



International Association for the  
Study of Insurance Economics

# Études et Dossiers

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Layout & Distribution: Valéria Kozakova

# Barriers to Global Insurance Business Operations: The position in Brazil, China, India, Mexico and Russia

Julian Arkell

## Foreword

- Facts based research paper commissioned by the Geneva Association – non-technical
- Entry of foreign insurance companies into large emerging economies – particular focus on situation in Brazil, China, India, Mexico and Russia
- Not devised as an advocacy piece or a lobbying platform
- Expected audience includes:
  - Companies in the insurance sector
  - Trade officials in capitals and Geneva
  - Insurance regulatory and supervisory authorities
  - Firms in other sectors; institutions; & researchers

## Exponentially more Ignorant !

As the Mexican author and critic, Gabriel Zaid is quoted as saying in 'So Many Books':

**“Books are published at such a rate that they make us exponentially more ignorant.”**

At times the present author has felt progressively more ignorant as he was being swamped by the flood of material and the feeling that the resulting selection might be seen as arbitrary, shedding light on certain features of the scene, yet leaving other notable aspects aside.

## Shape of the Report

- Chapter 1: Overview of global insurance commercial operations
- Chapter 2: Overview of global insurance regulation
- Chapter 3: Overview of international trade issues
- Chapter 4: Overview of the position in
  - Brazil**
  - China**
  - India**
  - Mexico**
  - Russia**
- Chapter 5: Conclusions and future trends
- Annexes: extracts from official documents

## Some statistics

|                          | B    | C   | I   | M    | R    |
|--------------------------|------|-----|-----|------|------|
| • Area Mn sq km          | 9    | 10  | 3   | 2    | 17   |
| • Population Bn          | 0.18 | 1.3 | 1.1 | 0.11 | 0.14 |
| • Services % GDP         | 52   | 40  | 54  | 70   | 58   |
| • Poverty % in pop'n     | 22   | 10  | 25  | 40   | 18   |
| • GINI index income d'n  | 54   | 44  | 33  | 55   | 40   |
| • Premiums \$Bn '03      | 15   | 47  | 17  | 11   | 14   |
| • Foreign share life %   | 32   | 2   | 0   | 75   | 5 -  |
| • Foreign share non-life | 43   | 1   | 0   | 58   | 15   |

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## Insurance as Risk Transfer

- Hedge again omnipresent uncertainty
- Unique service role: cash paid at outset – and recompense only if cover event occurs
- Legal precepts
  - Utmost good faith
  - Contractual relationship
  - Insurable interest
  - No bargaining power – resolve in insured's favour
  - Make good loss, no profit
- No speculative gain, unlike gambling
- Moral hazard needs to be controlled

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## Insurance policies and companies

- Long-term
  - Basic life cover (regular, single premium)
  - Permanent Health cover, total permanent disability, annuities
- General: very wide range of risks can be covered
  - Motor, property, accident, health, MAT, pecuniary loss, liability, travel, political risk, terrorism
- Company types
  - Life insurance companies: life, annuities, pensions
  - General: all other primary insurance products
  - Reinsurance companies: they insure the first two
  - Captive companies: of groups and associations

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## Insurance sector elements

- Distribution
  - Direct sales by the companies own staff, tele and internet sales
  - Tied agents acting as intermediaries
  - Independent financial advisers, brokers, banks, building societies
- Actuaries
- Rating agencies
- Auxiliary services
  - Loss adjusters, risk management, legal, financial etc
- Fund management services
- State-owned entities
- Privatisation of SOEs
- Compulsory insurance
- Investment flows

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## Factors affecting insurance - 1

- New technology and increasing globalisation
  - Global clients
  - Emergence of similar risks around the globe
- Global and national business conditions
  - Concentration and transnational companies
- Incursion of other players competing with insurers
- Tighter integration of world financial markets
- Performance of financial markets
- Vulnerability of inter-connected systems
- Climate change and catastrophic risks
- Fluctuations in interest and exchange rates, inflation
- Changes in tax; and other legislation affecting insurers

## Factors affecting insurance - 2

- Mortality and morbidity rates
- Declining birth rates and ageing populations
- Low consumer confidence in, or understanding of, financial services
- Policy renewal and lapse rates
  
- Policies and actions of regulatory authorities
  - Regulation goes international
- Closer cooperation in supra-national bodies
- Changes in capital, solvency and accounting standards

## Needs of the insurance sector

- International institutions and partners to enhance global trends – regulation management
- New risk identification and management techniques to confront complex and mutually inter-dependent risks worldwide
- More strength to International Association of Insurance Supervisors (IAIS)
- Closer coordination of insurance regulators with those of banks and securities markets
- Clarification of risks covered by governments

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## Solvency II in the EU

- Solvency II regime may have a major impact outside Europe over time – even in the US and Japan
  - **Assets mainly at market / fair values**
  - **Liabilities likely to be at market-consistent values**
  - **Income statements unlikely to be on full fair value basis**
  - **Unrealised gains and losses (real and accounting 'noise') likely to be in a new Comprehensive Income Statement**
  - **The only risk-based capital system in insurance consistent with the Basel II framework for banks**
- The Basel Committee of Central Bank Governors, and the Ministers of Finance of the G10 seek standardised regulatory architecture globally, and across the financial services sectors

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## Global Insurance Regulation

- International Monetary Fund (IMF)
- World Bank
- Basel Committee of Banking Supervisors (BCBS)
- International Organisation of Securities Commissions (IOSCO)
- International Association of Insurance Supervisors (IAIS)
- Organisation for Economic Co-operation and Development (OECD)
- European Commission

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## IMF

- Reports on Observance of Standards and Codes (ROSCs)
- Financial Transparency Policies
- Financial Action Task Force (FATF)
- Financial Sector Assessment Programme (jointly with World Bank)
- Financial Sector Stability Assessment

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## World Bank

- Financial Sector Reform and Strengthening – technical assistance
- 1988: Multilateral Investment Guarantee Agency – coinsurance and reinsurance
- Coherence with policies of:
  - IMF
  - World Trade Organisation

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## Basel Committee of Banking Supervisors

of the Bank of International Settlements

- Representatives of central banks and prudential supervisors of 13 countries
  - Accord Implementation Group – Basel II
  - Policy Development Group
  - Accounting Task Force
  - International Liaison Group
  - Committee on the Global Financial System
- Joint Forum – with IOSCO and IAIS
- Financial Stability Institute - training

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## International Association of Insurance Supervisors

- Formed 1994: now supervisors from 130 countries are members (accounting for 97% of world insurance premiums); 100 observers
- Aims:
  - Improve supervision at national and international levels
  - Promote the development of well-regarded insurance markets
  - Contribute to financial stability
- 1997: issue 'Insurance Supervisory Principles'
- 15 regional seminars each year to foster implementation of core principles and standards

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## Work on insurance at OECD

- Insurance Committee set up 35 years ago
  - remit is to work towards liberalisation of establishment, investment and cross-border trade
- Works closely with Committee on Capital Movements and Invisible Transactions (responsible for the OECD Codes of Liberalisation) and the Trade Committee

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## UNCTAD support for insurance

- Aim since 1964 has been to help developing countries establish competitive and well regulated insurance markets
- Assistance is provided to supervisory authorities, training organised, information provided, software for insurers developed
- UNCTAD X in 2000 mandated further analytical and technical assistance
- 2001 workshop for African authorities
- 2005 workshop on trade and regulatory aspects

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## Other bodies

- **CEIOPS of the EU**
  - Committee of European Insurance and Occupational Pensions Supervisors – includes European Economic Area countries
    - ensures consistent implementation of legislation and cooperation across all Member States;
    - active participation in the preparation of advice to the European Commission on Solvency 2
- **International Institute of Finance**
  - Strategic dialogues with insurance regulators
- **International Insurance Society**
- **International Chamber of Commerce – Commission on Finance and Insurance**
  - To break down barriers to international business in financial services and insurance, and to contribute to the elaboration of sound self-regulatory and supervisory frameworks.
  - challenge posed by long-tail liability risks
- **International Accounting Standards Board**
- **International Federation of Accountants**
  - International Accounting Standards

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## International Trade Issues

- World Trade Organisation
- General Agreement on Trade in Services
  - Annex on Financial Services
  - Understanding on Commitments in Financial Services
- OECD: pursuit of trade liberalisation
- UNCTAD: support to insurance regulators
- Free Trade Agreements
  - Regional
  - Bilateral

## GATS

- 2000: start of mandated liberalisation negotiations
- 2001: Doha Development Agenda - included services in 'single undertaking'
- 2005: Hong Kong Ministerial - approved target for further liberalisation of services trade (Annex C)
- Modalities of negotiations:
  - Request and offer process
  - Collective request on financial services
- Recently Acceded Members: high commitments
- Friends of Services – core group of supporters
- Disputes – panels to have necessary sector expertise
- Trade Policy Review Mechanism
  - Regular, transparent, peer review of information

## Regional Free Trade Agreements

- GATS Article V *Economic Integration*: this requires
  - Substantial sectoral coverage and no *a priori* exclusion of any mode of supply
  - Absence or elimination of substantially all discrimination
  - Flexibility for developing countries
- North American Free Trade Agreement
  - Mexico
- MERCOSUR
  - Brazil
- Commonwealth of Independent States
  - Russia
- ASEAN – might China join the AFTA?
- EU Internal Market – might EU regulations impact rules for insurance globally?

## The Position in the BCIMR

- The sub-chapter on each country sets out
  - Market – general background
    - Extracts from the WTO TPRM reports
    - Market access; regulator/regulations; state benefits; distribution; support professions; consumer awareness
  - GATS aspects
    - Specific Commitments currently bound
      - Horizontal commitments
      - Insurance sector commitments[with EU Requests interpolated in each]
    - Analysis of these commitments by FLWG
    - Initial or revised offer in Doha Round

## Brazil - background

- Public spending 39% GDP – 2/3 labour force
  - Ineffective government spending
- Infrastructure investment badly needed
- BoP deficit in financial services
- Official decisions lack transparency and can be arbitrary
- Unfair social security system
- Antiquated labour laws
- Financial institutions in domestic market are diversified, dynamic and competitive
- Dramatic rise in consumer credit

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## Brazil – insurance sector

- Numbers of companies
  - 130 insurers (of which 14 health)
  - 15 selling investment plans
  - 29 open private pension fund societies
  - 360 closed private pension fund societies
  - 78,500 brokers
- Premiums: life 35%, motor 22%, health 26%
  - Foreign enterprises accounted for 33%
- About 3% of GDP - big potential for growth
- No Ombudsman
- Foreign exchange: authorised brokers only, approval required for profit and capital repatriation

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## Brazil: restrictions on foreigners - 1

- Movement of natural persons – only the following permitted entry:
  - Highly qualified professionals and specialised technicians – when no nationals available, and not to account for more than one in three workers
  - Directors and managers – if vacancy, proof of need
  - Definitions of categories not clear
  - Not clear if Business Visitors included
  - Not clear if contractual services covered
  - Delays in obtaining work and residence permits

## Brazil: restrictions on foreigners - 2

- Investment: sole proprietorship and partnership juridical forms not permitted
- Subsidies: no commitment (unbound)
- Insurance services:
  - MAT commitment not in accord with the 'Understanding'
  - Case by case authorisation of establishment – no direct branching permitted
  - State reinsurance monopoly [modified in early 2007]
  - Limited intermediation & auxiliary services permitted
  - No consumption abroad permitted (Mode 2)
  - Prohibitive tax on fees for services rendered abroad
- GATS initial conditional offer – no change to horizontal restrictions, improvement for market access under Mode 3 for insurance on freight and other insurances, but not for intermediaries and auxiliary services

## China - background

- Predominance of state sector monopolies
  - Some are costly economic sink holes
- Services account for 41% of GDP (financial services 17%)
- Exchange rate policy uncertain
  - enormous foreign exchange reserves
- BoP services deficit including on insurance
- Tax incentives for foreign investment ended in 2007
- Limits on ownership of land
- Equity and bond market narrow
  - weak disclosure and accounting standards
- Access to bank credit restricted
- High household savings rate at 17% in 2005
- Population ageing fast – 4 workers per retired person by 2030
- Rising disparity between rural poor and urban incomes

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## China – insurance sector

- 80 institutions provide insurance
  - 26 non-life, 44 life providers (25 foreign)
  - 234 brokers (4 with foreign ownership)
  - 188 representative offices from 18 countries
- Premiums 3 to 4% of GDP – or about \$ 40 per head in 2004
- Foreign firms' market share = 1% of non-life, under 3% of life
- Highly concentrated – five firms have 98% share
- Shortage of actuaries
- Accounting standards low
- Lack of anti-trust law poses risks to foreign firms

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## China: restrictions on foreigners - 1

- Movement of natural persons – only the following permitted entry:
  - Managers, executives and specialists as senior employees of
    - Branches, subsidiaries and representative offices as intra-corporate transferees (up to three years)
    - Foreign invested enterprises (for length of contract, up to three years)
    - Business visitors (for 90 days) (not to create establishment)
  - Definitions of categories not clear
  - Contractual services not covered
  - Delays in obtaining work and residence permits

## China: restrictions on foreigners - 2

- Writing compulsory covers not permitted ie social security scheme, work related injury, motor accident liability
- Life insurance must be in separate firm
- Minimum 50% of reinsurance to be offered to two local reinsurers
- Not all licences are nationwide
- High working capital requirements
- Long delays in issue of branch licences – issued consecutively not concurrently
- Pressure to convert branches to subsidiaries
- Authorisation of cross-border capital transfers

## China: restrictions on foreigners - 3

- Participation cap of 50% in joint ventures
- Associations of underwriters not permitted
- Unclear whether acquired rights at accession still permitted, eg for juridical form and branching
- Branching capitalisation requirements unclear
- Insurance asset management not permitted
- Position of 100% owned insurer unclear as to reinsurance with parent or affiliate
- Insurance law lags on permitted investments
- Pensions: various problems arise for licensed annuity service providers (tax, participation)
- GATS revised offer: includes no further liberalisation

## India - background

- Services 54% of GDP
- Infrastructure investment needed in roads, sea and airports
- Household saving nearly 20% of GDP
- High regulatory impact, poorly administered, needs to be brought nearer to international best practices
- Overburdened legal system
- Banking and insurance sectors dominated by state-owned enterprises: 65% of insurance
- Diaspora remittances in FY06: \$24 Bn

## India – insurance sector

- Numbers of companies
  - 1 state-owned life (LIC), 9 private life insurers
  - 1 state-owned general (GIC), 7 private general insurers
  - 1 state-owned reinsurer (GIC)
  - 230 brokers
- Life insurance premiums 3% GDP in 2005
  - 57% of life funds invested in government securities
- Premiums averaged \$ 23 per head in 2005
- Motor premiums 43% of total
- Catastrophic risks under-insured at 15% of value
- One bank has 28 m customers, 2,000 branches – total bank branches about 66,000, competitor distribution
- Foreign exchange: authorised brokers only, approval required for profit and capital repatriation
- Fatalistic attitude – Karmic sins revisited, accidents will happen

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## India: restrictions on foreigners - 1

- Movement of natural persons – only the following permitted entry:
  - Managers, executives and specialists transferred to a branch or representative office, and
  - Professional employees to render services under a contract (ie self-employed not covered)
  - Business visitors (for 90 days)
  - Definitions of categories not clear
  - Repatriation of earnings not permitted
  - Delays in obtaining work and residence permits
- Establishment only on basis of reciprocity

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## India: restrictions on foreigners - 2

- Equity cap of 26% on insurance ownership – higher holdings may have to be reduced
- 50% cap in joint ventures
- Regulator sets policy wordings, liability limits, clauses, extensions, warranties etc
- Price controls for Auto Liability cover
- Compulsory cession of 20% to General Insurance Corporation: choice above that
- Cap on agents' commissions
- Insurance cover from abroad not permitted – including cession abroad
- Social obligation to write rural insurances

## India: restrictions on foreigners - 3

- MAT commitment not as complete as in 'Understanding'
- GATS revised offer:
  - Business visitors could stay up to 180 days
  - Intra-corporate transferee conditions relaxed
  - Self-employed contractual suppliers covered
  - Life and non-life insurers could establish (but 26% cap remains)
  - Providers of services auxiliary to insurance could establish, under 51% equity cap: actuaries would have to be certified by the Actuarial Society of India

## Mexico - background

- Macro-economic stability for 12 years
- Monopolists – both public and private - control most walks of life
- Telecoms costs high, low penetration
- South suffers from bad transport, poor schools
- Public sector borrowing down to 2% GDP
- Productivity generally low – due to size of informal sector, and incentives to stay in it

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## Mexico: insurance sector

- 2 state-owned, 2 mutual, 66 private insurance companies, of which 34 were foreign subsidiaries, 16 part of local groups
- 15 bonding institutions (of which 4 foreign)
- Foreign insurers have 58% market share
- Proportions ceded: 73% non-life (excluding motor), (in that 94% of catastrophe premiums)
- Insurance assets were 28% of total end 2004
- IMF stress testing showed resilience to shocks
- Policies cancelled if premiums not paid promptly

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## Mexico: restrictions on foreigners: 1

- Movement of natural persons – only the following permitted entry:
  - Executives, managers and specialists transferred within the same enterprise
- 20% cap on any individual foreign holding
  - These must be in neutral shares
  - But 40% cap for reinsurers
- Geographical land ownership restrictions
- Incentives to SMEs not extended to foreigners
- Prohibitions for obtaining cover abroad
- OECD Framework for insurance market liberalisation principles not followed yet

## Mexico: restrictions on foreigners: 2

- Direct branching not committed
- 2% tax on reinsurance ceded abroad
- ENT for cross-border sales (ie cover not available in Mexico + Ministry of Finance permit)
- GATS revised offer:
  - Temporary entry also for: investors, business visitors
  - 49% paid up capital would be allowed (and additional capital: limited to 30% voting rights in ordinary capital)

## Russia: background

- State interventions on increase
- Pace of structural reforms slowing down
- Export revenues boom on energy trade
- Investment and consumers drive demand
  - Dynamic consumer market
  - Low housing and utility costs, so disposal income up
- Business climate poor: red tape, corruption
- Lack of trust in financial institutions
- Banking system weak, regulator not strong

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## Russia: insurance sector

- 920 insurance companies (138 life)
- 1,200 insurance brokers
- Gosstrakh has 40,000 agents, 2,500 branches
- Top 30 companies have over 55% share
- Low penetration - \$ 21 per head in 2004 (OECD)
  - Concentrated in Moscow and St Petersburg: 70%
- Life insurance very low proportion
- Foreign-controlled share under 5%
- Non-life firms will need a big injection of capital

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## Russia: restrictions on foreigners

- FDI capped at 50% of insurance sector total investment
- Supply restricted in GATS Modes 1 and 2
- Legal form discrimination
- JV participation capped at 49%
- Nationality requirement for managing directors and finance directors
- Higher capital requirement for foreign firms
- Branching licences not yet granted
- State monopoly on compulsory lines

## Conclusions and Future Trends - 1

1. Categories of barriers and constraints
  - Legal measures specific to insurers
  - Other measures affecting commerce
  - Bureaucratic systems, provincial levels
  - Soft constraints arising from: culture, religion, history, politics, social norms
2. Rapid change affects supervisors and country operations
  - Impacts regulators, firms and consumers
  - Balance between protection of consumers and commercial freedom changing

## Conclusions and Future Trends – 2

### 3 Regulatory convergence

- IAS principles becoming widely accepted
- Accounting standards of IASB to be followed
- Financial Stability Forum and FSAP monitoring

### 4 Common trends in BCIMR?

- Strong economic growth in China, India – potential in Brazil, Mexico and Russia
- Entry barriers and constraints being reduced

### 5 Trends in Distribution

- Bancassurance to match incumbent agents
- Trials of internet and cellphone sales

### 6 BCIMR insurers investing abroad?

- No sign yet: big national groups might diversify

## Conclusions and Future Trends - 3

### 7 Business and Politics

- 'Serpent' of militarism, imperialism, racial and cultural rivalries, monopolies, restrictions, exclusion

### 8 Industry- Regulator Dialogues

- Long-term, far-reaching dialogue has begun

### 9 Development and Poverty

- Insurance can underpin first order welfare
- Trade in insurance can assist poverty reduction given sound regulation

### 10 Key Market Access Barriers

- a summary is appended

## Annexes in Report

1. GATS Annex on Article II Exemptions
2. GATS Annex on Financial Services
3. Understanding on Commitments in Financial Services
4. Hong Kong Ministerial Declaration: Annex C
5. Collective Request on Financial Services
6. FLWG Model Schedule of insurance commitments
7. OECD Framework for insurance market liberalisation
8. Selected statistics on the BCIMR
9. Acknowledgements

- Thank you for your attention
- Now we will hear from the four panellists
- After that – any questions ?

**Julian Arkell**  
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*Geneva, 23 March 2007*