the countries party to the arrangement, while distinct tariffs and other measures against third states are kept;

- The customs union, where customs tariffs and other protective measures are established in common against third countries ;

- The common market, where, as in customs unions, internal tariffs are abolished and external tariffs are established in common, but the degree of integration includes the free movement of goods, persons and capital amongst the participating States;

- The economic union, the closest form of economic co-operation which includes complete monetary and fiscal unification and where the separate national economies are completely merged. 3/

469. The concept of economic integration is not new to developing countries. Such arrangements as ALADI, CACM, CARICOM and SECA in Latin America, CEEAC and ECOWAS in Africa, and ASEAN in Asia, to name only a few, have been in existence for a number of years. The successful economic integration of the European Community countries has fueled new expectations in developing countries. In regard to insurance, economic integration may ultimately lead to increased competition and would enable companies to tap larger markets. The harmonisation of laws and regulations has been identified as a prerequisite for the efficient functioning of such arrangements.

470. The most recent economic integration arrangements which have a bearing on insurance markets in a number of developing countries include NAFTA and MERCOSUR in North and Latin America, PTA and Maghreb countries in Africa and the reinforcement of ASEAN in ASIA. In all these arrangements the insurance sector was included in the negotiations.

Conférence Interafricaine des Marchés d'Assurances (CIMA)

471. The most wide-reaching agreement during the period under review relating specifically to insurance is the one formed by the francophone countries of West Africa. They instituted a regional organisation called CIMA (Conférence Interafricaine des Marchés d'Assurances) whose objectives are:

- To reinforce and strengthen cooperation in the field of insurance so as to enable their markets to cover agricultural risks and those related to trade with policies adapted to African realities;

- To promote the establishment of facilities which will enable insurance and reinsurance concerns of member countries to exchange business in order to increase domestic and regional retention capacities;

- To make appropriate arrangements to enable the local investment of technical and mathematical reserves generated by insurance and reinsurance operations with due regard to technical requirements such as security, liquidity, diversity and return;

- To continue the common policy of training of executives and technical staff in insurance, for the benefit of the companies and the public administration of member countries;

- To rationalise the management of human resources in companies and administrations by introducing specialisation and continuous training;

- To establish common structures in charge of defining and introducing the political orientations and decisions relating to the aforementioned areas with a view to:

    (a) Facilitating the sound and balanced development of insurance companies;

    (b) Promoting the establishment over the entirety of the member countries of an enlarged and integrated market that creates balanced conditions from the technical, economic and financial point of view;

    (c) Introducing new financial instruments to enhance the return on the investments of insurance and reinsurance companies and other institutional investors, including the establishment of financial markets in their respective monetary areas;

- To continue the policy of harmonisation and unification of legal and regulatory dispositions relating to insurance and reinsurance operations, supervision of insurance concerns, and to all other objectives that might contribute to the full development of the insurance industry, including management tools and loss prevention measures in the member countries;

- To promote with financial, material and human resources the common institutions which will be established for the promotion of co-operation in insurance and reinsurance matters.

472. In order to comply with the harmonisation and unification mentioned above, the Conference adopted a unified code of legislation, established a common supervisory body for insurance, and harmonised the methods of national control uthorities. The Agreement establishes an integrated insurance industry in the African States of Benin, Burkina Faso, Cameroon, the Central African Republic, Chad, Congo, Côte d'Ivoire, Gabon, Mali, Niger, Senegal, and Togo (with two other countries to adhere later on). 4/ While the advantages of such an agreement are obvious, many African insurers have voiced concern that this may allow a strong foreign insurance company to have access to various African markets by establishing a subsidiary in one of the member countries. It is, however, reported that it has been agreed that a foreign insurer would need the specific consent of the country (or countries) concerned in order to operate in countries other than where he has been authorized.

473. In November 1991, the above countries enacted a new African Insurance Code and established a common scale for the indemnization of traffic accident victims. Motor tariffs were liberalized, each company establishing its own motor rates, with maxima and minima to be declared to the supervisory body. The harmonization of the Brown Card (see chapter IV on motor insurance) was also studied.

Maghreb countries

474. The Maghreb countries, namely Algeria, the Libyan Arab Jamahiriya, Morocco, and Tunisia, have entered negotiations covering the harmonization of legislation, co-operation between companies in the region and the creation of a regional organization of companies. One of the first regional achievements of this cooperation was the pooling of aviation fleets for common placement for cover in the international market, which resulted in a substantial reduction in insurance costs for the national carriers of the negotiating countries.

Notes

1/ "GATT activities" - GATT/1991-2.

2/ UNCTAD "Review of the Economic Integration experience of ALADI, ASEAN, CACM and ECOWAS" (UNCTAD/ECDC/217).

3/ Ibid.

4/ Traité instituant une organisation integrée de l'Industrie des Assurances dans les Etats Africains.