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**Opportunities for UK reinsurance broker  
on Russian insurance market**

(written for BMS Harris & Dixon Reinsurance Brokers Ltd.)

by

**Konstantin ROGOZIN  
Anton VAYSHNURS**

2006

A management project presented in part consideration for the degree of MBA

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# Index of Abbreviations

ARIA	- All-Russian Insurance Association
BMS H&D	- BMS Harris & Dixon Reinsurance Brokers Ltd.
BRIC	- Brazil, Russia, India and China
EME	- Emerging Market Economy
CEE	- Central and Eastern Europe
CIA	- Central Intelligence Agency
CIS	- Commonwealth of Independent States
FERMA	- Federation of European Risk Management Association
FISA	- Federal Insurance Supervision Authority
FSSS	- Federal State Statistics Service
IMF	- International Monetary Fund
MTPL	- Motor Third Party Liability
NARS	- North Atlantic Reinsurance Services Ltd.
OECD	- Organisation for Economic Co-operation and Development
RAMI	- Russian Association of Motor Insurers
RAP	- Russian Agricultural Pool
RATIP	- Russian Anti-Terrorist Insurance Pool
RNIP	- Russian Nuclear Insurance Pool
RPHO	- Russian Pool for Hazardous Objects

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# Executive Summary

Liberalisation of insurance industry, favourable and stable business environment, swift economical growth, increasing insurance awareness of population, constructive regulatory initiatives and number of other factors have a positive effect on the development of Russian insurance industry, making it one of the fastest growing insurance markets in the world.

Different opinions exist as regards market growth in the future. Thus, Princeton Partners Group estimates that by 2010 non-life insurance premiums may reach US\$ 16.1 billion, whereas estimation of UFG is much more optimistic, namely US\$ 26.2 billion. Arguably, such estimations are subject to numerous assumptions, for instance direction and pace of economic reforms, changes in overall quality of life, development of financial services industry in general, oil and gas price movements etc. Although there are significant variations in these estimations, all researchers agree that Russian insurance industry has a tremendous potential.

For that reason, a rapidly growing Russian insurance market may possess many business opportunities for reinsurance brokers such as BMS Harris & Dixon Reinsurance Brokers Ltd. (BMS H&D).

Obviously, there are no ready-to-go solutions, which BMS H&D would straight away benefit from. Deriving an actual reinsurance transaction from potential business opportunities necessitates market enquiries with an aim of identifying individual needs of particular market players which involves a fair amount of time and effort.

This report identifies the areas, which we think are more likely than others to lead to emergence of business opportunities on Russian insurance market. Some of them, such as offering easily accessible reinsurance capacity (by means of binding authority) in respect of personal accident insurance policies, may have an immediate effect. Others, such as offering MTPL reinsurance

programmes, are somewhat dependent on further developments in this sector. Besides, BMS H&D may also pay attention to other areas, which have been identified within a framework of this report. The potential business-generating opportunities include the following:

- Offering retrocession covers for Russian reinsurers;
- Offering reinsurance solutions to managing companies of insurance pools, in particular in respect of Russian Anti-Terrorist Insurance Pool, Russian Pool for Hazardous Objects and Russian Nuclear Insurance Pool;
- Making the most of growing property insurance segment by offering property reinsurance programmes;
- Taking advantage of growing motor casco insurance segment by offering appropriate reinsurance programmes;
- Providing access to alternative reinsurance markets, such as Bermudan or Asian.

It is widely acknowledged that reinsurance is people's business. In the context of reinsurance broker company, this notion immensely grows in importance. While managing and cultivating relationships with clients in a sound manner are among key prerequisites of reinsurance broker's successful operation, it is important to know and to use established springboards that may significantly facilitate communication with the market.

This report examines above issues in greater details by providing rationale for them as well as offers a number of recommendations in respect of practical steps that may be taken in order to raise the company's profile on Russian insurance market and increase business acquisition opportunities.

# Introduction

## Rationale and Report Objectives

Russian insurance market attracts increasing attention on the part of foreign investors. For instance, a list of recent entrants includes such companies as Aviva and Česká Pojišť'ovna on the life insurance side, ACE Group on the non-life insurance side, Colemont Insurance Brokers and RFIB Group on reinsurance brokers' side. Normally, a mode of entry varies from one company to another with most preferred ones being joint-ventures and representative offices. Reinsurance business is international by its very nature and establishing a physical presence in one region or another is very much a matter of strategic considerations.

BMS H&D already transacts reinsurance business emanating from Russia. However, the volumes of this business remain relatively low. Realising a substantial potential of Russian insurance market, BMS H&D is interested to get a wide-ranging picture of the market, to explore possible business opportunities and to find out the ways of strengthening its book of Russian business.

The aim of this report is to identify potential business opportunities for BMS H&D and ways of growing into Russian insurance market without embarking upon considerable investment strategy, i.e. keeping expenses associated with this endeavour to a minimum. The report should also assist the company in starting an informed dialogue with market players as regards key issues surrounding insurance industry.

## Report Structure

The report consists of an introduction, main part and conclusion. It also is furnished with an executive summary, which recaps our findings and touches

on major issues raised in this report. We deliver our findings with supporting statistical data and explanations of key points.

A first section of report's main part deals with the country profile outlining economical, political, social, and technological environment. It also refers to legal, legislative and regulatory trends which may impact Russian insurance industry in the future.

A second part deals with insurance market structure and concentration, outlines major developments on Russian insurance market, talks about insurance market customary practices, and identifies segments with potential business opportunities. It also contains a SWOT framework, which summarises our foremost findings and thoughts.

The report features opinions of market practitioners we had meetings with. These opinions are presented in a form of direct citations, which appear in the report in italic font with left indentation, or are quoted within the text. For the reason of confidentiality, the authors of cited opinions have been kept anonymous.

The report is concluded by offering our recommendations in respect of particular actions aiming at maximisation of business acquisition opportunities. Naturally, a list of our recommendations has been limited by perceived budget restrictions. Therefore, investment-heavy alternatives, such as opening a representative office, remained outside the scope of this report.

# Methodology

## Project Stages

The overall work on the management report was organised in three major stages:

1. Background research – we identified feasible sources of information, gathered statistical data, analysed general state of the market, made early assumptions in respect of potential business opportunities, created a general outline for interviews, and set up interview appointments;
2. Interviews – by and large, this stage concerned conducting the interviews, during which we obtained a practical information on different segments of the market and opinions of market practitioners, we also tested our earlier made assumptions;
3. Analysis and recommendations – based on results of preceding two stages we analysed and summarised our findings, arrived at what we consider to be realistic business opportunities, and produced a number of recommendations as to how to capitalise on opportunities presented.

## Used Resources

During our research we made every effort to use the most up-to-date information. To meet management report objectives we gathered and analysed a vast array of data and market information. In particular, we made use of the following sources:

### Official statistics

We accumulated official statistics on Russian economy in general and insurance market in particular. A relevant data has been derived from the Federal Insurance Supervision Authority (FISA), All-Russian Insurance Association (ARIA),

Federal State Statistics Service (FSSS), Ministry of Finance, Bank of Russia, World Bank, International Monetary Fund (IMF), Organisation of Economic Co-operation and Development (OECD).

## **Interviews**

We conducted 12 semi-structured interviews in Moscow and St. Petersburg with top and senior managers of Russian insurance and reinsurance companies, and reinsurance brokers. We have no shadow of a doubt about professional qualification and experience of individuals interviewed. These interviews provided valuable insights and first-hand practitioners' perspectives on key issues and emerging market trends, as well as gave us a better "feel" of the market.

## **Analytical reports**

We located a number of analytical reports, in part or fully dedicated to Russian insurance market. For instance, we examined reports by Swiss Re, Princeton Partners Group, Goldman Sachs, Interfax, Deutsche UFG, Expert RA rating agency and others. Although these reports varied in scope and focus, as well as in respect of period considered, they did assist to establish a firm ground for our own analysis and conclusions.

## **Company data**

The companies' data formed an important part of our research agenda. This category comprises both publicly available information, such as company reports, commentaries or market updates, and unpublished information with a certain degree of confidentiality attached to it. We obtained this type of information during the interviews, from different publication sources as well as through email as a result of our direct personal communication with individuals concerned.

## **Mass media publications**

During our work on the report we went through and critically analysed a wide collection of articles in general, financial and industry press, monitored internet sites featuring insurance news and interviews with industry professionals.

## **Legal documents**

We reviewed commentaries, bills being under consideration and other legal information relating to Russian insurance industry. For this purpose we used online legal databases, such as Garant, Consultant and Kodeks.

## **Used Analytical Frameworks**

To address report objectives we used two established analytical frameworks. First of them, PESTL, was used to portray Russia from political, economical, social, technological, and legal perspectives. Second framework, SWOT, was used to summarise our key findings and opinions in respect of BMS H&D prospects on Russian insurance market by classifying them into company's internal strengths and weaknesses, and external opportunities and threats.

## **Limitations**

There are a number of limitations, which we consider should be explicitly mentioned. They are as follows:

### **Number of interviews**

Although the interviews conducted did provide us with a good snapshot of Russian insurance market, we initially aimed to capture a broader sample of interviewees. For instance, during our visit to Russia the managers of such companies as RESO-Garantia, Progress-Neva, MSK, Standard-Rezerv and Moscow Re could not meet with us due to various organisational reasons. To some



extent this limited our possibilities to test our early assumptions and ideas, and decreased representativeness of interviewees' sample.

### **Market transparency**

Although there are positive signs of improvements, the transparency of Russian insurance market is still very low. Given this fact, one of the key sources of reliable information, which would reflect a real image of the market, were opinions of market practitioners obtained both through interviews and mass media publications. These opinions, however, are estimates of individuals and might sometimes be too optimistic due to different reasons.

### **Statistical data accessibility and accuracy**

As noted by Swiss Re, any information on Russian insurance market is not easily accessible. Moreover, given a presence, and indeed an extent of tax optimisation schemes handled by the insurance industry, the official statistics should be critically analysed, since it may not always represent a true picture of the market. Hence, a reference to alternative sources was required in order to make a necessary correction when estimating the volumes of real insurance. Even then data required critical evaluation and comparative analysis across different sources of information. However, in some instances we relied on one source only, since not always there was an opportunity to double-check an accuracy of information.

Our conclusions and recommendations reflect our own perspective and that, what we think are potential business opportunities for BMS H&D in Russian insurance market. Naturally, our reasoning cannot be a sole basis for strategic decision-making, but rather should provide a starting point for further considerations in a wider context of company's aims and objectives.

# Country Profile: PESTL Analysis

## Economical

### Developing and sustaining economical strength

Russia is the largest country in the world with population of 141.6 million in 2006 and roughly US\$ 11,100 GDP per capita.<sup>1</sup> During the last eight years Russia demonstrated annual growth of about 6.4% with GDP reaching US\$ 1.589 trillion in 2005.

According to the Ministry of Finance, the GDP growth in 2006 will be 6.6% and inflation is going to be around 9%.<sup>2</sup> According to official information budget surplus of Russia in 2005 was about 7-8% of the GDP and in 2006 it is going to be about 3.2% or US\$ 29 billion.<sup>3</sup> On 17 August 2006 the minister of finance announced that the budget surplus would double in 2007. International reserves of Russia (US\$ 266.9 billion in August 2006) now are the third largest in the world after China and Japan. Since advanced repayment of the debt to the Paris Club on 21 August 2006 Russia has one of the lowest national debts in the world amounting to 9% of GDP.<sup>4</sup> Current trade balance and the current account are of US\$ 11.9 billion and US\$ 25.5 billion respectively.<sup>5</sup>

These considerable economic developments led to recent upgrade of Russia's sovereign rating even by the most conservative Standard & Poor's rating agency

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<sup>1</sup> Main demographic data. [[http://www.gks.ru/free\\_doc/2005/b05\\_13/04-01.htm](http://www.gks.ru/free_doc/2005/b05_13/04-01.htm); The CIA World fact book. Russia. Retrieved on 25 July 2006, from [<https://www.cia.gov/cia/publications/factbook/geos/rs.html>].

<sup>2</sup> A. Kudrin A, Economical growth in Russia in 2006 will be 6,6%, inflation - 9%.

9 August 2006. Ministry of Finance. Retrieved on 25 July 2006, from [[http://www1.minfin.ru/off\\_inf/1883.htm](http://www1.minfin.ru/off_inf/1883.htm)].

<sup>3</sup> A. Kudrin A, The surplus of the federal budget in 2005 will be 7-8% of GDP. Ministry of Finance. Retrieved on 25 July 2006, from [[http://www1.minfin.ru/off\\_inf/1619.htm](http://www1.minfin.ru/off_inf/1619.htm)].

<sup>4</sup> Beker A, Kudashkina E, »Left behind the whole planet. Russia has now one of the lowest debts in the world.« Vedomosti. 22.08.2006. No155.

<sup>5</sup> Russia: Economic and financial data. 16 August 2006. Retrieved on 25 July 2006, from [<http://www1.minfin.ru/sdds/nsdp.htm>].

to investment BBB+ (in the foreign currency) and A- (in domestic currency) levels.<sup>6</sup>

According to the Central Intelligence Agency (CIA) World Fact Book, “real fixed capital investments have averaged gains greater than 10% over the last five years, and real personal incomes have realized average increases over 12%.»

Economic stability and constant growth, even though they are largely influenced by high oil and gas prices, prompt the development of insurance and reinsurance business in Russia.

### **Low diversification of economy and dependence on oil and gas prices**

At the same time according to the “Russian economy survey” made by OECD, dependence on high natural resource prices and low diversification of Russian economy raises a number of concerns as to sustainability of Russian economy’s strength: “There are dangers associated with such resource-dependent development, including vulnerability to external shocks, the risk of “Dutch disease” and the institutional pathologies often associated with heavy reliance on natural resource sectors.” In the case of considerable drop in prices of natural resources the systemic crisis similar to that of 1998 might happen again. The problem is that there is no considerable difference between dependence on international financial aid in 1998 and current dependence on financial flows from natural resources traded at historically high prices.

### **Integration in world economy**

Although on the governmental level Russia recently experienced some difficulties with joining the WTO, on the B2B level insurance companies and their associations are actively integrating into the world insurance industry.

For example, in October 2005 Russia was for the first time represented at the conference of Federation of European Risk Management Associations (FERMA),

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<sup>6</sup> Mjazina E, Overchenko M, Surprise from S&P. Vedomosti. No: 168. 08.09.2006.

held in Lisbon. Russian companies have also created its own risk management association, affiliated with FERMA.

Increasingly Russian reinsurers look for new opportunities to write inwards reinsurance from international markets, such as Africa, India, Greece, Turkey, Germany and other countries. For instance, Ms. Irina Golovatch of Moscow Re mentions that representatives of the company have to travel frequently to Africa. A member of Moscow Re's board, Mr. Alexey Titchev, travels regularly to Asia-Pacific and Middle East.<sup>7</sup> He says, "Moscow Re has about 45 international clients ... noting that the total premium income for 2004 was US\$ 27 million, with about 3% coming from outside Russia. The goal of Moscow Re for 2005 is a premium income of US\$ 35 million. The company would like to see 5% coming from the CIS states and 5% from the rest of the world."<sup>8</sup>

Since many years Russian companies actively participate in Baden-Baden reinsurance meetings and even established several regular domestic reinsurance forums, meetings and associations attracting increasing number of foreign players.

### **Role of Russian insurance industry in domestic and world economy**

Regardless of the fact that Russian real insurance market is for several years among the fastest growing in the world, a share of insurance industry in national GDP is still relatively low, if compared even to other East European countries.<sup>9</sup> According to ING and Swiss Re this creates "significant long-term potential".<sup>10</sup>

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<sup>7</sup> Robert O'Connor. Moscow Re Seeks Clients in Baden-Baden. Best Wire. 27 October 2005.

<sup>8</sup> Ibid.

<sup>9</sup> Russian insurance market: trends and prospective. Princeton Partners Group. October 2005.

<sup>10</sup> Nijssen J, Insurance Central Europe and Global Pensions: Two value creators for ING. Zurich. 23 November 2005. [[http://www.ing.com/cms/idc.cgi\\_isapi.dll?IdcService=GET\\_FILE&dDocName=132233\\_EN&RevisionSelectionMethod=latestReleased#search=%22Insurance%20Central%20Europe%20and%20Global%20Pensions%3A%20Two%20value%20creators%20for%20ING%22](http://www.ing.com/cms/idc.cgi_isapi.dll?IdcService=GET_FILE&dDocName=132233_EN&RevisionSelectionMethod=latestReleased#search=%22Insurance%20Central%20Europe%20and%20Global%20Pensions%3A%20Two%20value%20creators%20for%20ING%22)].; Sigma. Insurance in emerging markets: focus on liability developments. Swiss Re. No5/2005. p. 9.

Table 1: Premiums per capita, 2005

N	Country	All insurance, US\$	Life insurance, US\$	Non-life insurance, US\$
1	Switzerland	5 483.9	3 290.6	2 193.3
2	UK	3 887.3	2 724.9	1 162.4
3	Japan	3 721.7	2 927.9	793.8
4	USA	3 651.1	1 661.4	1 989.7
5	Ireland	3 371.7	2 028.2	1 343.5
6	Netherlands	3 209.1	1 726.4	1 482.7
...				
47	Poland	162.2	59.9	102.3
53	Mexico	107.7	41.9	65.9
54	Oman	101.3	14.0	87.3
55	Russian Federation	98.6	34.1	64.5
56	Latvia	90.4	4.0	86.4
57	Argentina	86.0	24.0	62.0
...				
91	Pakistan	3.3	1.3	2.0
92	Bangladesh	2.1	1.4	0.7

Source: Analytical report of FISA.<sup>11</sup>

Another reason for optimistic outlook for Russian insurance market is that in absolute terms Russia has a considerable share of 8.8% in EME insurance markets.

Table 2: Premiums gathered in non-life insurance by EMEs

Country	2004 premium volume, US\$ mln	Share of emerging markets
South Korea	19 944	13.8%
China	16 765	11.6%
Russia	12 809	8.8%
Brazil	9 843	6.8%
Taiwan	9 385	6.5%
Mexico	7 019	4.8%
South Africa	6 301	4.3%
Poland	4 604	3.2%
India	4 330	3.0%
Turkey	3 763	2.6%
Turkey	3 763	2.6%
Total	94 760	65.4%

Source: Swiss Re, "Insurance in emerging markets: focus on liability developments", Sigma No. 5/2005

<sup>11</sup> Analytical report based on the data of accounting 1C forms. Department of economic analysis and actuary of the Federal Insurance Supervisory Authority. 2005.

In 2005 Russian insurance market was about 0.5% of the world's market.<sup>12</sup> Insurance industry created around 0.8% of national GDP while in the most developed countries of Eastern Europe it constitutes 2-4%, and in USA, EU and Japan up to 7-15%.<sup>13</sup> This also allows us to think about the opportunities, which will emerge with the further growth and opening up of Russian economy.

## Political

Political situation in Russia may be characterised as fairly stable since the year 2000. The cabinet of the ministers has not been changing so frequently as during the presidency of Boris Yeltsin. In combination with a very favourable macroeconomic situation this creates a more secure environment for local businesses. Legislative activity has also intensified. Primarily it aims to achieve two main goals: 1) to create a framework for prompt development of Russian economy; and 2) to limit political rights of Russian citizens and opposing political organisations.

Many initiatives for stimulating economic growth showed to be successful, while others lead to systemic industry crises, such as recent crisis of alcohol industry. It was caused by deficient implementation of the new alcohol control system leading to effective inability to produce, transport and sell most of the alcohol types in Russia. This led to termination of business activity by nearly 50% of alcohol importers. The negative result of this and alike legislative attempts was caused by suppressed political and public debate before their adoption. Luckily these legislative initiatives had no adverse influence on insurance industry in Russia so far, but there are rumours in the media that alike situation might happen in tobacco industry if the government has not learnt any lesson from the summer alcohol industry crisis.

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<sup>12</sup> Insurance in emerging markets: focus on liability developments. Sigma. Swiss Re. No5/2006. p. 33.

<sup>13</sup> Analytical report based on the data of accounting 1C forms. Department of economic analysis and actuary of the Federal Insurance Supervisory Authority. 2005.

## Joining the WTO

During the G8 rounds on 17 July 2006 Russia has initially reached an agreement with US, its last counter-party, that it would open insurance market for the branches of foreign insurers and reinsurers as a part of WTO membership. But later on during the same day this agreement broke off because the representatives could not reach understanding on other issues of the WTO entrance package.<sup>14</sup>

Moreover, as noticed the head of the FISA I. Lomakin-Rumjantsev even if the agreement would be finalised it still could be difficult to implement it on the legislative level.<sup>15</sup>

The major concerns of the market players and professional bodies with respect to this possible decision are as follows.

First, US wants the branches to be exempted from the national supervision what creates conditions for unfair competition and contradicts the security interests of policyholders.

Secondly, authorities are afraid of not controlled capital outflow through quasi-insurance tax evasion and money laundering schemes with participation of offshore insurance and reinsurance companies.

Finally, establishment of direct branches will stimulate investment in foreign capital markets rather than domestic economy. It will also minimise the amounts of taxes paid locally by insurance industry.

Regardless of the contradictory nature of the proposed WTO entrance conditions and the fact that it was temporarily suspended most market players

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<sup>14</sup> The loop on the neck of insurers has been a bit relaxed. 17 July 2006. Retrieved on 25 July 2006, from [[http://www.allinsurance.ru/biser.nsf/StPic?OpenView&RestrictToCategory=1&NsgID=MV\\_News&Start=21&Count=20](http://www.allinsurance.ru/biser.nsf/StPic?OpenView&RestrictToCategory=1&NsgID=MV_News&Start=21&Count=20)].

<sup>15</sup> The Americans can be overreached by joining the WTO. 19 July, 2006. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/biser.nsf/AllDocs/ABYA-6RUHX4-19-07-06?OpenDocument>].

start preparation to act in the new market conditions.<sup>16</sup> In our opinion it is one of the major reasons for M&A waive and increasing capitalisation of Russian insurance industry.

### **Growing market cap for foreign insurers**

Russia still has a legislative cap on the market penetration by insurers with foreign control. This limitation is established by the Federal Law “About organisation of the insurance business in Russian Federation” (“Insurance Law”).<sup>17</sup> In the last 2005 edition of the law cap was increased up to 25% of the market share.

From the practical point of view market cap does not restrict business activities of foreigners so far as the market share of insurance organisations controlled by foreign investors has never exceeded 4% due to the other reasons.<sup>18</sup> All-Russian Insurance Association mentions that in 2004 there were 39 insurers and reinsurers with foreign control active on the Russian market.

### **Limitations on business activities for insurers with foreign control**

At the moment Insurance Law imposes some limitations on insurance companies controlled by foreign investors. In particular they cannot write some types of obligatory insurance, life insurance and insurance for state and municipal enterprises.<sup>19</sup> Hence, most of the companies with foreign investments providing broad range of products have to retain a minority stake (less than 50%) of foreign shareholders in their capital.

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<sup>16</sup> Expert RA: Possible shocks of insurance market as a result of joining WTO. 17 July 2006. Retrieved on 17 June 2006 from [<http://www.allinsurance.ru/biser.nsf/AllDocs/ABYA-6RS8VE-17-07-06?OpenDocument>].

<sup>17</sup> Federal Law ‘About organisation of the insurance business in Russian Federation’ 21.11.1992 with amendments by the Federal Laws 31.12.1997, 20.11.1999, 21.03.2002, 08.12.2003 N 169-FZ, 10.12.2003 N 172-FZ, 20.07.2004 N 67-FZ, 07.03.2005 N 12-FZ, 18.07.2005 N 90-FZ, 21.07.2005 N 104-FZ, (‘Insurance Law’). Rossijskaja gazeta. N 6. 12.01.1993.

<sup>18</sup> R. Ahmedova. Entering of the Russian market by foreign insurers will increase the tax benefits of the Russian government. Jurgens. Bureau of the legal information. 16.12.2003. Retrieved on 25 July 2006, from [<http://www.bpi.ru/news/20516.html>].

<sup>19</sup> Fedotov A, Drowning sharks. Finance. 2005. No44. Retrieved on 25 July 2006, from [<http://www.finansmag.ru/23018>].



## Political and country risks

In the country risk ranking designed by OECD, Russia has the fourth category of country risk (0 is the lowest and 7 is the highest). The same category has for example Morocco, Namibia, Peru, and Iran. Russia improves fast in this rating after the stormy 1990s when it was ranked in the seventh group of risk. Nevertheless, increasing dependence on natural resources and ongoing deliberalisation of economical and political life supplemented by some “expropriation” cases, such as Yukos and Media-Most, slowed down the country rating improvement process since 2003.

As an example of political risks could be considered a mass withdrawal of 133 licenses from insurance companies on 1 July 2006 as a result of alleged by supervisors lack of capital.<sup>20</sup> The same summer this withdrawal was stigmatised by journalists and insurers as a “mistake” because nearly half of the licenses were returned back during the following month.<sup>21</sup> Although withdrawal of licenses from some of the companies was justified, the means and procedures which paralysed many companies cannot be acknowledged as well planned.

## Social

Unlike favourable macroeconomic situation, social situation remains quite worrying regardless of increase in population’s well-being at the rate of 12% per annum. Still, differences in salaries within the country grow more rapidly and the national average salary and pension is in the area of US\$ 330<sup>22</sup> and US\$ 80 respectively.<sup>23</sup>

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<sup>20</sup> Mass withdrawal and reissuing of licenses to insurers was a result of FISA’s mistake, suppose the Ural market players. 19 July 2006. Retrieved on 25 July 2006 from [<http://www.allinsurance.ru/biser.nsf/AllDocs/ABYA-6RUH5X-19-07-06?OpenDocument>].

<sup>21</sup> Ibid.

<sup>22</sup> Average Monthly Accrued Wages. End of 2<sup>nd</sup> quarter, 2006. Retrieved on 25 July 2006, from the site of Federal State Statistics Service. [[http://www.gks.ru/free\\_doc/2006/Statob/03-08.htm](http://www.gks.ru/free_doc/2006/Statob/03-08.htm)].

<sup>23</sup> Average Fixed Monthly Pensions. End of 2<sup>nd</sup> quarter, 2006. Retrieved on 25 July 2006, from the site of Federal State Statistics Service. [[http://www.gks.ru/free\\_doc/2006/Statob/03-11.htm](http://www.gks.ru/free_doc/2006/Statob/03-11.htm)].

## Population

According to the U.N. World Population Prospects, in 2004 Russia had the 7<sup>th</sup> largest population in the world. Nevertheless, relatively low standard of living of the vast majority of non-capital population weakens the demographic situation in the country. About 17.8% of population in 2004 were living below poverty line what led to the life expectation for men of about 58 years and depopulation in the first half of 2006 of 304.7 thousand people, or 0.21%.<sup>24</sup> According to US Census Bureau cited in Danmark's Nationalbank analytical research, "Russia is expected to continue recent years' tendency for negative population growth. In 2050 Russia's population is expected to be only approximately 80% of the current level (approximately 118 million)."<sup>25</sup> Government currently takes a number of measures to overcome demographic problems. However, the pessimistic scenario drawn in the cited report cannot be completely ignored unless real improvements will take place soon.

## Employment

The number of economically active individuals in June 2006 was 74.4 million or 51% of the overall population. The number of unemployed is consistently decreasing since 1999. Official unemployment in May 2006 was about 7.1% of economically active population.<sup>26</sup>

## Education

As summarised in 2003 Goldman Sachs report on developments in BRIC, "Many cross-country studies have found positive and statistically significant correlations between schooling and growth rates of per capita GDP – on the order of 0.3% faster annual growth over a 30-year period from an additional one

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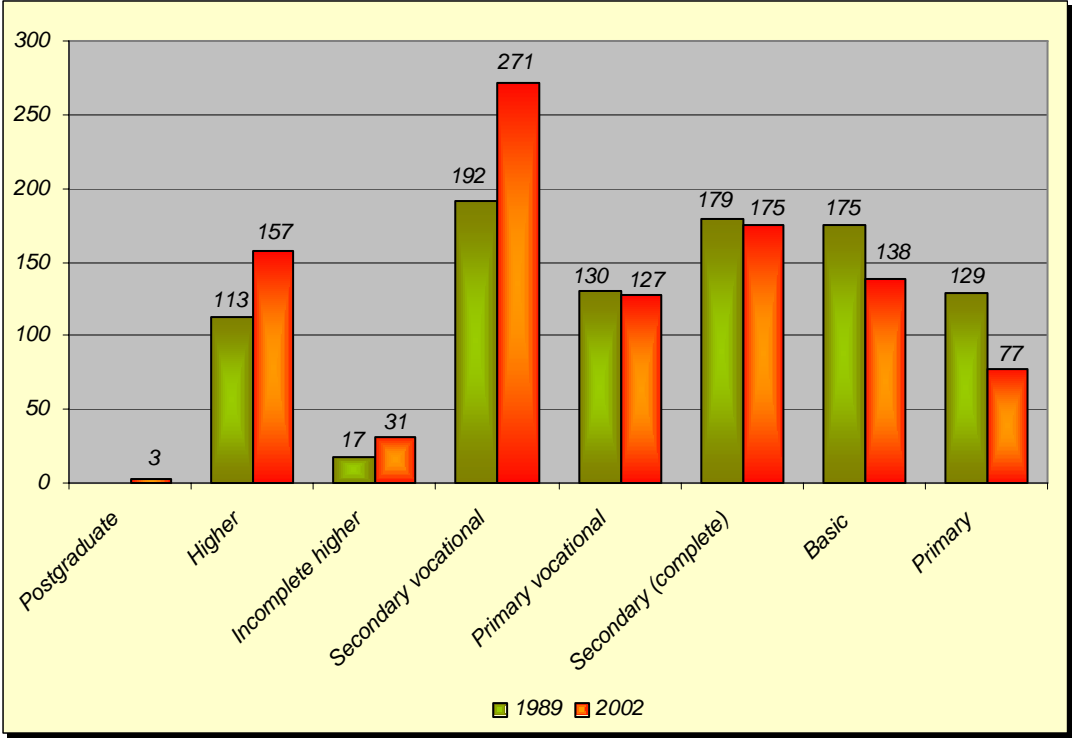
<sup>24</sup> Demography. Retrieved on 25 July 2006, from the site of Federal State Statistics Service. [[http://www.gks.ru/bgd/free/b06\\_00/IssWWW.exe/Stg/d06/08-00.htm](http://www.gks.ru/bgd/free/b06_00/IssWWW.exe/Stg/d06/08-00.htm)].; Life expectations. Retrieved on 25 July 2006, from the site of Federal State Statistics Service. [[http://www.gks.ru/free\\_doc/2005/b05\\_13/04-26.htm](http://www.gks.ru/free_doc/2005/b05_13/04-26.htm)].

<sup>25</sup> Jensen H, Larsen J, Monetary Review. 4th Quarter 2004. Retrieved on 20 August 2006 from the site of the Danmark's Nationalbank: Retrieved on 25 July 2006, from [[http://www.nationalbanken.dk/DNUK/Publications.nsf/1c326d7c6cdf6f66c1256c080048787c/e620f890a6185dc9c1256f7200310bb6/\\$FILE/kap03.html](http://www.nationalbanken.dk/DNUK/Publications.nsf/1c326d7c6cdf6f66c1256c080048787c/e620f890a6185dc9c1256f7200310bb6/$FILE/kap03.html)].

<sup>26</sup> Short summary of employment in May 2006. Retrieved on 30 July 2006, from the site of Federal State Statistics Service. [[http://www.gks.ru/wages/may\\_06.htm](http://www.gks.ru/wages/may_06.htm)].

year of schooling”. This means that education is one of the major factors stimulating intensive growth of developing economies. According to many analysts educational system of Russia is the strongest among all the BRIC countries and the overall level of education is quite high.<sup>27</sup> Danmark’s Nationalbank appealing to the Word Bank’s information in its analytical review recognises that “in terms of education level, Russia is the leading BRIC country.»<sup>28</sup> Figure 1 supports another statement of the Danmark’s Nationalbank that: “Based on a number of World Bank indicators, the population’s education level does not seem to differ significantly from the mature market economies, and illiteracy is almost non-existent.”

Figure 1: Types of education per thousand of individuals, who are over 15 years old



Source: 2002 All-Russia Population Census

<sup>27</sup> Wilson D, Purushothaman R, Dreaming with BRIC: The Path to 2050. Global Economics Paper No: 99. 1st October 2003. Retrieved from the site of Goldman Sachs on 20 August 2006. Retrieved on 25 July 2006, from [http://www2.goldmansachs.com/insight/research/reports/99.pdf].

<sup>28</sup> Jensen H, Larsen J, Monetary Review. 4th Quarter 2004. Retrieved on 20 August 2006 from the site of the Danmark’s Nationalbank: Retrieved on 25 July 2006, from [http://www.nationalbanken.dk/DNUK/Publications.nsf/1c326d7c6cdf6f66c1256c080048787c/e620f890a6185dc9c1256f7200310bb6/\$FILE/kap03.html].

## Languages

Existence of national-wide well-known language creates preconditions for prompt infrastructural developments and economic growth while knowledge of foreign languages by considerable share of population may prompt Russia's integration in the world economy. According to the 2002 All-Russia Population Census 98% of population speaks Russian. Among most popular second languages are English – 4.8% (7 million), Tatar – 3.7% (5.3 million), and German – 2% (2.9 million) of individuals respectively.<sup>29</sup> Nevertheless, with respect to foreign languages all BRIC countries loose to India, where English is one of the official languages.

## Technological

### Internet

It is often mentioned that internet has a great potential due to the large geographical scale of Russia and gathering pace of business life. It also might be seen as a means of supporting competition on insurance market, which otherwise might be reduced due to geographic reasons.<sup>30</sup> E-commercialisation of insurance industry accelerated after introduction of obligatory MTPL insurance in 2003. According to some analytics, internet sales reach at the moment 1-2% of the total industry turnover.<sup>31</sup>

There are now two major concepts of using internet as a distribution channel.<sup>32</sup>

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<sup>29</sup> Language proficiency. Report 'Results of the All-Russian Census 2002'. 21 May 2004. Retrieved on 25 July 2006, from the site of the Russian Federal Statistical Service [<http://www.perepis2002.ru/content.html?id=7&docid=10715289081450>].

<sup>30</sup> Mergers and acquisitions on the insurance market of Russia. Market analysis, Trends and Forecasts, Management. Retrieved on 17 June 2006 from [<http://www.allinsurance.ru>].

<sup>31</sup> Trudakina E, Insurance in RuNet busts. 17.8.2006. CNews Analytics. Retrieved on 25 July 2006, from [<http://www.cnews.ru/reviews/free/banks2006/articles/intinsure/index.shtml>].

<sup>32</sup> ROSNO company sold through internet 8000 policies. Agency of Insurance News. 11.09.2002. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/internet/index.html?id=3>].

Firstly, large insurance companies set up direct internet supermarkets where the clients can buy policies online. For example in 2002 ROSNO announced that during the first two years of operation their shop brought about US\$ 4 million of profit and only in 2002 sold about 8,000 policies online. Most market leaders have similar internet representation, for example RESO-Garantia and UralSib. Due to the legal uncertainty practices of conclusion a contract and payment vary in different companies. But still there are two major trends: the policies are not delivered electronically and money are usually paid in cash or by postal/bank transfer but seldom in an electronic way.<sup>33</sup> At the moment on the site [www.ifin.ru](http://www.ifin.ru) there is a list of at least 19 companies providing on-line insurance.<sup>34</sup>

Secondly, there are many online brokers offering obligatory MTPL, motor, property policies of various insurers. Online insurance brokers' boom can be explained by limited initial investment, absence of licensing and regulatory requirements and increasing competition on the Russian market leading to high commissions for intermediaries in a distribution chain. An example of successful online supermarket is a site [www.711.ru](http://www.711.ru).

### **Databases and lack of reliable statistical information**

While excessive pooling of available data and using it later as a basis for calculation of tariffs was acknowledged by EU authorities as anti-competitive practice, in Russia the problem is to the opposite: there is too little statistical information about risks and too few specialised databases. Different pools and associations in cooperation with relevant authorities create such databases. In a long run, we suppose, this should improve the quality of information supplied and thus simplify the work of reinsurance brokers and cut down administrative costs.

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<sup>33</sup> Internet – insurance today. IFin. Retrieved on 25 July 2006, from [<http://www.ifin.ru/insurance/ibtoday.stm>].

<sup>34</sup> Internet – insurers. Retrieved on 25 July 2006, from [<http://www.ifin.ru/insurance/operators.stm>].

# Legislative and Regulatory Trends

## Legislative

There are a number of anticipated legal developments concerning insurance industry. At the same time not all of them contain a great potential for BMS H&D business development in Russia. Hence, we will briefly address only the most considerable ones having substantial practical meaning for BMS H&D.

### Introduction of Mandatory Insurance of Dangerous Objects

According to the Exerts from the Legislative agenda of the State Duma of the Russian Federation (Lower Chamber of the Parliament) in October it is going to have a second reading of the bill on Mandatory insurance of liability of the operators of hazardous facilities.<sup>35</sup> Adoption of this law would create a large new segment of liability insurance.

The major two reasons why this sector might be interesting for the BMS H&D is volume of expected premiums and the nature of risks, which are going to be covered by this type of insurance.

At the moment the number of objects, which would fall under the new mandatory insurance is estimated to be around 240,000. According to the current draft the minimum annual premium is expected to be between several thousand US\$ per hazardous facility such as gasoline station. The limits of liability for the largest ones would be US\$ 250 million. Accordingly, the amount of premium collected is going to be remarkable for the Russian insurance market.

Second reason why BMS H&D might be interested in this sector is proximity to London reinsurance market. This will enable BMS H&D to offer competitive

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<sup>35</sup> Exerts from the Legislative agenda of the State Duma of the Russian Federation in the sphere of insurance during the autumn session of 2006. Retrieved on 25 July 2006 from the site of Russian Insurance Association [[http://ins-union.ru/U\\_FILE/MS\\_DOC/plan\\_zakonodatelnoy\\_dejat\\_vyderzhki.doc](http://ins-union.ru/U_FILE/MS_DOC/plan_zakonodatelnoy_dejat_vyderzhki.doc)]

reinsurance coverage for these complex catastrophic risks for Russian insurance companies.

### Introduction of Mandatory Insurance of State Officials

In October 2006 Duma is also going to consider amendments to the Civil Code, which enable later introduction of mandatory insurance of the state officials. Taking into account that the number of officials reached in the end of 2005 according to the Federal State Statistics Service 1,462 million people it could be also substantial market in the nearest future as well.<sup>36</sup>

### **Regulatory Trends**

Russian regulatory policies experience even more considerable change in the recent years. This leads to improved transparency and stability of the market, reduces the number of small companies conducting quasi-insurance operations. Recent measures boost capitalisation of insurance sector and aim to clear market from the dodgy companies and leaving more space for real reinsurance. This should make the market even more attractive for BMS H&D and other investors in the long run.

Recent regulatory developments can be briefed as follows:

- Tightening capital requirements since 2003;<sup>37</sup>
- More strict regulation of reserves and especially debtors' share in them;
- Gradual opening of the market to foreign investors and competitors;
  - × Freedom of foreign companies to buy a controlling stake in Russian insurers or even fully own them;
  - × Steady growth of the market penetration cap for insurers having foreign control;

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<sup>36</sup> Notice about the number of state officials in the government bodies and municipalities in 2005. Retrieved on 25 July 2006 from [<http://www.gks.ru/kadr/text.htm>]

<sup>37</sup> Mergers and acquisitions on the insurance market of Russia. Market analysis, Trends and Forecasts, Management. Retrieved on 17 June 2006 from [<http://www.allinsurance.ru>].

- Strengthening supervision, monitoring and even court and criminal proceedings against the companies and their clients involved in money laundering, tax evasion and semi-legal grey schemes.<sup>38</sup>
  - × Splitting financial and commercial risks insurance from other operations;
  - × Drawing the line between life and non-life insurance and separating operations in different legal entities by the middle of 2007. The main reason of separating above-mentioned different types of insurance and distinguishing between reporting corporate and retail operations is to concentrate on corporate practices, which are more often questionable from the point of view of regulators.<sup>39</sup> Separating risk and investment insurance will also hopefully increase trust in the life insurance, which so far has been primarily used for tax minimisation purposes;
  - × Reduction of the share of “grey” business in reinsurance, which now according to different estimations by 50-80 % consists of grey schemes.<sup>40</sup>

These measures are generally welcomed by professional society what indicates that the Russian insurance industry promptly moves from tax minimisation services towards providing real insurance.

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<sup>38</sup> FCIS: new stage of fighting the schemes. 24 July 2006. Retrieved on 30 July 2006 from [<http://www.allinsurance.ru/biser.nsf/AllDocs/ABYA-6RZHK4-24-07-06?OpenDocument>].

<sup>39</sup> Ibid.

<sup>40</sup> WTO: what should be permitted to the foreign insurers? 26 July 2006. Retrieved on 1 August 2006 from [<http://www.allinsurance.ru/biser.nsf/AllDocs/ABYA-6S3JYN-26-07-06?OpenDocument>].

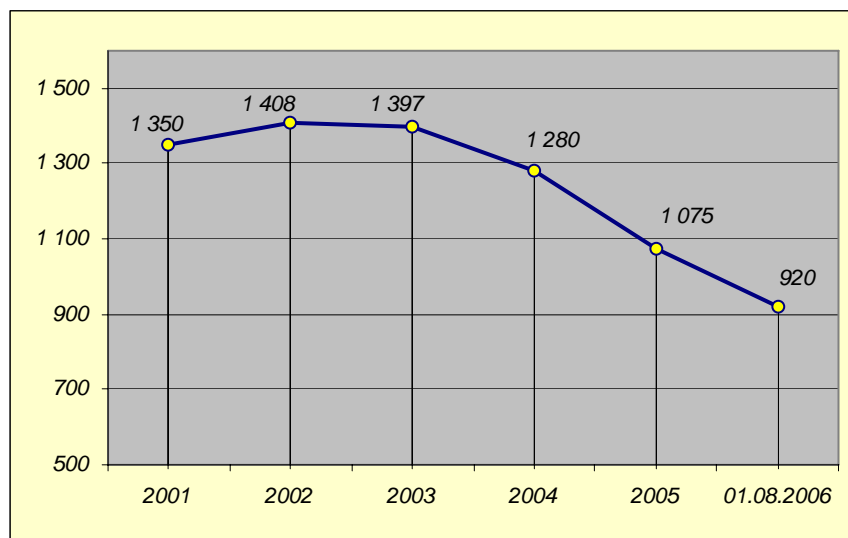


# Russian Insurance Market

## Market Consolidation

Liberal insurance legislation resulted in establishment of many insurance companies in 1990s. The lack of regulation led to active use of insurance industry as vehicle of capital outflow from the country. Some companies were established to serve a sole purpose, i.e. to operate tax evasion schemes, without any involvement in real insurance business. However, as from 2003 a number of insurance organisations started to decrease rapidly (Figure 2).

*Figure 2: Number of insurance companies in existence as at the end of the year, 2001-2006*



*Source: Federal Insurance Supervision Authority*

This came as a result of a more stringent regulation imposed on insurance industry by Federal Insurance Supervision Authority. A recently adopted legislation demands separation of life and non-life activities of current composites to be completed by 01.07.2007. Hence composite insurers will need to make a choice whether to invest in a new life insurance company or to withdraw from this line of business. Also, requirements in respect of the minimum chartered capital have significantly changed. Thus, by 01.07.2007 the chartered capital of general insurance companies should reach a minimum of

RUB 30 million (US\$ 1.04 million), life insurance companies – RUB 60 million (US\$ 2.08 million) and reinsurers – RUB 120 million (US\$ 4.16 million). This represents three times increase from pre-2004 levels which not all market players will manage, or indeed will be interested, to achieve.

In 2005 the cumulative chartered capital of Russian insurance companies increased by 21.3% reaching US\$ 5.00 billion as at 01.01.2006.

Alongside with the legislative initiatives, Federal Insurance Supervision Authority started to concentrate more thoroughly on the assessment of structure and quality of insurers' assets as well as to take steps aimed to improve and systematically monitor insurers' solvency. Thus, in August 2006 it has been reported that 57% of all insurance companies were under special control of regulator. A good consensus exists among industry professionals as to expected number of insurance companies, which will be operating on the market in the not too distant future.

*“A fairly strict approach has been adopted by the Federal Insurance Supervision Authority. They have in mind to bring a number of insurance companies down to few hundreds, may be about 200-300. Probably, this is a correct thing to do since it is nearly impossible to exercise an effective control over too many insurers. Moreover, small insurance companies don't provide a real insurance coverage, but are involved predominantly in tax evasion schemes. Therefore, this tendency is a good one.”*

## **Market Structure and Concentration**

The landscape of Russian insurance market has significantly changed during the last few years. We believe that introduction of compulsory MTPL insurance in 2003 and remarkable change in life insurance sector have been major developments, which reshaped a structure of Russian insurance market. A particular characteristic of the market is a widespread practice related to issuance by insurance companies of insurance policies aimed at tax

optimisation, i.e. risk-free policies which significantly distort the real image of insurance market. Thus, Fitch Ratings estimated the real volume of Russian non-life insurance sector in 2004 at the level of US\$ 10.3 billion compared to official figure of US\$ 13.3 billion.

*“Business grows. This is evidenced by investment projects, which we see regularly and which illustrate a substantial inflow of funds into Russia. For the most part, it is due to colossal natural resources, i.e. oil and gas, that lead the overall growth: generated funds then feed other branches of economics. At the end of the day, even our company gets a major part of its revenues owing to this segment. Besides, other lines of business start to catch up gradually. Prospects on insurance market are very good. Despite the growth though, still too little is being insured; very much uninsured. Prospects are very bright, but knowing peculiarities of the country and of the national character, all this will be developing, but it will be a lengthy process. Literally, a real growth will be around 10% per annum and it will be more than enough for a long time.”*

The market share of top 10 insurance companies approximates to 50%, with life and obligatory medical insurance premiums being excluded because they are normally underwritten by specialised daughter companies. (Table 3).

*Table 3: Top 10 Russian insurance companies, 2005  
(life and compulsory medical insurance premiums being excluded)*

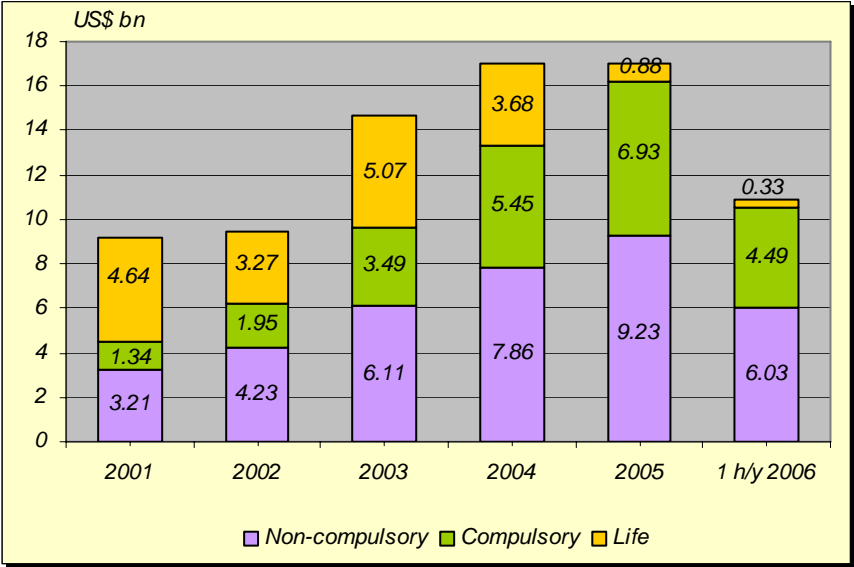
Company	Premiums written, US\$ mln	Market share, %
Rosgosstrakh	1 210.11	10.7%
Ingosstrakh	867.27	7.7%
RESO-Garantia	732.24	6.5%
SOGAZ	512.72	4.5%
ROSNO	395.57	3.5%
VSK	316.93	2.8%
Soglassye	302.56	2.7%
ZHASO	238.43	2.1%
AlfaInsurance	231.87	2.1%
MAKS	224.47	2.0%
Total	5 032.17	44.6%

*Source: Media-Information Group “Insurance Today”*

It should be noted however, that certain lines of business sometimes greatly prevail in portfolios of above-mentioned insurers. Therefore, alterations are possible if analysed from different perspectives. For instance, a share of MTPL insurance business amounted to 46% of all Rosgosstrakh’s premiums. Likewise, as much as 73% of ZHASO’s premiums have been derived from personal lines insurance.

For a detailed analysis of the market and identification of potential business opportunities we decided to distinguish between three major market segments, in particular life insurance, compulsory insurance and non-compulsory insurance (Figure 3).

Figure 3: Insurance market structure, 2001-2006



Source: Federal Insurance Supervision Authority

In the following sections we will consider major developments in respect of each of these segments, particularly focusing on possible areas of interest to BMS H&D.

## **Life Insurance**

The foremost development in recent years, and in particular in 2005, was a dramatic decrease in a share of life insurance: from 21.7% of all premiums written in 2004 to only 5.2% in 2005. This plunging trend also continues in 2006. For the most part, it is a result of measures taken by the Federal Insurance Supervision Authority to combat tax evasion schemes, which have predominantly been done through life insurance. Thus, Fitch Ratings estimated a real volume of Russian life insurance market in 2004 at the level of US\$ 150 million, or as little as 4% of officially reported figure. Although real life insurance market is set to grow, we assume that this segment represents little interest to BMS H&D.

## **Compulsory Insurance**

An introduction of compulsory MTPL insurance in 2003 has significantly boosted premiums in a segment of compulsory insurance. In 2005 its contribution amounted to 26.92% of all premiums written under compulsory lines of business. The attitude towards it is positively changing in Russian society. Thus, according to ROMIR Monitoring, market research company, the percentage of population, who consider compulsory MTPL insurance as yet another state-imposed tax, reduced from 40.2% in March 2005 to 27.1% the year later. It is recognised that compulsory MTPL was also a catalyst, which encouraged general public to purchase other types of insurance, principally motor own damage cover, and significantly raised insurance awareness of population.

Besides compulsory MTPL insurance, this segment is comprised of following lines:

- Travel health insurance (0.25% of premiums in compulsory segment in 2005);
- State insurance of tax officials (less than 0.01% of premiums in compulsory segment in 2005);

- State insurance of Russian armed forces personnel (2.31% of premiums in compulsory segment in 2005);
- Medical insurance (70.52% of premiums in compulsory segment in 2005).

By and large, compulsory lines of business are being kept unreinsured. We think that the only real opportunity, albeit in the long-term, exists for reinsurance of MTPL business. At present, there are approximately 160 insurance companies writing MTPL insurance business. However, the US\$ 1.87 billion (as in 2005) MTPL insurance market is predominantly controlled by large insurance companies owning wide regional networks, which make them easily accessible by clientele in different parts of the country (Table 4).

*Table 4: Top 10 Russian insurers in respect of MTPL business, 2005*

Company	Premiums written, US\$ mln	Market share
Rosgosstrakh	562.94	30.0%
RESO-Garantia	194.39	10.3%
Ingosstrakh	112.21	6.0%
UralSib Insurance	93.34	5.0%
Spasskye Vorota	65.93	3.5%
ROSNO	58.73	3.1%
VSK	54.00	2.9%
Standard-Rezerv	41.43	2.2%
Nasta	41.16	2.2%
Maks	40.72	2.2%
Total	1 264.85	67.4%

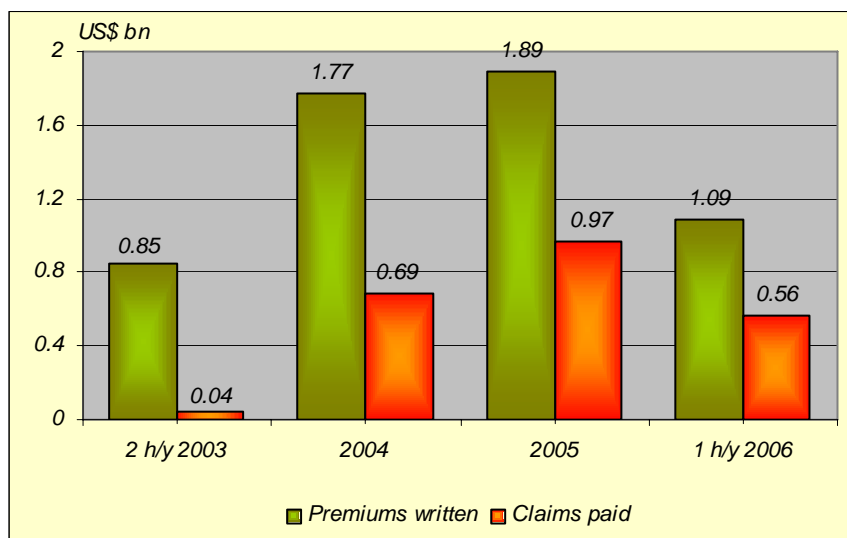
*Source: Expert RA rating agency*

A financial strength of market leaders and sufficiency of their capitals allow this business to be fully retained. Moreover, current liability limits are deemed to be rather low which is a major factor preventing companies from reinsuring their MTPL portfolios. The aggregate liability limit of RUB 400,000 (EUR 11,700) per event is split as follows:

- Bodily injury: RUB 240,000 (EUR 7,020) per event, but limited to RUB 160,000 (EUR 4,680) per person;

- Property damage: RUB 160,000 (EUR 4,680) per event, but limited to RUB 120,000 (EUR 3,510) per person.

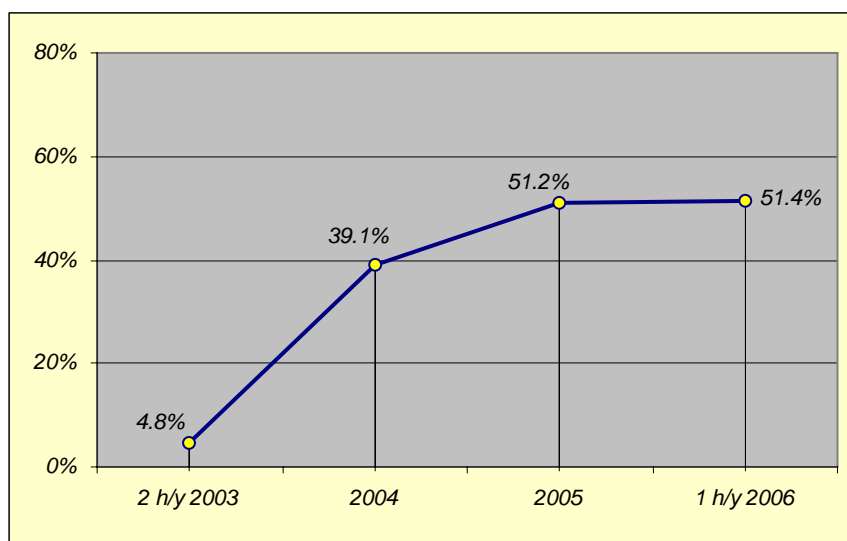
*Figure 4: Premiums written and claims paid in MTPL insurance, 2003-2006 (calendar year basis)*



*Source: Federal Insurance Supervision Authority*

However, we think that the interest towards reinsurance of their MTPL portfolios may emerge soon from small and medium size insurers. This can be due to a number of factors. Firstly, this may be a direct consequence of a more stringent approach adopted by the Federal Insurance Supervision Authority towards insurers' financial strength assessment in general, and insurers' solvency evaluation in particular. Hence, insurers may consider reinsurance buying options for solvency reasons. Secondly, liability limits have not changed since introduction of compulsory MTPL insurance and we expect that they will be increased sooner rather than later. For instance, yet in 2005 Ministry of Finance suggested that liability limit in respect of bodily injury claims can be changed to constitute RUB 240,000 (EUR 7,020) per event and per person. Therefore, legislative changes of this nature may trigger interest towards reinsurance of MTPL business. Without waiting for these changes to happen, already now some insurers may wish to establish reinsurance relationship so as to gain trust and be better positioned for future negotiations. Thirdly, after an euphoria, which accompanied MTPL insurance during its early stages of development, insurers started to see losses (Figure 5).

*Figure 5: MTPL insurance market loss ratio development, 2003-2006 (calendar year basis)*



*Source: Federal Insurance Supervision Authority, Ingosstrakh Insurance Company*

Although the rate of growth of loss ratio decreased, we believe that market equilibrium in respect of premiums and losses has not yet been reached. Under these circumstances reinsurance may be seen as a future claims cost stabilisation mechanism, which would allow insurers to meet their future MTPL obligations with a greater confidence.

According to *Autobusiness*, Russian analytical magazine, in April 2006 there were 6 insurance companies with a share of MTPL business in their portfolios close to 80% and 30 insurance companies with a share of more than 50%. We believe that such companies may find themselves in a particularly vulnerable situation in case of developments, adversely affecting their MTPL portfolios. On another hand, these insurers might more willingly than others consider buying reinsurance cover.

Obviously, the future development of MTPL insurance business largely depends on legislative changes, such as change in tariffs or liability limits, as well as changes in a presently bureaucratic and complicated bodily injury claims settlement procedure. The market will also be shaped by such factors as ability of insurance companies to achieve “economies of scale” in the light of squeezing margins as well as to benefit from cross-selling opportunities

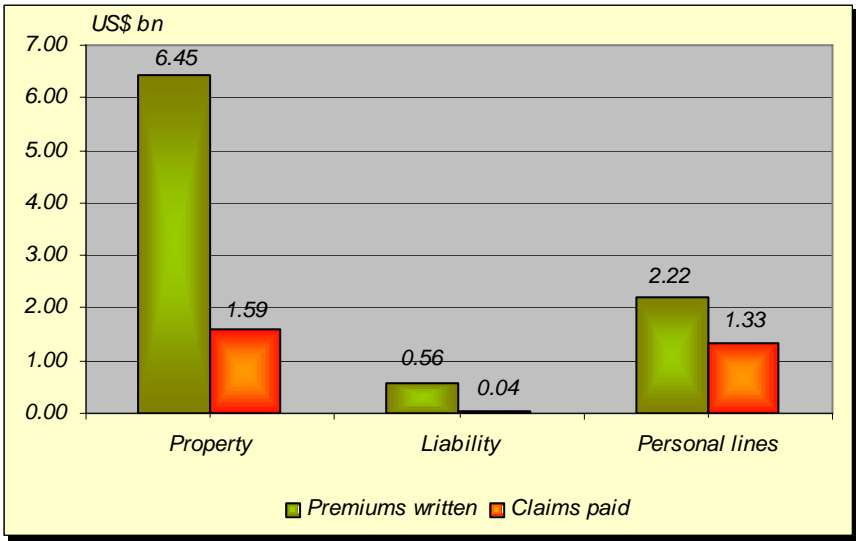


brought about by MTPL insurance. In 2005 there were 10 companies, who left the MTPL insurance market, and insurance market as such, due to insolvencies. Expert RA rating agency estimates that in 2006 the number of companies operating on MTPL insurance market will further decrease by about 30 companies.

## Non-compulsory Insurance

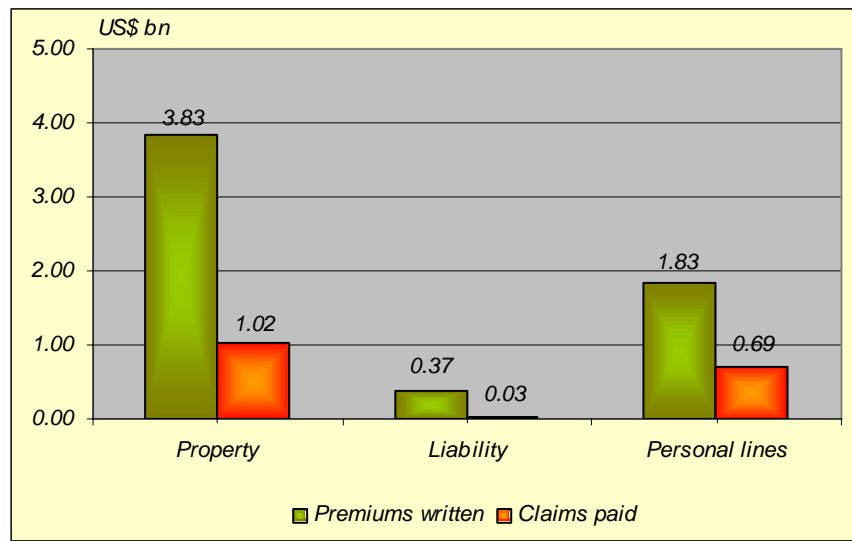
By and large, a segment of non-compulsory insurance can be split into property, liability and personal lines insurance classes (Figure 6, Figure 7).

Figure 6: Premiums written and claims paid in non-compulsory insurance segment, 2005 (calendar year basis)



Source: Federal Insurance Supervision Authority

*Figure 7: Premiums written and claims paid in non-compulsory insurance segment, 1st half-year 2006 (calendar year basis)*



*Source: Federal Insurance Supervision Authority*

It should be mentioned however that above figures should be taken with a grain of salt due to two major reasons.

Firstly, the term “property” above is all-inclusive and apart of property insurance per se, also refers to such classes as motor casco, marine hull and cargo, aviation and space, and engineering. Likewise, “liability” refers to all types of liability insurance, including commercial general liability, D&O, professional indemnity, etc.

Secondly, according to Federal Insurance Supervision Authority, tax evasion schemes had been extensively used in both property and liability lines of business. The remarkable discrepancies though exist in estimations regarding a share of tax evasion schemes in these insurance segments. Thus, the supervision authority estimates that in 2004 pseudo-insurance accounted for as much as 69.6% and 86.5% of all premiums written under above-mentioned classes of business respectively. Whereas, Expert RA rating agency’s estimation in respect of tax evasion schemes in property and liability insurance totalled to 46% and 48% respectively.

However, 2005 has strongly marked a trend, whereby officially published figures started to approximate to real situation on the market. The volumes of pseudo-insurance in non-compulsory insurance segment, as is a case with life insurance, are rapidly declining which makes officially reported data to be more reliable. Thus, according to official statistics premiums written under property and personal lines insurance have grown by 21% in 2005, whereas liability insurance premiums increased by 32%. Hence, assuming that in 2005 a share attributable to tax evasion schemes declined, which all interviewees readily agreed with (as well as was communicated by Expert RA rating agency), Russian insurance market is becoming more transparent and demonstrates considerable growth.

## **Liability**

In general, liability insurance sector in Russia is not sufficiently developed. An absence of judicial precedents relating to liability insurance, disloyal courts, official procrastination and trifling chances to get compensation through courts preclude liability insurance from development. There is no compulsory liability insurance for such professions as auditors, notaries, lawyers, architects, or insurance brokers. This does not mean, however, that these businesses do not buy professional indemnity insurance at all. A demand for it exists, but as we think, not to an extent which would allow us to speak about reasonable level of interest towards this cover. On another hand, a rapid development of construction industry, and consequently of engineering insurance, fuelled interest towards contractors' liability insurance. It is being bought by contractors either for a particular project as part of CAR/EAR policy, or as a separate liability policy.

Increasing number of Russian companies are seeking for additional equity capital by going public. An IPO activity on capital markets triggered interest towards D&O liability insurance, which is believed to have a considerable potential.

## Property

In this section we will focus on property insurance encompassing private and commercial property, and engineering insurance, as well as on motor casco. These two sectors are believed to have a major growth potential in the coming years, and hence may be of particular interest. We should mention however, that breaking down an all-inclusive property insurance class into various lines of business represented a particular challenge. Although every care has been taken to sort out the data as accurately as possible, some deviations from actual figures may exist.

Sizeable reinsurance covers allowed insurance companies to compete stronger with each other and led to considerable rate reductions in property segment. Although small and medium size enterprises demonstrate an increasing interest towards insurance, a majority of premiums is being derived from insurance of large commercial enterprises, financial and industrial groups etc. Obviously, such companies do deal with a broad range of risk management issues on a regular basis, and regard insurance as a risk transfer mechanism, which they have already been using for many years. As a result, the growth in this particular segment of property insurance is not high.

*“Predominantly, energy industry is being insured... It had been covered in the past and continues so in the present. Therefore the growth in energy insurance segment is not high.”*

It is widely recognised that this highly attractive business is largely insured on a captive basis. Although many insurance companies are changing their captive status by being sold to an outside investor as a non-core asset of the parent organisation, a transformation to a pure market-oriented company is not an easy process. Most of Russian top ten property insurers are (were) in one way or another affiliated with a major financial or industrial group (Table 5).

Table 5: Top 10 Russian insurers in respect of property business, 2005

Company	Affiliated business	Premiums written, US\$ mln
Rosgosstrakh		305.71
Lider	RAO EES	188.01
AlfaInsurance	Alfa Group	173.41
RESO-Garantia		164.06
Ingosstrakh	Bazoviy Element	157.06
SOGAZ	Gazprom	156.19
Soglassye	Interros	112.15
Kapital Strakhovaniye	Lukoil	72.68
UralSib Insurance	UralSib Group	68.67
Surgutneftegaz	Surgutneftegaz	27.10
Total		1 425.04

Source: Expert RA rating agency, Princeton Partners Group

The strong links developed over time between affiliated companies give captives (ex-captives) an essential advantage over competitors in serving a fair share of parent's (ex-parent's) insurance needs. It should be admitted though that degree of affiliation does vary from one company to another. Moreover, captive insurance companies are experiencing an increasing pressure from parent organisations to drive up premiums written from an open market. As a consequence, a trend exists whereby large businesses not only rely on insurance cover easily obtainable from the affiliated insurer, but also contract a wider market.

*“Firstly, a much easier life is for the large insurance companies, that have a captive status, i.e. are part of a certain holding or a group of companies. In this case, they mainly serve holding’s insurance needs plus may get something from an open market. And secondly, for the companies, that own a particular administrative resource, meaning that their founders or patrons are affiliated with influential governmental institutions. In this case all insurance issues are resolved very well.”*

Increasing activity in mortgage services and advancements in banks’ mortgage offerings to both businesses and individuals is an important driving force behind growth of property insurance. Princeton Partners Group estimates that it

will be one of the major factors supporting an average annual growth of 20% in property insurance segment over the next 5-6 years.

*“Increasingly, small and medium size enterprises demonstrate their interest towards insurance and it is possible to work with this segment on a basis of genuine market practice, as any insurance company should work. Whereas, specific agreements and special arrangements always exist for insurance of large businesses. Nevertheless, a bulk of income is derived from corporate clients... but unfortunately margins what we are getting decrease each year.”*

The development of construction industry also fuelled growth of engineering insurance.

*“What is growing really fast is engineering insurance: during the last 5 years it has been increasing by nearly 100% annually.”*

We think that property portfolios of insurance companies will become more diverse. Hence, they may wish more willingly to assess alternative options addressing their changing reinsurance needs. Also a number of insurance companies that need to restructure their reinsurance programmes may increase.

As regards motor casco business, it is believed to continue its impressive growth. The top 10 motor insurers reported an increase between 35.4% and 186% in respect of their motor portfolios, i.e. combined motor casco and voluntary MTPL in excess of statutory limits, for year 2005. A number of factors contribute to this effect:

- Competition and advancements in banking sector, which offers credits specifically designed for purchase of the vehicle, makes this source of finance increasingly favoured by population and businesses;
- Improving quality of country's overall fleet and increasing number of vehicles on the roads leads to substantial increases in total amounts insured;

- Obligatory MTPL insurance notably raises awareness of population and equips insurance companies with cross-selling opportunities with motor casco insurance being an obvious selection.

Table 6 below lists the top 10 insurers in respect of motor casco business.

*Table 6: Top 10 Russian insurers in respect of motor casco business, 2005*

Company	Premiums written, US\$ mln
Ingosstrakh	334.91
RESO-Garantia	234.75
Rosgosstrakh	192.59
ROSNO	106.39
AlfaInsurance	88.19
Standard-Rezerv	78.08
Soglassye	75.38
Nasta	71.50
Renaissance Insurance	65.98
VSK	60.00
Total	1 307.77

*Source: Expert RA rating agency*

As far as reinsurance needs are concerned, an increasing number of insurance companies opt for catastrophe cover in respect of their motor casco portfolios. Under increasing regulatory pressure, insurers may also wish to consider proportional reinsurance for solvency reasons. As motor casco accounts for a significant share in their portfolios, it may be considered as an effective solution addressing solvency issues and/or financing growth. Within a rapidly growing market this sector may well represent a field of opportunities.

### **Personal lines**

As we think, a major opportunity within personal lines insurance sector relates to personal accident insurance. It emerges from an increasing use of banking services, in particular credit instruments, by small and medium size enterprises. In contracts between lender and organisation lending money the organisation's

managing director often appears as a guarantor. Naturally, banks wish to secure the loan as much as possible and require guarantor to be covered by personal accident insurance policy. With a prospering economy the amounts given in loans to both individuals and businesses are growing rapidly. However, Russian insurance and reinsurance companies are somewhat unprepared to provide sufficient capacities for this class of business.

*“There is no capacity on Russian insurance market in respect of personal accident insurance, whereas this class of business is in a great demand. When the organisation takes a loan, very often one person appears as a guarantor in respect of the credit, say it may be a general manager of a large organisation. A bank would require the guarantor to be covered by personal accident insurance policy. For example, the bank required personal accident insurance for US\$ 10 million. I contacted 40(!!!) companies and managed to obtain only US\$ 2.5 million in capacity. A maximum retention for market leaders is US\$ 500,000 provided there are best possible terms, others are prepared to write around US\$ 50,000 only.”*

We think that having binding authority with London market underwriters may provide a relatively quick and straightforward access to some insurance companies. In many cases this may represent a very good starting point, on which a firm ground for further co-operation can be built.

## **Market Size: Nominal vs. Real**

One of the main difficulties in analysing Russian insurance market is a high proportion of tax optimisation business in insurance industry. Official figures submitted by the companies to authorities are often interpreted differently by supervisors and independent experts, such as Expert RA and Fitch Ratings (Table 7).



*Table 7: The nominal and estimated real size of Russian insurance market, 2005*

Class of business	Premiums written (nominal figures, US\$)	Share of tax evasion (% of nominal premiums)	Premiums written (real figures, US\$)
Property	6.45	37%	4.06
Liability	0.56	38%	0.35
Personal lines	2.22	28%	1.60
Life	0.88	78%	0.19
Compulsory lines	6.93	-	6.93
Total	17.04	22.95%	13.13

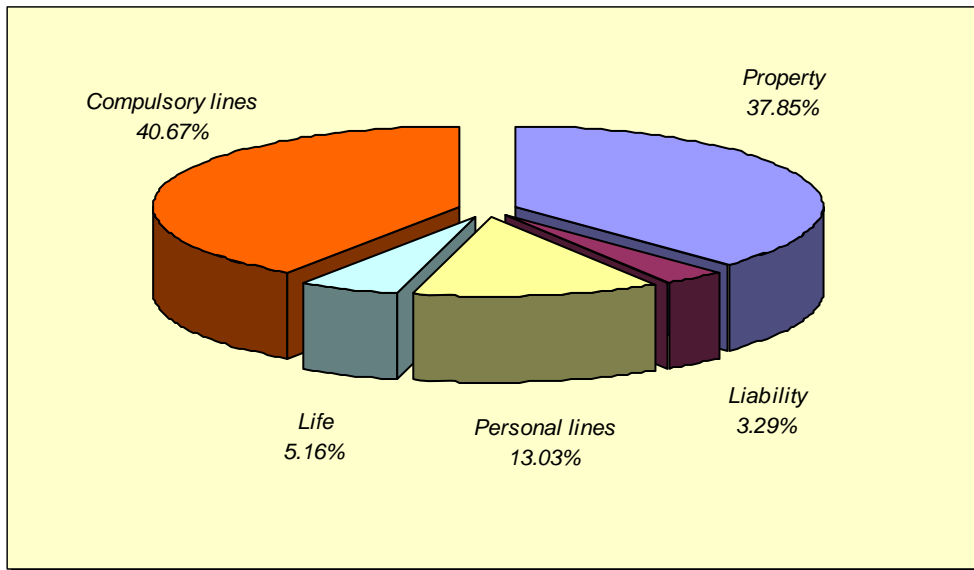
*Source: Federal Insurance Supervision Authority, Expert RA rating agency*

Absence of advanced reporting standards in the industry in combination with prevailing till recently inadequate regulation of insurance companies led to difficulties in estimation of the share of real business.

Situation in 2005 is already considerably better than several years ago as a result of continuous combating insurance schemes by FISA. The overall trend is positive – gradual reducing of a share of risk-free insurance. As noticed the first deputy of the CEO of Rosgosstrakh Insurance Company Mr. Dmitry Morozov, recent shifts in regulatory policies and legislation amendments will lead to the situation when “the issue of fighting the schemes will shift from the level of political restriction to the level of economic stimulation” (Expert RA, Russian Insurance Market, I quarter 2006). These recent developments create better environment for business development of BMS H&D.

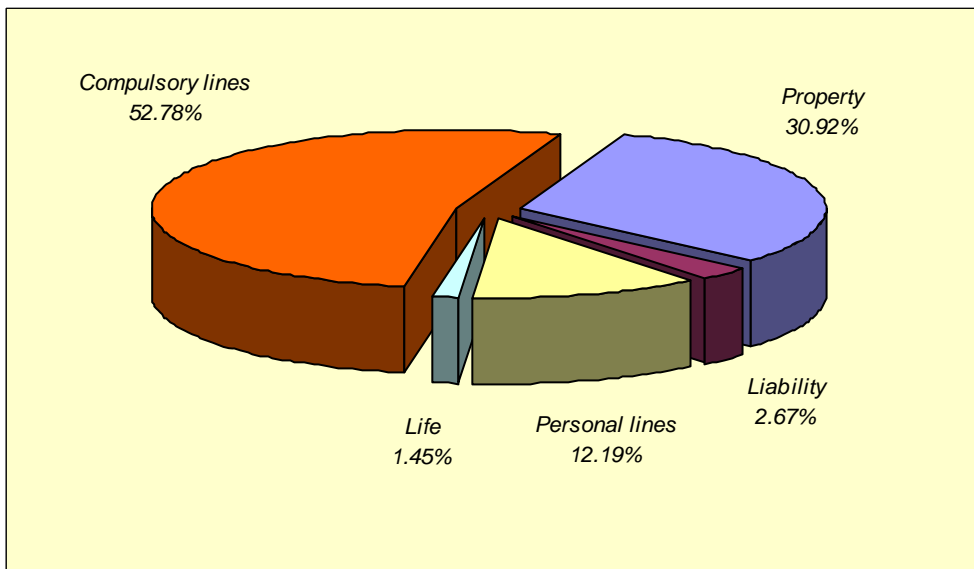
Given above reasons, we suppose that it might be beneficial for BMS H&D to have an assessment of proportion of real insurance operations in officially reported figures based on estimations of Expert RA (Figure 8, Figure 9).

Figure 8: Structure of Russian insurance market according to nominal figures, 2005



Source: Federal Insurance Supervision Authority, Expert RA rating agency

Figure 9: Real structure of Russian insurance market, 2005



Source: Federal Insurance Supervision Authority, Expert RA rating agency

# Insurance Pools

Lack of capital in the industry and prompt expansion of Russian insurers into new lines of business led to recent establishment of multiple national insurance pools. One of the main purposes of risk pooling in Russia is to guarantee more reasonable reinsurance opportunities by conclusion of reinsurance treaties. For example, Progress-Neva Insurance Company recently joined the Russian Anti-Terrorist Insurance Pool (RATIP) to participate in obligatory reinsurance treaty of the pool reducing reinsurance costs by approximately 25-30% for this company.<sup>41</sup> We believe that targeting insurance pools provides BMS H&D with some business opportunities described in conclusion part of this section.

## Russian Anti-Terrorist Insurance Pool

Russian Anti-Terrorist Insurance Pool was created in 2001 by six major Russian companies: Ingosstrakh, ROSNO, Rosgosstrakh, Reso-Garantia, VSK, Soglassye. At the moment it is managed by North Atlantic Reinsurance Services (NARS). According to Gulchenko A, the chairman of the supervisory board of RATIP, in March 2006 Anti-Terrorist Pool had 38 members and capacity of approximately US\$ 33 million.<sup>42</sup> In 2005 members of RATIP gathered about US\$ 2 million in premiums and in 2006 expects to reach US\$ 3 million according to interviewed by us reinsurance managers. The tariffs were averaging between 0.0125% and 0.05% of the insured sum.

Recent restructuring of the pool targets rapid increase of capacity and the number of members up to 5 times.<sup>43</sup> A. Gulchenko also mentions that according to a number of researches Russia is on the third place after Iraq and India in the rating of most dangerous places in the world from the terrorism risk

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<sup>41</sup> From January 2006 IC Progress-Neva joined RATIP. 27.01.2006. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/biser.nsf/AllDocs/AKNA-6LFFJD-27-01-06?OpenDocument>].

<sup>42</sup> Gulchenko A, Wind of change. 23 March 2006. Retrieved on 25 July 2006, from [<http://www.insur-info.ru/interviews/285>].

<sup>43</sup> Supervisory board of PATIP decided to change the structure of the pool. 15 December 2005. Moscow. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/biser.nsf/AllDocs/AKNA-6L9KK2-21-01-06?OpenDocument>].

prospective.<sup>44</sup> This permanent threat of terrorist attacks in the major cities of Russia in combination with pool's restructuring measures leads to increase in the number of members and demand for terrorism coverage.<sup>45</sup>

Managers of one of the interviewed companies also forecasted considerable rise of terrorism risk insurance also due to the legislative measures and possible introduction of insurance for the mass entertainment events. They said that regardless of that fact that several bills proposing mandatory terrorism cover for any commercial public place with capacity of more than 200 people were returned to the initiators,<sup>46</sup> the public discussion about this type of insurance is still going on and can lead to adoption of the relevant legislation.<sup>47</sup> In this case the amount of premiums will be avalanching and could easily reach US\$ 10 million per annum according to our interviewees.

In the last two years RATIP already has paid several claims totalling US\$ 430,000. The largest of them were caused by explosion in front of the National Hotel in Moscow and a terrorist attack in Malaysia damaging Russian embassy. RATIP is always looking for competitive reinsurance offers and contacts with NARS's managers could be highly recommended not only with respect to this pool but also taking in account strong support of this company by supervisory authorities promising stable growth of their reinsurance business in the future.

## **Russian Nuclear Insurance Pool**

The Russian Nuclear Insurance Pool (RNIP) was established in 1997 by 20 Russian insurers. In 2005 the capacity of RNIP was about US\$ 130 million.<sup>48</sup> One of the largest deals in 2003 was to take a US\$ 57 million liability of Ukrainian

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<sup>44</sup> Ibid.

<sup>45</sup> Gulchenko A, Wind of change. 23 March 2006. Retrieved on 25 July 2006, from [<http://www.insur-info.ru/interviews/285>].

<sup>46</sup> See also: List of the legislative bills introduced by the members of the committee of the security in 2005. Retrieved on 25 July 2006, from [<http://www.duma.gov.ru/csecure/otch/4/p1.doc>].

<sup>47</sup> G. Rusakova. Police against terror. Private money. 03.05.2005. Retrieved on 25 July 2006, from [[www.personalmoney.ru/txt.asp?id=377070&rbr=](http://www.personalmoney.ru/txt.asp?id=377070&rbr=)].

<sup>48</sup> Pause in reinsurance of the nuclear risks of Ukraine.. MAKS. 24 June 2005. Retrieved on 25 July 2006, from [<http://www.insur-info.ru/pressr/3352>].

state “Energogorant” corporation.<sup>49</sup> RNIP is recognized by International Pooling System since participation in 2003 in the London conference of national atomic pools.<sup>50</sup> RNIP is a member of International Nuclear Law Association and Forum of Atomic Pools.<sup>51</sup> It can be suggested to contact the RNIP through these organisations if BMS H&D has a membership in them. MAKS Insurance Company, currently managing RNIP, actively participates in the work of these associations and successfully lobbies together with Nuclear Ministry Russia’s integration in the world’s atomic safety system including recent joining the Vienna convention.

The largest share of 15% in RNIP belongs to Ingosstrakh but the pool is represented in majority of external relationships and deals by Ms. Natalia Martjanova, the President of the supervisory board of RNIP and a CEO of MAKS Insurance Company.<sup>52</sup> MAKS has a broad expertise in managing nuclear risks and has dozens nuclear companies among its shareholders.<sup>53</sup>

Another reason for establishing business relationships with RNIP’s management company should be the fact joining on 22 March 2005 by Russia of the Vienna Convention and respective rise of the nuclear risks segment of the market. Professor A. Jordish recently concluded that for the majority of nuclear objects participation in Vienna Convention will lead to doubled or even tripled premium payments in the following years.<sup>54</sup> At the same time, Prof. Jordish points out that even these increased amounts would be quite minor for most of the nuclear industry players. For example for Rosenergoatom (managing company for all the nuclear power stations of Russia) it will constitute 0.18% of turnover, for Siberian Chemical Plant – 0.07%, mining plant – 0.35% and for scientific centres – 0.4%, respectively. It is also mentioned that annual premium for

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<sup>49</sup> RNIP reinsured the risks of Enegroatom for \$US 57 million. Agency of insurance news. 31 May 2004. Retrieved on 25 July 2006, from [<http://www.insur-info.ru/news/2655>].

<sup>50</sup> RNIP is recognised by the international pooling system. Agency of insurance news. 15 October 2003. Retrieved on 20 August 2006 from [[www.insur-info.ru/news/884](http://www.insur-info.ru/news/884)].

<sup>51</sup> In China took place a forum of nuclear insurance pools. MAKS, 14 June 2005. Retrieved on 25 July 2006, from [<http://www.insur-info.ru/pressr/3291>].

<sup>52</sup> Insurance of the civil liability of the organisations running the objects with nuclear energy. Retrieved on 30 June 2006, from [[http://www.ingos.ru/ru/corporate/corp\\_alternate/industrial/liability/nuclear/](http://www.ingos.ru/ru/corporate/corp_alternate/industrial/liability/nuclear/)].

<sup>53</sup> Nuclear insurance in Russia – successes and problems. Nuclear strategy. 01.06.2005. Retrieved on 30 June 2006, from [<http://reklama.makc.ru/press.asp?y=2005&mode=read&id=19>].

<sup>54</sup> Jordish A, International regime of civil liability for nuclear damage. Nuclear Strategy. No 17. 2005. Retrieved on 30 June 2006, from [<http://www.proatom.ru/modules.php?name=News&file=article&sid=70>].

subsidised 5 scientific reactors would be in the range of US\$ 300-400 thousand. According to the financial reports of RNIP analyzed by Prof. Jordish own retention of the pool under some contracts will be reaching US\$ 130 million in 2005-2006.<sup>55</sup>

Taking into account that in Russia at the moment there are 24 energy reactors and there are plans to build another 40 till 2025 this market promises considerable and stable growth.

Another positive aspect for BMS H&D is that dominating pool's position allows accumulating the vast majority of risk in RNIP for further transfer to the international markets.

## **Russian P&I Pool**

Russian P&I Pool (RPIP) was established in 1996 by 5 insurance companies leading in P&I insurance. In the course of time pool's membership was extended and now it unites 11 insurance companies. In the first quarter of 2006 pool gathered US\$ 2.811 million of premiums and paid US\$ 310,000 in claims. Pool provides coverage with the limit of US\$ 500 million per vessel.

In June 2006 A. Matveev, the head of the P&I department of a member company AlfaInsurance, told to the journalists that at that moment RPIP was covering the risks of two vessels with US\$ 500 million limit, 20 vessels with US\$ 250 million limit and 8 vessels with US\$ 200 million limit. Most of them are refrigerators and tankers. Overall portfolio of the RPIP at the moment is 400 river and ocean vessels according to Zeller Associates.<sup>56</sup>

Pool is managed by Zeller Associates GmbH, a marine insurance management and consultancy company established in 1997 and based in Hamburg

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<sup>55</sup> Jordish A, International regime of civil liability for nuclear damage. Nuclear Strategy. No 17. 2005. Retrieved on 30 June 2006, from [<http://www.proatom.ru/modules.php?name=News&file=article&sid=70>].

<sup>56</sup> Russian P&I Pool celebrates its 10th anniversary. 01.03.2006. Retrieved on 25 July 2006, from [[http://www.zeller-associates.com/site/main/m\\_news\\_news.html](http://www.zeller-associates.com/site/main/m_news_news.html)].

(Germany). Zeller Associates have 3 representative offices in Russia and are very active on the regional market.

## Russian Pool for Hazardous Objects

As mentioned in June 2006 National Association of Liability Insurance the Russian Pool for Hazardous Objects (RPHO) can be created even before the introduction of the corresponding mandatory insurance by the Parliament.<sup>57</sup> The bill about insurance of hazardous objects is going to be considered in October in the second reading. Need for pooling is caused by relatively high limits of liability RUB 1.7 billion (US\$ 63 million). Some MPs argue that the limit should be increased up to 6.5 billion (US\$ 175 million). Accordingly this risk is considered by Russian insurers as catastrophic and requiring pooling and sharing. The capacity of the pool is going to be about RUB 65 billion (US\$ 2.5 billion). Only insurance companies with capital exceeding RUB 1 billion will be allowed to participate in RPHO.<sup>58</sup> This is in line with article 1 of the bill imposing the same capital requirements on the companies undertaking this kind of insurance.

Our interviewees representing one of the tender's participants for the management of pool expected not more than 20-30 companies to be joining the pool. Members of the pool will be allowed to keep up to 40% of the risk and the rest will be transferred to the pool and reinsured abroad.<sup>59</sup> RPHO participants also hope that pool will provide assistance in monitoring risks, claims and tariffs to avoid the abuse practices in this sphere.

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<sup>57</sup> Russian Pool for Hazardous Objects can start working before the bill will be passed through the parliament. 7 June 2006. Moscow. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/biser.nsf/AllDocs/ABYA-6QJD4D-07-06-06?OpenDocument>].

<sup>58</sup> Insurers of operators of hazardous objects will create a pool with capacity of 65 billion of rubles. 1 June 2006. Moscow. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/biser.nsf/AllDocs/EFIA-6QCASQ-01-06-06?OpenDocument>].

<sup>59</sup> Russian Pool for Hazardous Objects can start working before the bill will be passed through the parliament. 7 June 2006. Moscow. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/biser.nsf/AllDocs/ABYA-6QJD4D-07-06-06?OpenDocument>].

## **Russian Agricultural Pool**

The Russian Agricultural Pool, which now unites 30 members, was established in 2004 by 13 companies to cover risks of agricultural producers.<sup>60</sup> Market of agricultural insurance estimated to be US\$ 600 million market in 2008. The results of the Pool's activities were presented last year by CEO of Soglassye Insurance Company Igor Zhuk and first deputy of CEO of Rosgosstrakh – Dmitry Makarov.<sup>61</sup>

## **Business opportunities in targeting Russian insurance pools**

This brief overview of the largest Russian insurance pools illustrates a trend for increasing risk concentration in the industry segments with high and not standard risks. Taking into account that the amount of premiums gathered by mentioned pools significantly increases every year we consider targeting insurance pools as one of the major business opportunities for BMS H&D. Currently considered legislation about introduction of mandatory insurance of hazardous industrial objects and terrorist risks, subject to its approval, is going to increase the demand for tailor made reinsurance solutions and industry-specific coverage.

We believe that the management companies of these pools could be interested in BMS H&D's services as the very nature of the risks they transfer to the international markets is very specific and complicated. BMS H&D having expertise in the London market and good working relationships with Lloyd's Syndicates could provide optimal solutions to Russian insurance pools.

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<sup>60</sup> Pool treaty. Ministry of Agriculture. Retrieved on 25 July 2006, from [[http://fagps.ru/fagps\\_pul.htm](http://fagps.ru/fagps_pul.htm)].

<sup>61</sup> Russian agricultural pool had a meeting of the supervisory board. 26 August 2005. Moscow. Retrieved on 25 July 2006, from [<http://www.allinsurance.ru/biser.nsf/AllDocs/AKNA-6LDCQJ-25-01-06?OpenDocument>].



Appendix 1 supplies contact details of Russian insurance pools' managing companies along with names of the persons who can be approached with further enquiries.

# Outwards Reinsurance

According to industry professionals, Swiss Re has considerably strengthened its presence on Russian market by offering very competitive quotes for 2006 renewal in respect of property excess of loss reinsurance programmes which some even referred to as “dumping prices.» In some instances this led to low-priced upper layers being purchased with no obvious need thus marking a trend to obtain large capacities from excess of loss reinsurance markets (Table 8).

*Table 8: Property Excess of Loss Treaty capacities of selected Russian insurers, 2006*

Company	Capacity, US\$ mln	
	Property	Engineering
Ingosstrakh	150	50
SOGAZ	100	20
ROSNO	75	75
Rosgosstrakh	50	50
AlfaInsurance	50	30
RESO-Garantia	50	50
Renaissance Insurance	50	20
VSK	50	-
Kapital Strakhovaniye	50	50
Progress-Garant	30	15
Soglassye	25	25

*Source: Willis CIS Insurance Broker*

The reinsurance capacities of Russian insurance companies impact the volumes of internationally placed reinsurance.

*“The larger are obligatory reinsurance capacities of Russian players, the smaller is necessity in international reinsurance. A majority of Russian insurance companies don’t need to spend their time and apply efforts placing business internationally, whilst say top 10 domestic insurers have large reinsurance capacities... General trend is that chunk of business is*

*being reinsured through obligatory treaties (of large insurers). In case of risks exceeding automatic capacity, then they would be reinsured directly on international reinsurance market.”*

Russian insurance companies often regard reinsurance as additional revenue stream thus engaging actively in writing inwards reinsurance business. This allowed the culture of reciprocity reinsurance to flourish on the market. A vast majority of companies opt for higher deductibles in respect of their internationally placed programmes, but at the same time arrange a sub-layer for local placement. Not only this is economically beneficial, but also may bring in reciprocity business from its sub-layer reinsurers. For instance, Ingosstrakh’s deductible in respect of its property excess of loss programme is US\$ 5 million, but the company also reinsures US\$ 4 million in excess of US\$ 1 million outside the main programme.

*“A reciprocity reinsurance has a strong presence on the market. Even large companies, who have a world-class reinsurers as leaders, deliberately structure their programmes so as to place certain proportion on the Russian market which allows them to expect reciprocity business. In other words, they can without any problem whatsoever to place the whole programme with two, or even one large international reinsurer, but instead would deliberately contract say 10 Russian companies. For top companies though, reciprocity reinsurance is less typical, but starting from the second top 10 this would be so. “If you give us, we will give you too”, this is being heard everywhere.”*

Another reason for reciprocity reinsurance emerges from low level of proficiency in English language, especially found within smaller and medium size insurers. As one of our interviewees noted, “Many reinsurance departments don’t know English on sufficient level, such weakness exists.” A lack of ability or low confidence in conducting negotiations with non-Russian speaking reinsurers and brokers limits the choice of available reinsurance alternatives and makes these companies to reinsure their risks with the companies they can easily communicate with.

However, a recent loss at Azovstal Iron and Steel Works metallurgical plant in Ukraine uncovered downsides of this market practice. On 23.03.2006 a fire caught one of the plant's blast furnaces. According to optimistic estimations the loss at the US\$ 400 million insured plant might amount to US\$ 50 million comprised of property damage and business interruption. A subject risk entered Russian market by means of two facultative reinsurance arrangements and spread all over the market. For instance, St. Petersburg based insurer Russkiy Mir saw its two inwards obligatory reinsurance treaties, underwritten from Russian insurance market, touched by the loss. As a result, the company estimates its payout in the region of US\$ 0.4 million. A claim quickly spiralled round the market and it became apparent that cumulation risk might sometimes be barely controllable.

*“By and large, Russian reinsurance market exists owing to insurance companies, which practice reciprocity reinsurance. Even though our company doesn't work with Ukrainian market and we haven't underwritten this risk from Ingosstrakh, who happened to bring it to Russian market, we still got this loss reported to us by 5 different sources. This is because Ingosstrakh reinsured this risk with the companies, in outwards reinsurance treaties of which we have participation. Luckily, our retentions there are not high so we will settle the loss with no difficulties. But this is an unpleasant sign.”*

It is believed that an accident at Azovstal Iron and Steel Works metallurgical plant did set a precedent, Russian insurance industry must learn from. Thus, Rosgosstrakh, first among Russian insurers, had reviewed its reinsurance buying strategy and has already placed its property excess of loss reinsurance programme effective as from 01.07.2006 solely on international reinsurance market. This gives a reason to believe that a common practice of placing large facultative risks through treaties' indirect sections will reduce which may lead to a higher demand for international facultative capacity. This trend may also be driven by insurers' sophisticated clients, which realise that quality of insurance cover does not only depend on how financially strong their insurers

are, but also on quality of reinsurance arrangements in respect of risks insured. Thus, such clients demonstrate awareness of the fact that there is a longer chain of risk transfer, and influence a choice of reinsurers to achieve a better protection for their insured assets.

*“In principal, Lloyd’s as a reinsurance market is in demand. Nowadays, not always a price of cover is a major determinant when clients buy insurance. The clients are prepared to spend good money on insurance and to get for it 100% cover, quality security etc. Sometimes they may even make a firm requirement: “I want it to be Lloyd’s and am prepared to pay for it.” Also in respect the state-owned objects, there are good moneys allocated for insurance purposes.”*

# Russian Reinsurance Market

According to the data of the Federal Insurance Supervision Authority, there were 42 reinsurance companies operating on Russian market as at 01.01.2006. Besides, a large number of insurance companies are currently operating in reinsurance business by writing inwards reinsurance, thus providing a strong competition to local reinsurers. We believe that three major factors allow many insurance companies to effectively compete with reinsurers:

1. Reinsurance is often seen by insurance companies as additional revenue stream which allowed the culture of reciprocity reinsurance to develop on the market;
2. Insurance companies involved in writing inwards reinsurance business are by far more capitalised than domestic reinsurers and hence allow higher levels of net retentions (Table 9);
3. For the risks underwritten by way of facultative reinsurance insurance companies make an active use of their reinsurance programmes developed to cover their core insurance business which further enhances their efficiency as of reinsurance providers.

*Table 9: Chartered capital of reinsurers and insurers writing inwards reinsurance business*

Chartered capital of reinsurance companies as at 01.01.2006, US\$ mln		Chartered capital of insurance companies as at 01.01.2006, US\$ mln	
Moscow Re	10.3	Ingosstrakh	86.9
Transsib Re	3.0	SOGAZ	32.5
Russian Re	4.2	ROSNO	37.1
Nakhodka Re	1.4	AlfaInsurance	83.4
Asiatrans Re	2.4	RESO-Garantia	107.7
In total	21.3	In total	347.6

*Above companies have been selected based on the interviews conducted*

*“Largely, reinsurance is being transacted between local insurance companies, followed by international reinsurance market, and only then*

*placed with Russian reinsurance companies which are too few anyway... I mean market-oriented reinsurers.”*

According to estimations of Malakut Insurance Brokers, about 25% of all reinsurance is currently being placed within Russia. At the same time, they believe that increasing financial strength of local reinsurers along with a growth of local reinsurance capacity may lead to a reduction in the share of international reinsurers, since some lines of business can be placed entirely within Russia (Table 10).

*Table 10: Estimated capacity of Russian reinsurance market per line of business, 2006*

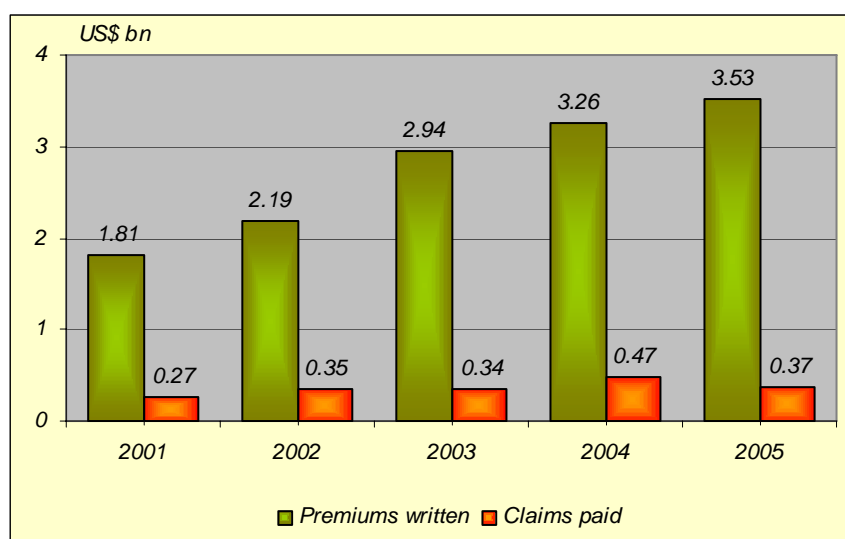
Line of business	Net capacity, US\$ mln	Gross capacity, US\$ mln
Property	20	400
Energy	15	300
Engineering	15	100
Marine Hull	60	120
Cargo	60	90
Aviation Hull	10	35
Aviation Liability	75	150

*Source: Malakut Insurance Brokers*

The net capacity of the market is rather moderate. However, for risks with Russian interest insurance companies may use their outwards reinsurance treaty capacities which enables them to underwrite substantial shares in such risks.

Due to strong economical and cultural ties, Russian reinsurance market has grown in importance and is currently recognised as a major reinsurance centre for CIS countries. The volume of Russian reinsurance market has grown considerably over the last five years (Figure 10).

Figure 10: Reinsurance premiums written and claims paid, 2001-2005



Source: Malakut Insurance Brokers

In 2005 the share of premiums, written by reinsurance companies, amounted to US\$ 1.1 billion (or 31.1%) of all reinsurance premiums written, whereas US\$ 2.43 billion (or 68.9%) constituted an input of the insurance industry. This again illustrates an important role of insurance companies in serving the market as reinsurers. Regarding geographical split of reinsurance premiums written in 2005, US\$ 3.34 billion (or 94.7%) of premiums originated from Russia and US\$ 0.19 billion (or 5.3%) from overseas. It may be suggested therefore that Russian reinsurance industry remains self-focused, lacks geographical diversification and international profile, and as such is highly vulnerable to changes in a national insurance marketplace.

Russian reinsurance companies suffer from low capitalisation and without additional capital injection it is getting difficult as never before to keep pace with a rapidly growing insurance industry. They are often unable to provide a sufficient capacity and thus efficient reinsurance solutions. In effect, scarcity of capital makes many reinsurers to operate as an intermediary pooling their underwritten risks and reinsuring these risks under their own reinsurance programmes, thus ceding significant proportions of collected premiums (Table 11).



*Table 11: Reinsurance premiums written vs. premiums retained, 2004*

Reinsurance company	Premiums written, US\$ mln	Premiums retained, US\$ mln	% of premiums retroceded
Moscow Re	27.61	27.02	2.14%
Transsib Re	39.68	12.68	68.05%
Russian Re	18.14	6.55	63.90%
Nakhodka Re	12.75	4.19	67.11%
Asiatrans Re	6.31	2.56	59.46%

*Above reinsurance companies have been selected based on the interviews conducted*

A notion of patriotism, which is strongly established on the market, complements reciprocity reinsurance allowing Russian reinsurers to rely upon a long-standing support of national insurance market.

As is a case with direct insurance premiums, it is rather difficult to rely on the volume of reinsurance premiums written or some other available criterion derived from official statistics when selecting a sample for comparison and/or analysing data. This is because such reliance can be potentially misleading and might not represent a true picture of the market. For instance, such companies as Nadezhda Re and Universal Re ranked on the top of the list in 2004 as far as premiums written are concerned. However, both companies saw their reinsurance licenses withdrawn in June 2005. In addition, although such companies as Kapital Re, Megaruss Re, RESO-Re, Rosstrakh Re and many others do serve a whole market, they are either spin-offs of their parent companies' inwards reinsurance operations or are products of other restructuring activities within the group. Hence their major clients often are other insurance companies affiliated with a parent organisation.

*“Some owners of insurance companies have kind of obsession to create so-called groups. It gives them a sense of greatness: they have general insurance company, create life insurer, medical insurer and whatever else, plus create reinsurance company. But the point is that such reinsurers are destined to reinsure predominantly captive business, although they are also trying to get whatever is possible from an open market. All these captive reinsurers have a task to increase a share they write from the*

*open market. But of course they don't receive qualitative and attractive offers. Hence, quite serious antiselection problem exists for all reinsurers, which let's say are not market leaders, and it is very difficult for them to get transformed from being a captive reinsurer to being a market-oriented reinsurer... And at the end of the day, everyone understands that such a company is, by and large, a direct competitor. That is why no one will reinsure some decent substantial project in say RESO-Re, ROSNO-Centre, Kapital Re or anywhere alike."*

There are some developments on the market that are worth mentioning. Moscow Re, named by Reactions as a "Best local reinsurer" in 2006, has announced in July that Mr. Gunter Geisler, who in the past served Swiss Re and most recently Partner Re, has been appointed as Chairman of the Board of the company. He replaced in this capacity Mr. Grigory Fidelman, one of the founders and visionary leaders of Moscow Re who resigned prior to Mr. Gunter Geisler's appointment. It is expected that during next AGM Mr. Gunter Geisler's would also be elected as CEO of the company. Many observers believe that this highlights a sea change, which Russian reinsurance industry is undergoing.

Mr. Grigory Fidelman can still realise his vision of creating an internationally recognised Russian reinsurer by heading a new venture – Unity Re, the company, which will be established on the base of existing RESO-Re. The far-reaching goals suggest that a new company will increase its chartered capital from current US\$ 10 million to US\$ 100 million within 3-5 years, with an ambition to become one of the world's largest reinsurance companies. Although there is a fair amount of scepticism as to whether declared targets would be at all achievable, this episode illustrates dynamics and pace of Russian reinsurance market development.

It is expected that at the end of 2006 there will be about 30 reinsurance companies left on the market. For instance, since the beginning of 2006 Federal Insurance Supervision Authority already withdrew reinsurance licenses from at least six reinsurers and licenses of at least seven reinsurance companies have been suspended. Not only it is a result of changing requirements in respect of a

minimum chartered capital for reinsurance companies, but also of a more rigorous approach towards investigation of tax evasion schemes, which are being used in reinsurance. Thus, according to estimations of Moscow Re, in 2004 the volume of pseudo-reinsurance on the market amounted to US\$ 1.7-1.8 billion (or about 50% of all reinsurance premiums). Whereas Expert RA, Moscow based rating agency, suggested that in 2004 the pseudo-reinsurance accounted for as much as 70% of all reinsurance premiums. However, a general trend towards greater transparency and removal of tax evasion schemes is evident in reinsurance business too.

We believe that decrease in a number of insurance companies represents one of the major challenges to local reinsurers: the wave of mergers and acquisitions in insurance industry, insolvencies and run-offs wipe off many business opportunities. As insurance companies grow, their retentions also increase and reinsurance requirements get more demanding. A failure to serve the market adequately may lead to reinsurance companies falling behind rapidly developing insurance industry.

*“Yes, retentions increase, but... I don’t see any problem. Russian insurance companies are relatively small anyway. Well, large insurers increase their reinsurance capacities every year, and at present having a capacity of US\$ 100 million is normal. But, firstly, we participate in these programmes. Secondly, there are lots of projects valued at US\$ 500 million which need to be reinsured on a facultative basis anyway. And speaking about oil and gas industry, say in respect of Yukos plants deductible alone is US\$ 20 million. Values insured are massive and there will be enough for everyone. Yet again, net retentions are not big anyway. I don’t speak about such companies as Ingosstrakh or ROSNO. Well, net retention was US\$ 100 thousand, has become US\$ 200 thousand. Not a big difference... Even Ingosstrakh and ROSNO don’t have high retentions... OK, US\$ 500 thousand... Well, US\$ 1 million.”*

In a foreseeable future reinsurance companies will continue purchasing retrocession cover, as this is a vital facility, which enables them to serve local

insurance market somewhat adequately. In our opinion, this segment does represent business opportunities for BMS H&D and hence approaching Russian reinsurance companies on a selective basis is worth considering.

# Reinsurance Brokers in Russia

## Competitive Environment

By and large, insurance and reinsurance brokers in Russia may be split into three major groups of companies: international brokers, well established Russian brokers and small local brokers.

Presently, there are about 1,500 insurance and reinsurance brokers in the State registry of brokers. However, industry professionals estimate that only about 200 of them operate on the market with majority of them being involved in direct motor insurance market.<sup>62</sup> This is due to the fact that most of them appeared after the financial crisis in 1998, when many people lost their jobs and registered insurance and reinsurance brokers, which still are not subject to the supervisory regulation.<sup>63</sup> Some companies have already terminated their operations, but since no respective notification has been rendered, their names still appear in the State registry of brokers thus distorting official statistics. Others, especially individual broker firms, in fact act as insurance agents rather than brokers which also makes it difficult to estimate a number of active insurance and reinsurance brokers operating on Russian market.

There are positive signs emerging from FISA's initiatives. According to them until 01.07.2007 all brokers are required to obtain a license.<sup>64</sup> They will also be required to report about their activity to FISA on a regular basis. It is believed that these developments will enable to attain a much clearer picture in respect of insurance and reinsurance brokers' market, and will lead to market consolidation and greater transparency.

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<sup>62</sup> Kadushin A, Insurance brokers will tell about themselves. Business. 26 June 2006. Retrieved on 25 July 2006, from [[http://www.b-online.ru/articles/a\\_16440.shtml](http://www.b-online.ru/articles/a_16440.shtml)].

<sup>63</sup> L. Jurchenko. Problems and Developments of Insurance Brokerage in Russia. Jurchenko L. A. Real Estate and Investment. Legal Regulation. No. 3-4. December 2003. Retrieved on 25 July 2006, from [[http://www.b-online.ru/articles/a\\_16440.shtml](http://www.b-online.ru/articles/a_16440.shtml)].

<sup>64</sup> Kadushin A, Insurance brokers will tell about themselves. Business. 26 June 2006. Retrieved on 28 August 2006 from [[http://www.b-online.ru/articles/a\\_16440.shtml](http://www.b-online.ru/articles/a_16440.shtml)].

## International brokers

International brokers through their Russian offices may represent a major source of competition to BMS H&D. All “Big Three”, i.e. Aon, Marsh and Willis, operate on Russian insurance market since 1990s. Although their major focus lies within serving clients on the direct insurance side, they do place outwards reinsurance for Russian companies. Moreover, taking advantage of growing market they may expand their reinsurance operations. For instance, one of “Big Three” brokers plans to establish a separate unit, which would serve reinsurance needs of Russian cedents.

Apart of “Big Three”, there are other international reinsurance brokers, BMS H&D will have to compete with. In 2005 the Russian office of RFIB Group opened its doors and in 2006 Colemont Insurance Brokers set up representative offices in Moscow and Samara.

Mr. Surinder Beerh, a Chief Executive Officer of Colemont’s global operations, explains the decision of entering Russian market in the following way: “The entire region represents an area where we expect a significant amount of growth and a tremendous amount of opportunity.»<sup>65</sup> CIS region is now seen by the global players as an essential and growing part of international market. “Our new operations in Moscow and Samara will undoubtedly prove to be cornerstones of our ongoing expansion around the world”, comments Mr. Beerh.

Colemont has already started to target small and medium size insurance companies offering them to join a motor casco reinsurance facility, whereby insurers would pool their motor casco portfolios and Colemont, as a managing company, would arrange a reinsurance of pooled risks.

Oakeshott Insurance Consultants is yet another international insurance and reinsurance broker with a strong presence on CIS markets. Registered in UK,

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<sup>65</sup> Colemont Opens Operations in Moscow, Samara. July 12, 2006. Retrieved on 20 August 2006 from [<http://www.colemont.com/LinkClick.aspx?link=http%3A%2F%2Fwww.colemont.com%2FDefault.aspx%3Ftabid%3D984&tabid=468&mid=1532>].

the company has its offices in London, Moscow and Kiev and benefits from an in-depth knowledge of Russian market.

Société de Courtage Re, Cooper Gay and others have their offices in Russia. On the other hand, some international brokers choose the strategy, similar to that BMS H&D opts for, and develop Russian business from their non-CIS locations by visiting the market, establishing contacts, attaining a better understanding of the market with attempt to seize emerging business opportunities.

### **Well established Russian brokers**

There is a number of well established local insurance brokers with an excellent market knowledge and earned reputation for first-class services.

A major player, which provides a strongest competition to “Big Three” and other international brokers, is Malakut Insurance Brokers. In 2006 the company has been named as “Best local reinsurance broker” by Reactions, a renowned magazine for reinsurance industry. Although historically a bulk of Malakut’s revenue is derived from aviation business, the company is very active in other classes as well. Headquartered in Moscow, Malakut Insurance Brokers has offices in Ukraine, Kazakhstan and Azerbaijan with overall about 65 people in staff. The company is being hold in high regard by Russian and CIS insurance markets.

North Atlantic Reinsurance Services has a different approach. It specialises in big projects with high values insured, and hence sizeable brokerage. It is involved in placing reinsurance for such projects as offshore oil rig construction, construction works in respect of Moscow-City (a tallest office building in Europe to be commissioned in 2008), ring road of St. Petersburg (construction project with an estimated project value over US\$ 1 billion). North Atlantic Reinsurance Services also provides direct insurance broking, consultancy and risk management services, and is a managing company for Russian Anti-Terrorist Insurance Pool.

There are other companies, such as RIFAMS or AFM Insurance Consultants and Brokers, which actively work on Russian insurance market by providing not only direct insurance services, but also offering reinsurance placement capabilities.

### **Small local brokers**

The competition emerging from this group of brokers is likely to be very weak, if any. This is because they are either involved on the direct insurance side serving particular region and have very little or no connection with reinsurance, let alone on international scale, or have been established to perform particular transactions, usually associated with tax evasion schemes. Although this group of insurance brokers is arguably the largest, it is believed that many of them will leave the market as a result of FISA's regulatory initiatives.

Apparently, BMS H&D needs to be prepared for a strong competition from existing players. As one of our interviewees put it, "We, as a reinsurance broker, don't carry a risk, we are an intermediary. Hence, we must offer our services in such a way so as to differentiate. There are quite a few good reinsurance brokers, competition is keen." It should be explicitly mentioned that all reinsurance brokers, including "Big Three", do account for specifics of Russian insurance market by placing some of their reinsurance business locally.

### **Reasons for contracting the broker**

Conducting a background research, and more importantly during the interviews, we tried to identify what are major reasons making Russian cedents to place risks through reinsurance brokers and what they are aiming to achieve by contracting a reinsurance brokers. Although some of them are very generic, our findings can be briefly summarised as follows:



## **Prestige**

According to one of our interviewees, “Many well-known insurance companies contract reinsurance brokers for placement of their obligatory programmes. It is considered to be a question of prestige, a modern fashion.” Indeed, often co-operation with highly regarded reinsurance brokers is presented as insurers’ additional strength, which allows them to compete more effectively for sophisticated clients. There is an opinion that placing reinsurance programmes through reinsurance brokers, which have powerful brand (typically, one of the “Big Three”), also increases perceived reputation of insurer and lifts its status within insurance community.

## **Access to alternative markets**

It is believed that some insurance companies seek originality and innovation, and this trend is increasing. Conventional reinsurance markets has a long-lasting presence in Russia, whereas access to alternative reinsurance markets is rather limited. Increasing activity of Russian insurance companies on international arena prompted their interest towards alternative reinsurance markets. As one of interviewees commented, “Many reinsurance professionals, who know traditional reinsurance markets very well, approach reinsurance brokers in respect of large facultative placements with a request to find for their risks alternative reinsurance markets. They are ready to consider other alternatives, e.g. to look at Asian, Bermudan or other reinsurance markets which are not that well-known in Russia.” We believe that this interest was also fuelled by such companies as Malakut Insurance Brokers, who acquire international business and reinsure it on Russian market, thus creating reverse interest from Russian insurers.

## **Time constrains**

Sometimes insurance companies contract reinsurance brokers with no reason, other than time constrains. There are occasions when reinsurance departments are under tight deadlines and heavy workloads or temporarily lacking staff.

Although In such situations reinsurance broker may get a placement order, it is likely to be seen as a last resort rather than thoughtfully chosen partner.

### **Complex and unusual risks**

Not always insurance companies have immediate access to reinsurance markets, which underwrite insurers' complex or unusual risks. Hence, one of the reasons for contracting reinsurance brokers is their capability to provide tailored solutions for complex risks as well as to place unusual risks, which stand out from what is regularly being handled by reinsurance departments' own staff.

### **Better contacts**

It has been recognised that reinsurance brokers normally have a wider network of well-established contacts across different reinsurance markets. They may also have a better understanding in respect of risk appetite and risk preferences of different reinsurers. Hence, reinsurance brokers may enjoy a stronger negotiation power which makes them better positioned to achieve more efficient solution than their clients would have achieved on their own.

# SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Internationally recognised brand</li> <li>• Excellent reputation</li> <li>• Long-established strong connections with the London market</li> <li>• Ability to place complex risks and offer tailored solutions</li> <li>• Vast experience in arranging and placing MTPL reinsurance programmes</li> <li>• Experience in serving CEE insurance markets</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of continual commitment to Russian insurance market</li> <li>• Lack of dedicated staff serving Russian clients</li> <li>• Lack of information about the company and marketing materials in Russian language</li> <li>• Loose relationships with Russian market and industry professionals</li> <li>• Relatively low awareness of BMS H&amp;D and its services on Russian insurance market</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>• To offer personal accident reinsurance via binding authority with London market</li> <li>• To capitalise on experience gained in MTPL reinsurance by relating this knowledge to Russian market</li> <li>• To offer retrocession covers to Russian reinsurers</li> <li>• To offer reinsurance solutions to the managing companies of Russian insurance pools, in particular in respect of those risks that require specialised reinsurance markets (often Lloyd's), for instance terrorism or nuclear energy risks</li> <li>• To take advantage of growing property and motor casco insurance markets by offering appropriate reinsurance covers</li> <li>• To provide access to alternative reinsurance markets, for instance Bermudan or Asian, which attract increasing attention of Russian cedents</li> </ul>	<ul style="list-style-type: none"> <li>• Reputation risks in case of client's involvement in tax evasion transactions or in other doubtful practices</li> <li>• Political and country risks</li> <li>• Russia's dependence on natural resources prices and subsequently on the international commodity markets</li> <li>• Strong competition</li> <li>• Underdeveloped market culture of buying reinsurance through the broker</li> </ul>

# Recommendations

It is clear that in a modern era of dynamic customer-focused environment business success of any service sector company largely depends on organisation's ability to build strong relationships with its customers. In reinsurance industry, which is often referred to as people's business, and in particular within a context of reinsurance broker's business activity, this concept is of a vital importance.

Although there is a number of areas with potential business opportunities for BMS H&D, it is self-explanatory that achieving a factual reinsurance transaction is not a straightforward process. It requires establishing and enhancing client relationships, which are both a lifeblood of reinsurance broker's business and a source of sustainable competitive advantage. For this reason, we strongly believe that striving to build up such relationships with Russian cedents that would be valued by both reinsurance broker and the client, should be a fundamental goal of BMS H&D. Naturally, this requires significant amount of time, effort and above all, commitment.

BMS H&D may wish to consider particular recommendations, which have been identified within the framework of this report. We believe that specific steps, discussed below, would greatly assist the company in building sustainable relationships with Russian clients, thus creating a firm ground for business development on Russian insurance market.

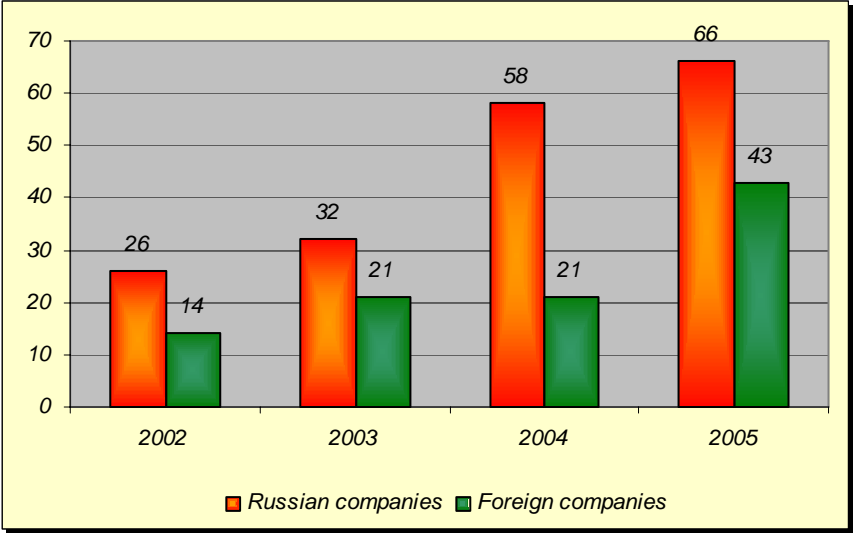
## Participation in November Business Meetings

Since 2002 Moscow hosts November Business Meetings of reinsurance professionals. An annual event, which is organised under a patronage of The Reinsurance Committee of All-Russian Insurance Association, is a Russian analogue of traditional Baden-Baden Reinsurance Meeting. The concept of November Business Meetings is that similar to gathering in Baden-Baden,

whereby participants schedule their appointments in advance by contacting companies they would like to meet with and agreeing on a particular time of the meeting. The event serves as a logical continuation of meetings in Monte-Carlo and Baden-Baden by providing buyers of reinsurance with the opportunity to discuss their reinsurance needs with the sellers and/or intermediaries before renewals season gets on its peak.

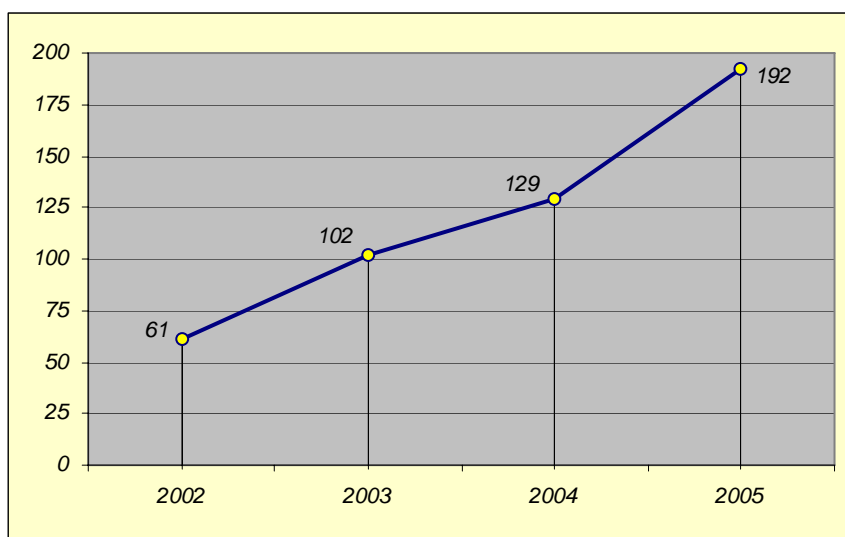
Since its first edition in 2002 the event has significantly gained in popularity and has seen a considerable increase in a number of registered participants from both Russia and abroad (Figure 11, Figure 12).

*Figure 11: Number of companies participating in November Business Meetings*



*Source: Ingosstrakh Insurance Company*

*Figure 12: Number of registered participants of November Business Meetings*



*Source: Ingosstrakh Insurance Company*

Number of countries represented has increased from 9 in 2002 to 18 in 2005 which confirms a growing interest towards Russian insurance market. Apart of Russian companies, 2005 November Business Meetings have attended companies from Kazakhstan, Ukraine, Belarus, Moldova, Azerbaijan, Armenia, Estonia, Latvia, Poland, Bulgaria, Slovenia, Czech Republic, Germany, France, Switzerland, UK, Korea and Bahrain.

Before the start of bilateral meetings there is an opening plenary session, which addresses latest developments on the reinsurance market from the perspective of selected industry professionals.

In 2006 the November Business Meetings will take place on 20-22 November at the President Hotel, Moscow. Unlike gathering in Baden-Baden, the participation in November Business Meetings is not free of charge and in 2006 will cost RUB 9,250 (EUR 270) per person. There is a range of advertisement options provided by conference organisers for additional fee. For instance, it is possible to include company's advertisement materials in the conference information packs which are distributed to delegates on registration, to place a company's poster in the meeting hall, to be presented as a partner of the conference, etc. It is also possible on the plenary session to give a brief presentation of the company, its products and services to all the delegates. Although giving a

presentation might seem to be a quick and simple way of company introduction to the market, we would not recommend using this opportunity in the first year of attendance. Given a popularity of reciprocity reinsurance and high level of sensitivity in respect of protection of national insurance market, we believe that some might consider this step as yet another attempt of foreign company to take advantage of the fast growing Russian insurance market and hence, might adopt defensive stance. Alternatively, we would suggest that a presentation of BMS H&D could be arranged during the second or third year of attendance, when certain degree of recognition is achieved, initial contacts are made and commitment to serve the market in the long-term is demonstrated. In the meantime, we consider that some of the less catchy advertisement options are worth looking at in more details depending on the budget available.

In general, we strongly believe that participation in November Business Meetings in Moscow would provide BMS H&D with an excellent platform, on which the company can start to build the network of Russian contacts, rise its profile on Russian insurance market and indeed, receive business offers. We think that it is the event, which is not to be missed by the company willing to grow its book of Russian business. Besides, participation in this event would allow to target not only Russian companies, but also wider CIS region as well as CEE.

## **Attendance of All-Russian Reinsurance Conference**

The All-Russian Reinsurance Conference is a widely recognised annual event, which draws increasing number of participants every year. Held in March the conference saw its 10th edition in 2006, when it has been attended by 434 delegates from 18 countries. Among 184 companies, which attended the two-day event in March 2006, there were 152 insurers, 22 reinsurers, and 10 re-insurance brokers.

The conference largely focuses on Russian re-insurance industry and represents an exceptional opportunity to get acquainted with the market, to learn about

latest trends and developments. It also is an excellent venue for networking and making contacts with market players in both formal and informal settings.

In 2006, participation in All-Russian Reinsurance Conference had cost RUB 18,600 (EUR 544) per person with a range of advertisement options available for additional fee. The conference organisers have been very selective in respect of inviting guest speakers and choosing topics to be covered during the conference. For example, among others, 2006 conference covered such issues as:

- Results of 2006 renewals and the share of reinsurance brokers;
- Dumping in reinsurance;
- The objective and role of ratings;
- Insurance and reinsurance pools: experience, analysis and perspectives;
- Investments in reinsurance;
- Globalisation and Russian reinsurance market's competitiveness problems;
- Russian reinsurance market as an element of global market.

We believe that a good manoeuvre for BMS H&D would be finding an area, which is of interest to the market, and giving a presentation. Such a presentation, for example, could be drawn around specific skills and competences of BMS H&D so as to send a clear message to the market in respect of company's key expertise and its position on the market. For example, experience and knowledge gained by BMS H&D reinsuring MTPL business in various CEE countries might constitute an interesting and important subject for Russian insurance market.

We think that attending All-Russian Reinsurance Conference is a good opportunity of signalling the market about a genuine interest towards Russian insurance industry on the part of BMS H&D as well as demonstrating company's openness to the market. It is also important for achieving an acceptable level of recognition and getting a feel for the market which is hardly possible without sufficient amount of communication with market players.



## Marketing Information in Russian Language

Taking into account a degree of sensitivity in respect of protection of national insurance market, notion of patriotism, culture of reciprocity reinsurance and other specific characteristics of Russian insurance market, we believe that having marketing information in Russian language would greatly assist BMS H&D in acquiring Russian reinsurance business. Producing and distributing marketing information in Russian language may have the following effect:

- Declaration of commitment – it would emphasise a commitment of BMS H&D to serve Russian insurance market in the long-term, rather than taking a short-term advantage of the fast growing market;
- Bridging a gap with competitors – If not all, then a vast majority of international brokers, who have their Russian offices, do produce a fair amount of marketing and analytical information in Russian language; doing the same (but better) would create an effect of presence, allow simple comparison to be made with other international brokers, and would neutralise one of their competitive advantages;
- Targeting wider market – given a relatively low level of proficiency in English, this would allow to deliver key facts on BMS H&D and its services to a wider market, thus increasing company recognition and market reach.

In view of above reasons, we believe that marketing information in Russian language is highly desirable. It would not only assist BMS H&D to attract new clients incurring minimal costs, but would also significantly raise company's profile on Russian insurance market.

# Conclusion

Based on the analysis of interviews with a number of Russian insurance sector companies, information gathered from the variety of sources as well as relying on our own experience working with Russian and international insurance markets, the following conclusions can be drawn.

Relatively stable political situation, improving insurance regulation, greater availability of financial services products to wider clusters of Russian population, steady economical growth as well as other factors lay a solid foundation for a promising future growth of Russian insurance industry.

Notwithstanding such problems as low market capitalisation, difficulties in meeting solvency requirements, widespread use of tax evasion schemes and others, there are major changes signifying notable improvements in these areas which makes Russian insurance market to be less biased.

Due to positive developments on Russian insurance sector and its great potential an increasing number of international insurance, reinsurance and reinsurance broking companies focus their expansion strategies on Russian market as on one of the regions, which possess a tremendous amount of opportunity.

In view of BMS H&D's general strategy to increase the amount of business the company transacts with Russian insurance sector, we identified a number of opportunities for potential business development on Russian insurance market. These opportunities include the following:

- Retrocession covers for Russian reinsurers;
- Reinsurance solutions for managing companies of insurance pools;
- Taking advantage of growing property and motor casco insurance segments;
- Providing access to alternative reinsurance markets;

- Personal accident reinsurance via binding authority with London market;
- MTPL reinsurance programmes.

However, it should be recognised that attaining a particular reinsurance transaction requires establishing and nurturing relationships with prospective clients. To gain a sustainable competitive advantage BMS H&D should aim at establishing such relationships, which would go beyond purely economic bonds and be highly valued by both parties. Obviously, this is not an easy process and requires significant amount of time and effort. To facilitate communication with Russian insurance market BMS H&D may consider taking such steps as participation in November Business Meetings, attendance of All-Russian Reinsurance Conference or producing marketing information in Russian language.

To maximise business acquisition opportunities, it is essential to demonstrate continuous commitment to Russian insurance market, develop relationships with market players and build recognition of the company and its services.

In general, we believe that the time is now ripe for BMS H&D to embark upon more active business strategy on Russian insurance market. We trust that opting for business opportunities identified in this report and pursuing some or all of our recommendations will greatly improve chances of successful business development in Russia.

# Appendices

## Appendix 1: Managing companies of Russian insurance pools

### Russian Anti-Terrorist Insurance Pool

North Atlantic Reinsurance Services Ltd. Representative Office

Address: 27 st. 4, Malaya Nikitskaya Ul, 3rd Floor, 121069 Moscow, Russia

Phone: +7 (095) 291-6225

Fax: +7 (095) 291-6296

Mr. Igor Prandetsky

Head of Representative Office

email: prandetsky@nars.ca

### Russian Nuclear Insurance Pool

MAKS Insurance Company

Address: Korp. 1, building 78, Kashirskoe Shosse, Moscow 115409, Russia

Phone: +7 (495) 540-11-01

Fax: +7 (495) 951-19-01

E-mail: dis@makc.ru

URL: www.makc.ru

Ms. Natalia Martjanova

### Russian P&I Pool

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Head of the Moscow Office

### **Russian Pool for Hazardous Objects**

Management company for Russian Pool for Hazardous Objects is currently being selected by the means of tender.

### **Russian Agricultural Pool**

Russian Agricultural Pool is managed by the Supervisory board, where represented all of the companies participating in the pool.

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The Chairman of the Supervisory board of RAP and CEO of Soglassye Insurance  
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