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Belarus' Accession to the World Trade Organization: Insurance Sector Liberalization

Summary

This paper analyzes the current regulatory state of the Belarusian insurance market, discusses possible transition paths for the liberalization and subsequent development of the sector, and provides policy recommendations concerning specific insurance service issues now being negotiated with WTO member countries.

Contents

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1. Introduction

At the present time, Belarus is negotiating its accession to the World Trade Organization (WTO), which stipulates that the domestic market must be open to the foreign companies, in return for providing access to the foreign markets for domestic firms. The insurance sector[1] is one of the hotly debated issues of the bilateral discussions now in progress. Same as in all other countries of the Commonwealth of Independent States (CIS) the Belarusian insurance industry is still in an infant state and thus extremely vulnerable to foreign competition. The General Agreement on Trade in Services (GATS) provides for flexibility to reach compliance for all WTO country-candidates, and allows for a transition period[2]. Moreover, GATS agrees that there should not be a one-size-fits-all scenario for compliance; hence the schedules and exemptions proposed by different member countries to meet their commitments are quite heterogeneous. The commitments of the countries of Eastern Europe and Africa appear to be more liberal than those of Latin America and Asia. However, only Bahrain, Gambia, Guyana and the Solomon Islands gave preference to full liberalization with respect to all three modes of supply on direct insurance. Other countries adhere to more protectionist policies.

This paper considers different aspects of the insurance sector operations, which need to be amended within a certain transition period in order to bolster trade in insurance services and speed up Belarus' WTO accession. The paper proceeds as follows: Part 2 addresses the reforms, which need to be launched quickly in order to encourage competition between all insurance market participants, and which will benefit Belarus quite independently of the WTO considerations. Part 3 focuses on the particular issues of insurance policy now under negotiations with WTO member countries with respect to Mode 3 of Supply[3], which considers the imposition of quotas on the capital of foreign companies, the branch operations of foreign companies, and the regulations for compulsory and life insurance. We end the paper with policy recommendations related to the insurance sector, and propose regulatory changes to improve the sector's performance by using a gradual liberalization approach.

2. Major impediments to developing the insurance market

The insurance sector in Belarus still remains in its infant state. All indicators of insurance sector development are well below those for the countries of Central and Eastern Europe (CEE) and the CIS. Insurance density defined as the dollar value of the insurance premiums per capita was USD 10.5 per person in 2003, and insurance penetration, which is the insurance premium total as a percent of gross domestic product (GDP), was 0.82%. For the last decade the insurance sector suffered a dramatic change from a promising start in the mid 90s to an over-regulated state at present[4]. However, the need for sustainable economic growth and the rapid progress towards WTO accession by the neighboring countries (Russia and Ukraine) requires that the Belarusian insurance sector develop more rapidly, which can be achieved through discretionary liberalization. Taking concerted steps towards insurance market liberalization will not only speed up the negotiation process with WTO member nations, but also bring benefits to the Belarusian people and enterprises.

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[1] An analysis of the social insurance field is beyond the scope of this paper.

[2] General Agreement on Trade in Services, Annex to Article II, Exemptions.

[3] Trade in services is provided for four modes of supply. Mode 1 concerns cross-border supply, when, for example, insurance coverage is purchased from a supplier residing abroad. Mode 2 covers consumption abroad, when financial services are consumed while traveling abroad. Mode 3 is defined in GATS "as the supply of service by a service supplier of one member, through commercial presence in the territory of any other member." Mode 4 indicates the supply of services through the movement of natural persons, i.e. financial services supply by a natural person of one member country on the territory of another member country.

[4] See PP/07/04 "The Insurance Sector in Belarus: Analysis and Recommendations" for a more detailed analysis. This paper can be found at http://ipm.by/pdf/pp704e.pdf.

The insurance market constraints can be addressed by tackling the following basic impediments, the elimination of which will benefit Belarus even before WTO accession:

- The preferential treatment of the state insurers, which leads to a lack of competition between state and private insurance companies.
- The unfair treatment of foreign companies, which entails limited competition between domestic and foreign competition.

2.1. Competition between state and private insurance companies

According to Presidential Decree No 320, adopted on July 9, 2004, motor third party liability (MTPL) insurance is to be provided exclusively by state insurance companies or insurers whose state capitalization exceeds 50%[5]. All other compulsory insurance lines are to be provided solely by state insurance companies[6]. Moreover, Belgosstrah – the biggest insurer on the market[7] – is the only one that can provide certain compulsory insurance lines such as insurance against injury or occupational diseases, and compulsory individual property insurance. As a result, the share of the compulsory insurance premiums in the total premiums was 64.8% for the first half of 2004, which is 8.4 percentage points higher than for the first half of 2003[8]. Both private and state insurance companies may provide voluntary insurance lines, which account for 35.2% of the insurance premiums gathered by all insurance companies for the first 6 month of 2004 (43.6% for the first half of 2003). These statistics clearly demonstrate the increasing concentration and monopolization of the insurance sector, leading to discrimination of the private insurance companies, which are currently totally cut off from all compulsory insurance lines.

Belgosstrah is well justified to be the national insurer that renders services related to government insurance, as well as to government and municipal property insurance. However, the regulation reserving all remaining compulsory insurance lines for state companies (or, in the case of MTPL insurance, to companies with a state share of more than 50%) discourages competition between state and private companies, decreases their operational efficiency, and lowers the incentives of insurers to maintain a high quality level of services for customers.

2.2. Competition between domestic and foreign companies

The legislation in force stipulates a minimum amount of statutory capital of EUR 0.8 m for subsidiaries of foreign companies and for companies having a share of foreign investors in its statutory fund exceeding 49%. Other companies are required to maintain a statutory capital of EUR 0.4 m to provide life insurance, and EUR 0.2 m for non-life insurance. Re-insurers are similarly treated. Subsidiaries of foreign insurance companies or companies where the foreign share exceeds 49% have to posses a statutory capital of EUR 1 m versus EUR 0.5 m for those with less than 49%. It can be argued that the established statutory capital requirements can relatively easily be complied with by multinational insurers, while the low capital requirement for national companies guarantees their preservation and facilitates the emergence of new domestic companies. However, in reality the discriminatory treatment of foreign insurers in the

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[5] At present, there are six companies meeting this requirement out of 32 companies operating on the market. They are Belgosstrah, Beleksimgarant, TASK, Belinfostrah, PromTransInvest, and Belkoopstrah.

[6] There are two state non-life insurance companies (Belgosstrah and Beleksimgarant) and one state life insurance company operating in Belarus.

[7] Belgosstrah had a market share of 65% for the period between January and June 2004, which is defined as the share of the Belgosstrah insurance premiums including reinsurance in the total amount of all insurance company premiums. These and other data on the insurance sector can be found on the official web-cite of the Ministry of Finance of Belarus at http://ncpi.gov.by/minfin/.

[8] Adoption of Regulation No 19 "On approving of instruction on calculation and payment of the taxes on revenues and profits" in January 2004 furthered the growth of compulsory insurance premiums and discouraged voluntary insurance payments. According to this regulation compulsory insurance can be deducted from the profit tax while the majority of the voluntary insurance lines may not be deducted.

form of differentiated minimum statutory capital requirements, accompanied by the condition to have been invested in the statutory fund of their Belarusian partner company[9] for at least 2 years, deprive the insurance market of the influx of new technologies, innovation and know-how, along with the inflow of foreign capital.

Besides the listed restrictions, subsidiaries of foreign insurance companies or companies with foreign shares exceeding 49% cannot offer life insurance, compulsory insurance, compulsory state insurance, property insurance connected with the fulfillment of deliveries, rendering services or carrying out contractual works for state needs, and also insurance of property interests of the Republic of Belarus and its administrative territorial units. The nature of both compulsory and life insurance does not justify this monopolistic provision. Compulsory insurance lines are insurance services specifically designed to provide a safety net for legal and private entities that are required by law. The government uses compulsory insurance as a vehicle to redirect potential risk to insurers that it would have otherwise to compensate. On the other hand, life insurance provides voluntary protection from the economic losses caused by the death of the person insured. It is a long-term product, which may also include savings features. Life insurance is an indispensable part of any personal investment scheme, the market share of which constantly increases everywhere. International experience shows that foreign insurers have greatly aided not only in the rapid development of life and private retirement insurance in recent years in all those countries that allow consumers to make their own provisions for old age, accidents and sickness, but also in the advancement of compulsory insurance.

Liberalizing the insurance sector enhances its companies' efficiencies. For example, China invited foreign insurance companies to assist in developing its domestic insurance market through training and technical input such as hosting symposiums on insurance issues and supporting insurance education, all as a part of market liberalization.

3. The convergence path toward WTO accession

Belarus applied for WTO accession in the mid 90s. Since then considerable progress should have been made to open domestic markets. However, the Belarusian insurance sector is still in its infancy and little has been done to bring its regulations and company operations into compliance with WTO principles. Although alignment with the WTO norms would seem to be easy, the experience of many counties has shown that some difficulties only become evident in practice. In Belarus, as in many WTO member countries, the insurance sector appears to be less open than the banking sector and its regulations seem much less advanced. At present, the Ministry of Finance is drafting new legislation on insurance, which is of crucial importance for promoting the negotiation process with the WTO working parties. The openness of the insurance market to foreign competition based on the WTO rules, and the bilateral agreements reached with individual countries will primarily determine when Belarus will be able to enter the WTO.

Lengthy negotiations with all the WTO working parties are quite normal. Fully and immediately opening the market of such a vulnerable sector as insurance - which was caused by discouraging competition and market monopolization, and the discrimination against private and foreign companies - would force most domestic companies out of business right away. Thus the question of how to prudently regulate

[9] According to Presidential decree No 20 "On improving the regulation of insurance activity in the Republic of Belarus," subsidiaries of foreign insurance companies have the right to carry out insurance activities in the Republic of Belarus, if the foreign investor has been an insurance company carrying out insurance activity according to the legislation of the country of residence for at least 10 years, and for at least 2 year has had a share in the statutory fund of the insurance organization registered on the territory of Belarus. Subsidiaries of foreign insurance companies or companies with foreign shares exceeding 49% can open independent subdivisions in Belarus if special permission is granted by the Ministry of Finance.

the trade in insurance services is undoubtedly an important one, which needs to be solved by introducing certain transitional provisions on the way to market liberalization and compliance with GATS.

The main members of Belarus' working party on trade in insurance services are the EU and the US. Both desire unlimited access to the Belarusian insurance market. Although, full insurance market liberalization should be the ultimate goal of the upcoming reforms, we will restrict ourselves to the arrangements for the transition period and those regulatory aspects, which present the most important issues of the bilateral negotiations currently under way in the WTO working parties:

(i) The quotas for foreign capital participation,
(ii) The permission for foreign companies to open branches,
(iii) The compulsory insurance regulation,
(iv) The life insurance treatment.

The length of the transition period and the way it is structured will to a large extend determine how fast foreign direct investments (FDI) will flow into Belarus, which technologies and know-how enter the market, how price competitive the insurance products and companies will be, and as a result how well the customers will be served. In this regard, it is of vital importance for Belarus to examine the commitments of some WTO member countries and their experience with liberalizing the insurance sector. Particularly relevant are the insurance sector regulations in Eastern European countries. Firstly, they are already WTO members and thus we are able to assess the impact of their policies on their economies, and secondly, they - same a Belarus - had all been planned economies in the past and had thus been endowed quite similarly at the beginning of transition. (Selected characteristics of the present state of the insurance sector of the Baltic countries are presented in Box 1).

Box 1. Characteristics of the insurance sectors in Estonia, Latvia and Lithuania

Minimum capital requirements

Country	Non-life insurance companies	Life insurance companies
Estonia	USD 0.3 m	USD 0.7 m
Latvia	USD 2.3 m	USD 3.4 m
Lithuania	USD 0.5 m	USD 1.0 m

Motor Third Party Liability (MTPL) insurance
MTPL is treated as a compulsory insurance line in all Baltic countries. The statutory tariff is removed in Estonia, which allows insurance companies to compete for customers; however, insurers are obliged to submit their rating schedules to the regulatory authorities for verification and approval. In Lithuania, the only insurance line where tariffs are regulated by the government and kept low is MTPL. In Latvia, however, despite tariff regulation, strong competition pushes insurers to offer significant discounts to customers.

Life and non-life insurance
In all Baltic countries licensed insurance companies can offer either life or non-life insurance services but not both. In Lithuania, however, life insurers are allowed to provide such non-life insurance lines as accident and health insurance.

Compulsory insurance

Compulsory insurance line	Estonia	Latvia	Lithuania
MTPL insurance	+	+	+
Aviation liability	+	-	-
Aircraft operators	-	-	+
Professional indemnity for lawyers, notaries, auditors, bailiffs, insurance brokers, etc.	+	+	+
Liability for emergency services (fire and rescue)	+	-	-
Liability insurance for contractors before tendering for construction work	-	+	+

Branches
Foreign insurance company branches are permitted in Estonia and Latvia. Lithuania only allows branches of foreign insurance companies from WTO member countries.

Licensing
Only direct insurance activities are subject to licensing in Lithuania. In Latvia companies providing reinsurance only are not subject to licensing, while companies providing direct insurance are to be licensed and can also provide reinsurance services. In Estonia reinsurance activity is subject to licensing.

Source: Insurance in the Baltic Countries, *OECD,* No 7, 2004

(i) Quotas for foreign capital participation

The WTO member country commitments[10] regarding quota imposition vary quite widely. Ghana, for example, restricts foreign ownership in the entire insurance sector to 60%, stating in its schedule of specific commitments: “at least 40% of the capital or other proprietary interest in the insurance business shall be owned by a Ghanaian national.” Foreign shareholdings in locally incorporated insurance companies cannot exceed 51% in Malaysia. The Philippines entered the WTO with a foreign equity limitation of 40% in locally incorporated companies, easing this restriction after four years by allowing foreign investments of up to 51% of the voting stock of insurance companies. Pakistan restricts foreign participation only in the life insurance sector, permitting 51% of foreign ownership. The countries of Eastern Europe, on the contrary, do not impose similar restrictions on foreign participation in their insurance sectors. In 2000 the market share of companies with 50% or more foreign ownership was more than 80% in Estonia and Lithuania; only Hungary has a higher percentage. The Eastern European countries do not seek to limit foreign capital, quite the opposite, they strive to provide high quality insurance services, to insure the solvency of companies, and to aid local customers.

The Belarusian legislation imposes a 30% quota[11] for the presence of foreign capital in the total capital of all insurance companies together. At this time this quota is only half filled. The foreign capital presence is further restricted by the requirement to obtain a special permission from the Ministry of Finance to open an independent subdivision for subsidiaries of foreign insurance companies or of companies with a foreign share greater than 49%. Foreign insurers also need to have operated for a minimum number of years in the insurance business in their home countries (10 years) and in Belarus (2 years) (Part 2.2.). Currently, out of the 32 insurance companies in operation only 12 possess foreign capital, with none of them holding more than 49%. The existing regulations considerably hamper the inflow of the foreign capital into Belarus. The problem of foreign capital participation on the Belarusian insurance market is closely related to the need to create the necessary environment within the national insurance companies that would allow them to attract capital and diversify their insurance products.

(ii) Permission for foreign companies to open branches

Branch operations for foreign insurers are another important issue under negotiations. Several WTO members have imposed restrictions on the legal form of the commercial presence of foreign insurers in the form of branches. Slovenia, for example, in its schedule of specific commitments not only prohibits branching but also bans foreign participation in the privatization process of state-owned insurance companies. Many other countries, however, restrict branching during their transition periods, or make it subject to a specified event or date. Hungary did not agree to allow branches, rather making their establishment contingent on the adoption of specific legislation. In China, for example, foreign branches where first allowed only in a restricted number of cities, and only later on all over the country. Poland joined the WTO in 1995, but allowed for licensed branches only after January 1, 1999. By the end of 2003 only four main branches of foreign insurance companies had been licensed to conduct insurance activities in Poland. Latvia permitted branching after December 31, 2002, having acceded the WTO on February 1999 (Box 1). Some other countries, such as Bulgaria, allow branching subject to licensing by the insurance supervisory authority.

Currently, Belarusian legislation does not permit foreign insurance companies to open branches in Belarus, instead requiring local incorporation. As has been noted above,

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[10] Schedules of the specific commitments and exemptions of each WTO member country can be found on www.wto.org.
[11] Presidential decree No 20, dated September 28, 2000.

the Belarusian insurance sector is still quite underdeveloped and vulnerable. Besides, its prudential regulation lags behind the one for the banking sector. Therefore, without regulatory reinforcement any hasty permission to open branches of foreign companies, could lead to an undesired impact on the Belarusian economy. However, in the eventual development towards liberalization, the permission to open branches will considerably benefit insurance sector development.

(iii) Compulsory insurance regulation

There are five classes of compulsory insurance in Belarus, which are 1) compulsory individual property insurance; 2) medical insurance for foreign residents and stateless individuals temporarily staying in Belarus; 3) professional indemnity for lawyers, notaries, military personnel, etc.; 4) carrier liability insurance for passengers; 5) MTPL insurance. As already mentioned, the regulations now in force require that all of these insurance classes are to be provided by state-owned companies or insurers in which the state share exceeds 50% (Part 2.1.). However, in order for Belarus to be able to accede to the WTO, it has to comply with the GATS regulations for trade in insurance services. According to the Understanding on Commitments in Financial Services "each member shall list in its schedule pertaining to financial services its existing monopoly rights and shall endeavour to eliminate them or reduce their scope." In compliance with this requirement most WTO member counties have scheduled a transition period during which the compulsory insurance market is to be gradually liberalized. For example, the Czech Republic joined the WTO stipulating in its schedule of specific commitments: "the compulsory motor third party liability insurance, the compulsory air transport insurance, and the liability insurance of employers against injury or occupational diseases have to be effected through the Czech Insurance Company." After four years, monopoly rights were to be maintained only for the compulsory motor third party liability insurance, though with the intention to eventually remove this restriction too in compliance with the "Understanding on Commitments in Financial Services." The Slovak Republic has undertaken the same policy of reducing its monopolies for compulsory insurance, though at a slower pace. Many WTO member countries have liberalized their compulsory insurance market without instituting a transition period. In most Eastern European countries compulsory insurance lines are provided on a competitive basis (see also Box 1 for the compulsory insurance treatment in the Baltic countries). As mentioned above, by imposing compulsory insurance the government aims to reduce its own financial losses, and not to restrict competition and or provide monopoly rights to predetermined insurers. For example, the lists of compulsory insurance categories exceed 100 items in France and Portugal; other counties endeavor to increase their number of categories too, while, however, strongly promoting competition among insurers.

(iv) Life insurance treatment

An analysis of the life insurance market in Belarus shows that life insurance premiums decreased from 7.2% for the fist half of 2004 to the 6.7% for the first half of 2003. In Belarus life insurance penetration (direct gross premiums to GDP) remains low (0.05% in 2001) relative to the average in the EU–15 (5.41% in 2001), the OECD (4.85% in 2001), and even the CEE countries, as for example the Czech Republic (1.31% in 2001), Hungary (1.19% in 2001), and Poland (1.01% in 2001)[12]. Obviously, the life insurance market remains underdeveloped; besides, it lacks both expertise and incentives for advancement.

Insurance companies are not allowed to provide both life and non-life insurance in Belarus. The same separation of insurance companies activities exists in several countries such as Latvia, Bulgaria, Lithuania; other countries require that banking and

[12] Insurance Statistics Yearbook 1994-2001.

insurance activities be separated (Slovenia), while many do not impose any restrictions at all.

Since an open market is much more efficient than isolated markets are, the share of foreign participation in the life insurance market has constantly increased. Currently, foreign insurers own more than half of the life insurance companies in the Baltic countries. Except those few countries that have still not agreed to a schedule of specific commitments, foreign participation is allowed everywhere for companies providing life insurance. In Belarus, however, foreign insurance companies are not allowed to sell life insurance, while domestic firms are still quite inefficient. The entrance of foreign companies into the market is essential for life insurance development. As the Baltic countries' experience has shown, insurance awareness within the commercial sector and the population in general was greatly raised by increasing the levels of foreign direct investment (FDI) in the local economies. Local firms with foreign capital participation have not only been a source of local insurance products, but their use of these products to hedge against potential risks has also had a demonstrated and contagious effect on other commercial businesses.

4. Policy recommendations

The regulations covering the insurance market should concentrate on protecting consumers and not depriving them of desirable insurance products and high quality services at low cost. An adequate regulation promotes companies that function more efficiently and offer consumers better prices. However, on the way from a centralized to a liberalized market, rapid changes and imprudent actions could lead to the ruination of domestic insurers. Hence, the negotiations on insurance services within the WTO framework should provide for a transition period that would allow sufficient time for domestic companies to adjust to the new liberalized market conditions and to achieve the necessary potential to operate competitively along with the foreign rivals.

We strongly recommend that the schedule of specific commitments provide for the following:

First: The 30% quota should be eliminated without delay. Also, all obstacles to majority ownership in joint ventures and subsidiaries should be reduced during the transition period. Companies should have the right to operate competitively, independent of their ownership.

Second: The discriminatory capital requirement has to be abolished. Foreign insurers must have the same access to the domestic insurance market as domestic insurers.

Third: In congruence with the Understanding on Commitments in Financial Services, the compulsory insurance market has to be gradually liberalized. Thus, compulsory insurance lines should not be restricted to fully state owned companies or companies with majority state ownership.

Forth: The compulsory and the life insurance markets have to become competitive markets with foreign participation following a predetermined transition period.

Fifth: The steps necessary to permit foreign insurance companies to open branches in Belarus should be defined. The starting point is the creation of an adequate prudential regulation. Also, Belarus could make the authorization to open branches contingent on the adoption of such a regulation and, following the experience of other WTO member countries, could include special requirements for branches in its schedule of specific commitments, for example, it could limit the number of licenses to be issued per year.

As noted, the total expenditures on insurance in Belarus are still low and the market penetration is limited. Evidently, there is a significant potential for the insurance market to grow by way of liberalization of the insurance market as can be witnessed by the performance practices of many WTO member countries.

5. Concluding remarks

Belarus has to take steps to bring its insurance system into line with WTO norms and principles. The experience of many WTO member countries has shown that the alignment process resulted in the creation of effective and efficient legal environments for the operation of insurance companies. All economic entities have benefited from insurance market liberalization, from privatisation of state insurance companies, and from permitting foreign insurance companies into the industry. There is still a long way to go for Belarus: Prudent actions aiming to foster trade in insurance services must be taken immediately to realise as soon as possible the many benefits international trade can bring.

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