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**Barriers to Global Insurance Business
Operations: The Situation in Brazil,
China, India, Mexico and Russia.”**

Research Report
by Julian Arkell

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**“BARRIERS TO GLOBAL INSURANCE BUSINESS OPERATIONS:
THE SITUATION IN BRAZIL, CHINA, INDIA, MEXICO AND RUSSIA.”**

by

Julian Arkell

International Trade and Services Policy
Box 41, Mussupta 2
07712 San Clemente
Menorca, SPAIN

tel/fax: +34 971 366392

arkell@arkell.info

www.arkell.info

FOREWORD

This research paper was commissioned by The Geneva Association as a contribution to the analysis and debate on issues surrounding the entry of foreign insurance companies into large emerging markets. It attempts a facts-based analytical study of the barriers to market access and operating constraints for foreign insurance companies in five major emerging markets: Brazil, China, India, Mexico and Russia (henceforward 'BCIMR'), with brief notes on the general business conditions in those markets.

Given the nature of the remit of The Geneva Association itself, this study is not devised as an advocacy piece or a lobbying platform, though its material could well be of interest to the sector's lobbyists should they be interested in opening up the BCIMR insurance markets to increased foreign competition.

Throughout, the author has tried to use technical terms only where it is essential to avoid ambiguity, otherwise the text has been drafted in general language to make it easier for any interested non-specialists to follow the issues.

The expected audience includes those who are:

- (a) In the insurance sector and would have deep knowledge of insurance principles and products, but who may not be expert on trade liberalisation issues arising in the negotiations under the General Agreement on Trade in Services (GATS) at the World Trade Organisation (WTO), and at other multilateral and regional fora
- (b) Government officials in capitals and in Geneva handling trade negotiations, but who may feel in need of briefing on insurance issues
- (c) Insurance regulatory and supervisory authorities in capitals, who may wish to read about trade liberalisation issues, and
- (d) In other sectors and institutions, or are researchers, who may want to hear about the issues addressed by this paper.

The coverage in the first three chapters may therefore teach little or nothing, and probably seem incomplete, to one or other of these groups, and they can turn those pages over quickly scanned. The page limit set for this report conditions the level of detail that could be addressed. This is especially so in areas that may not yet be of direct relevance to the five markets concerned.

The first Chapter gives a brief overview of the principles of insurance and the chief insurance products in the commercial market, and touches on some products provided by governments, and describes some business trends.

The second Chapter surveys briefly the current position on the regulation and supervision of insurance, mainly at the international level, and touches on related standards.

The third Chapter gives a brief overview on international trade issues as found in the principal multilateral institutions concerned with liberalisation in the insurance sector.

The fourth Chapter forms the core of the paper. It presents the detailed picture for each of the five countries of the legal, market and trade situation, both particular to the insurance sector, and more generally if relevant to the commercial environment for insurers and consumers of insurance products.

The fifth Chapter attempts to describe the future causes of change in insurance markets and the challenges faces by insurers, and the issues that arise when the private sector actors aim to increase the profile of their interests at the multilateral level. Conclusions are drawn as to future trends, looking at both drivers and challenges.

The Annexes provide the wording of selected key documents as a useful reference, together with a glossary of insurance terms, some comparable factors and statistics on the five countries, and a list of those who kindly gave their time and documents to the author. References to such material and other sources accessed by the author are given in each Chapter.

Please bear in mind, that the potential mass of material in the public domain¹ to assess has been truly daunting, and the inroads made into this universe have been curtailed by the time available for concluding the study. This has greatly conditioned both the extent of coverage and the depth of analysis and the dependability of the conclusions. Under each heading considered, an apparently unlimited horizon opened up, with each such expansion threatening to destabilise the balance of the entire study framework.

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.

¹ There was no budget to purchase any of the many commercial products that record great detail on these markets in many dimensions.

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1 OVERVIEW OF GLOBAL INSURANCE BUSINESS OPERATIONS

1.1 INTRODUCTION: the nature of insurance

This study necessarily cannot be a text book on insurance, nor even be a digest of the vast range of potential material, and therefore the selection of what to include and to highlight, can only be an individual choice rather than an objectively balanced view.

A single concept lies at the centre of a gargantuan economic scene containing endless and growing ramifications: insurance aims to transfer some risk from one person to another (whether personal or juridical on either side). The risk is expressed as a potential loss in financial terms, and the premium paid at the outset is a risk management hedging instrument in the face of uncertainty. A relatively small group of insurers deals with a wide range of consumers and aims to spread the accepted risks by forming a pool which has statistically computable probabilistic stability. The insurers exclude cover for the smallest risks which would be relatively too expensive to administer, and the largest which would put them out of business. These pools of different categories of risk can cover those that arise in part of a jurisdiction or all of it, or a number of countries and even globally in the case where a few reinsurers insure the primary insurers.

Thus the role of insurance is unique in economics because the normal commercial sales sequence of acquisition of a physical product, or receipt of a service, upon payment, is reversed. The price, in the form of an insurance premium, is set before the final extent is known of the cost of any compensation to the consumer within the set limits of the cover. This final cost may even remain unknown until long after the insured event has occurred.

Because risk is omnipresent to human existence and activities, the beneficial effects of properly constituted insurance can be experienced in many dimensions. Given such a central and pervasive role, the legal principles and precedents in systems of law are crucial to its predictable functioning.

The legal doctrine governing insurance contracts is that of “utmost good faith” (*uberrima fides*). Both parties must make a full declaration of all material facts at the outset, unlike the situations that “let the buyer beware” (*caveat emptor*). The insurer-insured relationship is contractual: they are parties to an arms-length agreement. The principle of *uberrima fides* does not change the arms-length nature of the agreement, and cannot be used to import a general fiduciary relationship.

The insurance policy covers the “insurable interest” of the consumer expressed in terms of financial loss of the property owned or the liability faced: the insurance comprises a personal contract for payment due upon the occurrence of a contingency, and the measure of reimbursement depends on the economic loss suffered.

Some insurance policies, such as for property or liability, are “conditional contracts” due to the insured being obliged to satisfy certain conditions – usually to reduce the risk.

Once a policy has entered into force, upon payment of the premium, the insurer is legally bound by contractual obligations for the promise of future performance, and there is a potential to be charged with breach of contract (hence the term “unilateral contract”).

Where any ambiguities in the cover have to be resolved legally, they have to be resolved in favour of the insured, because the insured party had no or little bargaining power, having had to take the insurer’s offer (hence the term “contracts of adhesion” for certain covers).

Insurance contracts are also “contracts of indemnity” because the insurer indemnifies the insured to make good the loss the latter has suffered, and here the principle is that the insured shall not profit from the contract, and indeed under many types of policy, can be left with some part of the loss (for example where there is a ‘deductible’ or ‘excess’ to be met by the insured under motor insurance policies).

In all cases a contract of insurance is only valid in law where there is an insurable interest through an economic loss to be suffered as a result of an adverse occurrence to the insured – the financial relationship of the insured is such that he stands to lose out when the damage (to the subject) occurs. The insurance policy forms the legal contract, and it sets out the terms and conditions, specifying the extent of coverage (amount of compensation) in the event of a loss from the perils covered for the term (period) of the indemnification. When the insured experiences a loss for any peril covered, a ‘claim’ can be made against the insurer in the amount specified in the policy contract.

The difference between gambling ‘wagers’ and insurance is that the gambler chooses to put a sum at risk in the hope of a speculative gain, in the context of odds fixed by the gambling operator at the outset and the betting house rules (an endogenous relationship). A risk insured, however, is exogenous, and may have to be mitigated by taking certain actions (such as installing security equipment or fire sprinklers), but there is no prospect of gain. Appraising and controlling risk is important so that the insured do not increase their risk exposure through their own behaviour (described as “moral hazard”).

1.2 PRINCIPAL TYPES OF INSURANCE POLICY

1.2.1 Services covered in the private sector

Insurance services can be placed into two categories: term and general.

1.2.1.1 Term insurance

This category includes:

Basic life insurance which consists of either:

Regular premium business: usually paid on a monthly basis. The proportion of which is mortgage-related can be an important determinant.

This can provide cash to the family of the deceased or a named beneficiary, and can cover funeral, burial and associated expenses

Total permanent disability insurance can be covered in this category, to compensate someone who can no longer work in their profession due to disablement.

In many countries the interest arising on the invested premiums is not taxable as income, and acts as an incentive to save in this way.

or

Single premium business: paid for by a single lump sum. These policies act as savings vehicles which can yield a higher rate of return than bank and building society deposits. In the developed markets some of this business can come from abroad.

There are also 'Endowment policies' and 'Annuities' in this category. They provide a stream of payments, as do pensions, but as they are issued by insurance companies which are regulated, annuity policies are classed as insurance products. Both annuities and pensions, which pay a benefit for life, are a complement to life insurance, and can insure against the possibility that those who have retired might outlive their own financial resources.

As for pensions, they can be of the 'Occupational' (or Corporate) and 'Individual' types.

Long-term health insurance is a supplemental insurance product for coverage of nursing home and similar care

The issues for term insurance include the demographic patterns of increased longevity (or life expectancy), rising or falling birth rates, and health trends.

Also account has to be taken of public pension schemes, since the private sector can provide complementary pension schemes, either as a substitute, or acting as complementary provision.²

² Section 5 of this chapter looks further at issues for pensions.

Where the life policies include 'with-profits' and 'unit-linked' products, then relevant factors include inflation rates and market performance, both as to rates of return and capital value. The proportion of investment being accounted for by life insurance is steadily rising and for example in the European countries covered by the European Insurance Committee (a federation of national insurance associations) members, it is currently about 81%.

Under this general heading also are 'equity release' products, for example where an annuity for life is paid by the insurer to a couple, with their house used as collateral to be sold after their death to recover the loan.

The term insurance market has become more concentrated over the past decade (in 2004 ten largest in UK accounted for 75% and top three 33%) due to competitive pressures resulting from global concentration resulting from diversification and increased efficiency through economies of scale.

1.2.1.2 General insurance

This category includes policies that are usually in force for a year. They are taken out both by companies and individuals.

The principal covers offered by private sector insurers are:

Motor insurance (or 'auto', 'car'): some parts of cover in this category can be mandatory under the law for private vehicles and thus can account for a significant proportion of the total general insurance premiums in emerging markets. For example, even in the UK highly developed market this proportion is 25%, and in developing countries the share is usually higher, being the first cover taken out by many consumers. Cover is both for legal liability claims against the driver by third parties and for damage to the car, or its loss. In some jurisdictions, for bodily injury of the victims under the 'No Fault' system, there is provision for automatic eligibility for benefits, though a reduced ability to sue for compensation.

Giving increasing concern are the problems raised by traffic accidents when driving out of the home jurisdiction - a frequent occurrence when abroad - and can include: cross-border personal injury claims, rules for private international law, limitation period for claims, dealing directly with the insurer of the liable party, applying the same conditions which would have applied had the accident taken place in their country of residence. There are claims settlement schemes and differences in compensation. These accidents can only be reduced by the enforcement of road-safety rules (speed limits, driving after drinking alcohol) and new in-car technologies.

Property insurance: This covers a wide range of risks for homes and commercial and industrial properties, including fire, theft, weather-related damage (such as flooding, earthquake, storms, hurricanes and so on) and for boilers, machinery and equipment. Some of these risks may be covered by specialised insurance policies. It can also cover accidents to third parties incurred on the property or arising from it.

Much in this category can be connected with loans (or mortgages) on property, whether that of individuals or businesses and can be the second highest proportion of general insurance (18% in UK, for instance). Of relevance here are the prices of housing and commercial premises, and the costs of construction.

Accident and health insurance: This covers medical bills incurred due to accidents or ill health.

This category is of increasing importance for both the sickness of individuals and of company staff (and in the UK it accounts for 10% of general premiums).

Workmen's compensation insurance aims to cover a proportion of the wages lost and accompanying medical expenses arising from work-related injury.

Health insurance is of especial value where a state health insurance scheme is insufficient. Some health policies also cover dental treatment, though this can be expensive if not part of an employment package.

Marine, Aviation and Transport (MAT) insurance can cover both average risks and specialised risks such as in aviation policies, whether for personnel, the owners of the cargoes or the actual carrier or vessel eg: ship, plane, train, lorry (truck) and so on. There are various specialist marine policies, for example, related to vessels under construction, war risks in certain sea lanes, increased market value of vessels, cover for overdue arrivals and valuable cargoes. Cover for salvage and ship capture in war precipitating prize money are also available.

Marine insurance is a major subject in itself with a long history in the UK, for example, where it is the oldest form of insurance going back to 1601 when a specialised chamber of assurance separate from the Courts was set up, and later on the formation of Lloyd's of London (a group of underwriters), which was one of the main suppliers of marine insurance. In 1906 the Marine Insurance Act was passed which codified the legal principles applied and the Institute of London Underwriters (a group of insurance companies) developed standardised clauses – now widely used internationally. Much of the law relating to other types of insurance and reinsurance has been developed from this base.

Pecuniary loss, credit and general liability covers

Liability insurance is taken out, for example, by professional practitioners to cover claims for negligence, errors and omissions, providing both legal expenses to the practitioner and indemnification to the patient or client.

Credit insurance is to cover loans that cannot be paid back, for example, due to unemployment, disability or death.

Financial loss insurance can cover a variety of risks, such as loss of sales due to a fire on the owner's or adjacent premises, and the failure of a creditor to pay money owed. Fidelity and surety bonds come under this category also.

Other categories of cover include:

Travel insurance: usually for travel abroad, to cover various types of loss due to belongings, delay, personal liability and certain medical expenses.

Environmental liability insurance: eg to cover the costs of injury, damage to property and cleanup costs, caused by the escape of a pollutant.

Political risk insurance: eg to cover risks arising from revolution and other politically-induced instability.

Terrorism insurance and nuclear incident insurance (eg caused by the escape of radioactive materials), though these are usually wholly or substantially covered by government schemes.

The general insurance suppliers have become more concentrated over the past decade than life markets. For example in 2004, the ten largest firms in the UK accounted for 87% and the top three alone as much as 45%.

1.2.2 Types of insurance enterprises

The classification of insurance enterprises usually comprises the following categories:

- Life insurance companies: for life, annuities, pension and health products
- General, or non-life companies: all other primary insurance products
- Reinsurance companies: which reinsure the first two categories, and each other
- Captive insurance companies: which cover risks for their own group of companies or of an association of firms

In many jurisdictions the regulations for the four groups are different, with the reinsurers only recently becoming regulated in some countries.

The regulation of life insurers reflects the fact that their liabilities extend over the long term, so their tax position can be treated differently from the general insurers, the policies of which are shorter term, typically for a one year period.

Most insurance enterprises are now joint stock companies, though a few mutual companies remain, which are owned by the policyholders. The owners of shares in joint stock companies do not necessarily take out insurance policies with these companies.

1.2.2.1 Reinsurers

Increasingly insurers are transferring some of their risk to other insurers (reinsurers) which also has the effect of increasing their capacity. In effect they gain access to further capital and the transfer of risk in this way acts as a capital management tool.

Finite insurance is a means of transferring risk to a reinsurer whereby the quantity is both limited and measured, in order to increase the capacity of the primary insurer. Usually these transactions are limited in time. (www.irmi.com)

1.2.2.2 Captives

Captive insurers are either wholly owned by the parent entity, and can act as an in-house self-insurance vehicle, or are mutually-owned by an industry group, or insure the members of a professional or other type of association. The reasons for forming such entities can include commercial and tax advantages, reduction of costs, ease of risk management, financial planning and cash flow flexibility. They can also provide covers for risks not available in the market. Many captives limit their overall liabilities by taking out reinsurance.

1.2.3 Distribution

The distribution of insurance sales is carried out through three main modes:

Direct sales to customers are made by a sales force, and by direct telesales which are growing fast in developed countries, in addition to telephone and mail campaigns. Another trend in some western markets is the rise in the proportion from bancassurance and building / loans societies, which is having the effect of reducing direct sales forces and increasing cross-selling of other financial products with insurance.

Some insurers have even created their own financial services subsidiaries which offer unsecured personal loans, credit cards, mortgage and savings accounts (ie banking services), as well as the distribution of general insurance products. Other formats include partnerships with banks and affinity groups of retailers and so on.

Tied agents act as intermediaries for their related insurers. Some of these can act for groups of insurers.

Independent intermediaries can be either Independent Financial Advisors and independent brokers, or banks building / loans societies. There has been very heavy concentration among insurance brokers with three US firms and one UK firm accounting for a dominant proportion of revenues in these two markets and globally.

The insurance brokers earn a commission from the policies sold by insurers. They advise the consumers and find the most appropriate policies at the best prices in the market. Despite the commission coming from the insurance companies, they should give impartial advice to consumers, who do not pay any commission to them.

Insurance consultants are paid fees by their clients but otherwise act like brokers and shop around for the best deals.

1.2.4 Auxiliary services

Other companies provide specialist services with expertise not found in all insurance companies, such as for claims handling, loss adjustment and even underwriting advice.

Loss adjusters: these can be either independent claims specialists who verify liabilities of insurers, or in-house staff. These professionals are relied on for quantity, description and pricing information.

Actuaries are significant professionals in this field. Insurance companies can be required by law to have an Appointed Actuary for life and pension product calculations. Actuaries use probability theory, life-expectancy and other data to estimate levels of risk. They set premium rates for life insurance and personal pension policies and advise on bonus payments. They may also be involved in product development, marketing, portfolio management and a range of managerial roles. They tend to be involved increasingly in general insurance matters as they can make use of the growing availability of statistics.

Other relevant skills needed by insurers include financial advice, computing, recruitment, legal services, risk management and general consultancy.

1.2.5 Management services for funds and pensions

Fund managers independently manage assets on behalf of institutional and retail investors, with some being owned by insurers to manage life and pensions products and their balance sheets. Retail products include open-ended investment companies, unit trusts, investment trusts, individual savings accounts and personal equity plans. Funds are invested in equities, fixed income securities and property.

Institutional business consists of segregated fixed interest pooled pension funds, structured and private finance, and segregated and pooled global macro-strategy mandates, for pension funds, insurance companies and other financial institutions. Where owned by an insurer the services include internal business where long-term funds are managed, such as with-profits and multi-linked funds, annuities and corporate pension products.

Pension management services can include record keeping, government reporting, plan participant (ie member) communications, investment services and advice, and automatic investment balancing.

1.2.6 Other issues affecting insurers

State-owned entities: the existence, dominance and practices of state-owned insurers can be a major issue in the big emerging markets for both direct insurance and reinsurance. They can make it either impossible for foreigners to compete for certain products, or they provide very tough competition, until consumers can be made aware of the value of private sector products.

Privatisation of state-owned entities: not all governments yet desire to privatise their SOEs and can provide a half-way house by making them more independent wholly-owned corporations. The politics involved can make the outlook on full privatisation unclear. Even when they are privatised, they can retain their dominance for long periods through customer inertia and lack of information available to the public.

Compulsory insurance: where the state makes certain insurance cover compulsory, this can dominate the market in the nascent period, the most typical being motor insurance, and often pension contributions and workers' accident cover. This usually involves the state approving the standard cover terms.

Public-private partnership: one of the fields for cooperation between the state cover and private complementary products, is for terrorist risks and major man-made and natural disaster risks, especially 'catastrophic' risks, with the state picking up the highest levels of claims which are uninsurable. However, this pattern is not yet prevalent in the big emerging markets, and there will always be limits for private non-life cover available in the markets. The welfare state has either not arrived in the BCIMR countries, or is in the early stages of development.

1.3 MARKET TRENDS IN THE INSURANCE SECTOR

1.3.1 Recent insurance market growth

Worldwide

Global GDP grew by 3.9% in real terms during 2006 to \$ 48,342 billion, above the 10-year average of 3%. Emerging markets expanded by 6.9%, twice as fast as the industrialised countries.

Worldwide insurance premiums in 2006 were \$ 3,723 billion, composed of \$ 2,209 billion in life insurance and \$ 1,514 billion in non-life, representing growth rates of 5%, 7.7% and 1.5% respectively. The life market growth rate was the highest since 2000 and faster than overall economic activity in most countries.

The world average of premiums per head (density) was \$ 555 and penetration 7.52% of GDP.

Emerging markets

In emerging markets, growth trebled from the rate in 2005, due to the positive impact of strong economic growth.

In 2006, emerging market premium volume amounted to \$ 333 billion, 8% of world premium volume, 53% being for life insurance. Double-digit growth occurred in emerging markets, almost twice the long-term growth rate of 9.4% during the period 1996 to 2005. GDP grew by 6.9% in 2006, compared with the ten-year average of 4.6%.

Life insurance grew by 21% in 2006, up from 6.8% in 2005, and well above the ten year average of 12%. This included a wide variation, for example with India up by 60% compared with Russia recording a fall of 43%.

Non-life insurance grew by 11%, up from 7% in 2005, above the ten year average of 7%, driven by strong GDP growth. Motor insurance played a key role in non-life expansion generally and the introduction of mandatory MTPL in China added further growth impetus.

The average per head expenditure on insurance (density) in 2006 was \$ 60, of this \$ 32 was for life and \$ 28 for non-life, though there was a wide difference in levels across the diverse group of countries comprising the emerging markets.

Insurance penetration average 1.4% in life and 1.3% in non-life, growing faster than GDP.

The pattern of recent growth in the BCIMR countries is shown in the attachment at the end of this chapter.³

1.3.2 Major challenges

The factors which can affect insurance companies, their plans, goals and expectations, cover a wide range, but perhaps for western insurers the main challenges are:

- Demographic
- New technology, consolidation and globalisation
- Climate change: the increasing frequency of weather-related catastrophe claims

In the BCIMR markets the last two are also challenges, whereas their populations are still relatively young and increasing, which underlies their market potential for western firms.

1.3.3 Ageing populations and declining birth rates

The ageing and shrinking populations are features of some OECD countries which is putting adequate funding of state pensions at risk, and providing opportunities for complementary private pension schemes.

Diversification into the BCIMR markets can be a way to grow for western insurers, particularly for long-term insurers which need to take especial notice of such demographic trends.

1.3.4 Globalisation

The insurance sector is affected by the globalisation trend of deeper economic integration, just as are other sectors. This is driven by the falling cost of transport and telecommunications and the need to achieve economies of scale and scope, the latter being more important than for manufacturing. In addition for financial services, closeness to consumers is of prime importance (customer 'centricity') which dictates the need for foreign direct investment either through mergers and acquisitions or setting up joint ventures or

³ Section 1.3.1 and the attachment are derived from the publication by Swiss Re "World insurance in 2006: Premiums came back to 'life'.", Sigma No 4/2007.

wholly-owned entities. As in other sectors, insurers follow those clients which are extending their activities to become global.

Although markets can be very different due to cultural, historical and geographical situations and insurers have to adapt their products accordingly, there are still advantages from becoming multinational, even for companies in the BCIMR countries. These include diversification of resilience to shocks through locational assets and experience, privileged access to proprietary knowledge and specialisation, and access to larger markets which can increase the financial base. The extent to which this expansion abroad is permitted by the governments of the BCIMR is an issue, because it has already begun.

The result of many of the mergers and acquisition activity and consolidation of insurers over the past decade in OECD economies has been the marked concentration among relatively few major multinationals in most markets, for direct insurers, reinsurers and brokers. This trend has also included the formation of conglomerates with subsidiaries in two or three of these areas.

At present the major international competition comes from US, Japanese and certain European multinationals. For example, of the top ten life insurance companies, six are European, three Japanese and one US and among the ten largest property/casualty companies, five are US, five European and one is Japanese. As for the top ten brokers, seven are US-owned, two UK owned and one is based in South Africa.

The proportion in global assets stocks of the investment assets of the insurance sector is growing in the major markets and thus globally, which is attracting the attention of the Financial Stability Forum (www.fsforum.org). The way in which such funds are allocated to different types of assets can be of concern, and the extent to which some of the funds are invested abroad with consequent associated exchange risks. If the insurance supervisors impose certain formulae on all the companies, this can lead to perverse herd behaviour in certain crisis situations. Observers have proposed the counter-cyclical management of capital solvency ratios to avoid these situations.

It is estimated that at the end of 2004 globally, insurers held USD 14.5 trillion of funds under management of which about 80% was from life insurance and the remainder mostly from health, property and casualty insurance. With about USD 5 trillion, the US insurance companies accounted for a third of the total, with Japan and the UK holding 14% and 13% respectively, ahead of Germany and France at about half that level.

The hedging of insurance and asset risks and currency matching capabilities are important for the insurance sector due to the large assets and liabilities involved in the long-term covers.

1.3.5 Trade and investment flows

Although there are reasonably comprehensive data for the major trade and investment between the OECD countries, which make up the major proportion of such flows, the statistics for the BCIMR are less reliable due to measurement problems and lack of survey capacity.

An article written in the autumn of 2005 by a former senior UNCTAD official⁴ showed that the BCIMR countries are becoming sources of outward FDI, though the pattern between them is rather uneven. In the period 2001-2003, their FDI outflows were as shown in column 2 below

⁴ "New sources of FDI: the BRICS – outward FDI from Brazil, Russia, India and China", Karl P Sauvart, in "Competing with the BRICS", Subhash Jain (ed.), Edward Elgar, Cheltenham UK

and this expressed as a percentage of gross fixed capital formation is in column 3. The total stock at end 2003 is in column 4.

1	2	3	4	5	
	Outflow	%	stock	of which in finance	
	US \$ bn		US \$ bn	%	
Brazil	0.2	0.2	54.9	22.4	
China	4.1	0.9	33.2	n/a	other business = 2.1
India	1.1	1.0	5.1	n/a	
Mexico	2.2	1.8	13.8	n/a	
Russia	5.3	7.9	72.3	20	of which insurance = 7

In the period 1999-2005 only just over one per cent of India's approved outward FDI went into the financial services sector.

At present there is little evidence of outward FDI into the insurance sector from the BCIMR countries, as that into financial services is more likely to be in banking or to havens such as the Bahamas for redirection to other locations.

1.3.6 E-commerce

The former Chairman of the Indian IRDA⁵ has said: "the internet is creating new exposures for business and for all of us. The heightened dependence of global business on information technology and specifically on the internet has introduced new, confusing and potentially dangerous elements into the traditional business risk analysis. [] Regrettably there are no insurance policies in the traditional underwriting world than can begin to address the threats and risks of the internet. Business interruption policies don't cover internet related business interruption. Property policies don't cover intangible assets such as trade secrets or customer lists. Business liability policies called Comprehensive General Liability are neither – especially when applied to cyber liabilities and cyber extortion policies."

Insurers offering their own products over the internet have to consider a variety of risks ranging from their strategic orientation and priorities, the impact on solvency, company image and brand loyalty, the target consumer group and the effect on their traditional business. This is in addition to risks classified as operational, transactional, data security, connectivity and conduct of business (authentication, document and signature security, disclosures and disclaimers, electronic payments and regulatory compliance), all of which assume greater significance if any transactions are to be conducted across national borders.

Already some direct insurance can be conducted on the internet by consumers, and even across borders in Europe between a few countries. This is not likely to develop between OECD and the BCIMR countries for some time due to legal prohibitions and differences in culture and language.

1.3.7 Corporate governance

Good corporate governance and responsibility has to be aimed at by insurers in all markets, defining and increasing sound values around trust, ethics and environmental responsibility (one UK firm has achieved full ISO 14,001 certification, the internationally recognised environmental management standard, for its entire property portfolio). Insurers have a wide range of stakeholders to consider, including: consumers; business associates and suppliers; employees; shareholders and the investor community; academia; the media;

⁵ "Role of an insurance supervisor in regulating new emerging risks in a developing economy", N Rangachary. Paper presented to the 18th PROGRES International Seminar, 12-13 September, 2002, Geneva.

non-governmental organisations; consumer associations; governments and the regulatory authorities.

Good corporate governance will ensure full compliance with regulatory requirements and the best risk management procedures.

Some insurers now publish Corporate Responsibility reports with titles such as 'Acting Responsibly'. Some also conduct financial literacy programmes which aim to improve consumers' understanding of their long-term financial needs and build up their confidence in financial services, which enhances their ability to take appropriate decisions on a range of issues from debt to the management of savings. This can be of particular importance in the emerging markets of the BCIMR countries.

1.3.8 Insurance Patents

In the US the grant of business method patents has enabled firms to innovate in unusual ways. For example one company offers tele-car insurance, under which policy a driver's behaviour is monitored directly while on the road with the information being transmitted back to the insurer, which helps with the assessment of risk and thus of premium rates. In the US about 150 new patent applications were filed, and less than 30 granted. Such patents pose an added risk for insurers, as they might have to pay inventors for any infringements unwittingly made.

1.3.9 Tax Deferral and avoidance

There can be criticism of policies given special tax treatment, such as in the US where tax can be deferred or avoided for certain policies such as variable annuities and life covers, and where life insurance can be held in an irrevocable trust to avoid estate duty altogether.

1.3.10 The Run-Off market

In insurance parlance 'run-off' means the management of liabilities and exposures left behind when an insurance or reinsurance company stops underwriting a business. Insolvency has been the biggest factor that has forced companies to cease underwriting and go into run-off. The bulk of this market is accounted for by the US, UK, Bermuda, Japan, Germany and France. In the UK, for example, it is regarded as a separate part of the market with its own specialists and is supervised by a separate department of the Financial Services Authority.

1.3.11 Surplus Notes

A surplus note is a bond issued by an insurance company and it ranks behind in preference to their other capital obligations. They are issued primarily by mutual insurance companies, which are not public and are owned by their policyholders. They are like debt in that they pay interest and have a finite maturity, and can under the law have the same status as equity. The need to issue such notes arose when supervisors required higher capacity for capital adequacy. Although the holders have the last claim on the assets of an operating insurance company, this can still rank ahead of a holding company's obligations.

1.1.12 Securitisation of risk

The mutual benefits of securitisation arise where an insurer wishing to reduce exposure to a risk which is hard to place, meets an investor wishing to diversify the capital exposure risk in an investment portfolio. Clearly there is only benefit if both parties to the transaction calculate that the exchange will reduce their expected risk profiles. The insurer has first to transform expected future cash flows into a tradable instrument in a new entity and then transfer the

attendant risks of this entity to the capital market investor who will expect a return commensurate with the risks taken up. This operation by the insurer can provide an attractive alternative source of insurance capacity.

An investor will typically maintain a diversified portfolio of traditional assets such as stocks, bonds, properties, commodities and cash, and will seek ways to obtain higher overall returns with less risk. Insurance risks, such as weather-related or mortality catastrophes tend to be uncorrelated with other more typical capital market risks, arising from interest rates, currency exchanges and economic cycles. This may be the case when buying surplus catastrophic risks from an insurer or reinsurer, for example insurance on claims arising from hurricanes, tornadoes and earthquakes in excess of the risk retained by the insurer. The occurrences of such claims are unlikely in principle to be correlated with the economic risks that can simultaneously affect the other portfolio holdings, and further they are less frequent than most other insurance claims.

The 'bet' the investor places is that the downside calculated by the modelling of the frequency and severity of these catastrophic occurrences, as attested by professional modelling simulator and rating agencies, together with the default creditworthiness of the insurer counterparty, do not outweigh the rate of return over the selected period being offered. Informational asymmetries can be reduced where the investor only accepts risks that are calculated based on accepted scientific scales for, say, hurricane wind speed classes and earthquake severity and proximity (known as parametric triggers). In certain cases such bets have been seen to have lower informational asymmetries even than high yielding corporate bonds, where the bet is on the underlying assets of the firm, because of the lower moral hazard risk associated with the calculation and use of natural-event measures.

The surplus catastrophic risks are not necessarily offered alone, and the securitisation package can include other risks on commodities, interest rates and equity found in the traditional capital market instruments. Thus have the markets for insurance risk and capital funding now converged, though initially it was the assets of life insurers that were securitised with very little reinsurance transfer of risk associated with mortality and morbidity rates.

There exist now a range of mechanisms for achieving the transfer of risk generally to the capital markets and indeed some see its possibilities as endless. It serves to free up capital on insurers' balance sheets, and can allow investment banks to enter the insurance market without the need for substantial amounts of capital. It gives insurance brokers the opportunity to compete directly with insurers. Owing to its complexity it has increased the involvement of specialist consultants and law firms. It has generated a new line of business for rating agencies, who assess the insurance risk. It also enables corporations to bypass the insurance industry and sell their risk exposure directly to capital markets. This has increased competition and put price levels and profit margins under greater pressure. The formation of securitisation deals is relatively labour intensive and they generate substantial amounts of documentation, so are only cost effective for large portfolios. There is also a bottleneck due to the scarcity of knowledge and skilled people available.

References:

- * "Insurance risk – Securitisation: the best of both worlds", Joseph Cole and Anthony Chiarenza, Risk Magazine, Risk Publications (www.financewise.com)
- * IAIS issues papers on "Life insurance securitisation" and "Non-life insurance securitisation" (www.iaisweb.org)
- * "Securitisation of Risk", Matthijs de Bruijn, Artemis Risk Portal (www.artemis.bm)

1.3.13 Micro-insurance

Micro-insurance is the provision of insurance to low-income households, which are especially vulnerable to risk, both in the form of natural calamities as well as more regular occurrences of illness and accidents. Such insurance can help reduce or protect against this vulnerability through providing credit for increasing income earning opportunities and through providing savings services to build up resources that can be drawn down in cases of emergencies. Micro-insurers are providing different forms of insurance for life, health, property, disability, agricultural crops and so on. Poor households pay a small premium for limited coverage in the event of losses. Such covers are offered by formal insurers, microfinance and health institutions, agricultural and health cooperatives, traditional societies (eg for funerals) and other institutions.

It is challenging to design a sound micro-insurance scheme because in poor areas demand is usually thin, and it has been only by trial and error that the right combination of prices and services has been achieved. It is especially hard to operate in areas with frequent natural disasters of a very large magnitude.⁶

1.3.14 Supervision of Islamic Takaful insurance⁷

Takaful insurance complies with Islamic Sharia law in relation to the form of the insurance policies, the nature of the insurance fund and how these funds are invested, however managed. The two basic principles are that the insurer must not profit at the expense of the insured, and investment must not be placed in unacceptable enterprises, such as those that support alcohol consumption. This also applies to reinsurance: Retakaful. Insurance can be on a mutual/cooperative basis, or through a juridical entity operated by an agent who charges a fixed or percentage fee and is supervised by a board of Sharia scholars to ensure operational compliance with the religious principles.

The IAIS has been studying the extent to which its 'Insurance Core Principles' include those that are universally applicable and those which will need further study and interpretation for Takaful schemes. The latter issues include corporate governance, financial and prudential regulation, transparency, reporting and market conduct and the supervisory review process.

1.4 INSURANCE ORGANISATIONS

1.4.1 Marine insurance

The UN International Marine Organisation (IMO) (www.imo.org) is concerned with the safety of shipping as well as cleaner oceans. Consistent application of its standards and regulations is of concern to insurers and its drive to develop a safety culture.

The International Union of Marine Insurers (IUMI) (www.iumi.org) The International Union of Marine Insurance is a professional body run by and for its members. It provides an essential forum to discuss and exchange ideas of common interest and to protect and advance members' interests. It also provides, through its worldwide communication network, a platform from which views on matters of concern to its members are disseminated to the marine and shipping industry, international organisations and international media. IUMI has a unique status in the world of marine insurance, whose members are dedicated to expand trade and to enter emerging markets.

⁶ Taken from The Microfinance Gateway – www.microfinancegateway.org/microinsurance/faq.htm.

⁷ See "Issues in regulation and supervision of Takaful (Islamic insurance)", Islamic Financial Services Board and IAIS, August 2006.

1.4.2 Aviation insurance

The International Civil Aviation Organisation (ICAO) (www.icao.int) has a committee on aviation war risk insurance.

The EU, for example, imposes minimum insurance requirements on all aviation operators that use EU airspace.

International Union of Aviation Insurers (IUAI) (www.iuai.org) The International Union of Aviation Insurers is the voice of the aviation insurance industry worldwide. Members are the insurers and reinsurers who between them provide cover for every aspect of aerospace business:

- from privately-owned ultra-lights to entire airline jet fleets
- from maintenance shops to airframe and engine manufacturers
- from small general aviation airfields to major airports and
- commercial space launchers and satellites.

IUAI estimate that some 90% of the worldwide aerospace insurance cover is written by its members. The IUAI is actively engaged as an international organisation and has 51 members in 30 countries throughout the world.

1.4.3 Surplus lines

The National Association of Professional Surplus Lines Offices (www.napslo.org), is a US-based national trade association representing the surplus lines industry and the wholesale insurance marketing system.

Since it was founded in 1975, NAPSLO has become the authoritative voice of surplus lines. Acting as a source of information, NAPSLO spends a great deal of time identifying and explaining to regulators, other segments of the insurance industry, the media and the public the vital role surplus lines plays in the insurance industry.

The surplus lines industry is important because it provides a market for insurance covering 'hard to place' risks that are not written by the standard markets. There are three basic categories of surplus lines risks: Non-standard risks which have unusual underwriting characteristics; unique risks for which insurers do not offer a policy form or rate; and Capacity risks where a client seeks a higher level of coverage. Examples of such risks include aviation, product liability, inland marine, earthquake, and professional liability.

Since 1994 the A.M Best Company has performed an annual survey of the excess and surplus lines market and has found that its solvency record is as good, if not better, than the overall industry

1.4.4 Protection and Indemnity Clubs (P&I Clubs)

These clubs are mutual insurance associations of ship owners and charterers. Their risk capital is subscribed by their policy holders rather than by shareholders. The Marine P&I Clubs were formed to insure against risks not covered by the Lloyd's and marine companies' policies. This includes collision damage and liabilities for loss or damage to cargo, pollution, loss of life or personal injury on ships and collision liability including damage to port installations.

London is the biggest centre in the world for P&I Clubs with about 70% of global business volume handled, and the International Group of P&I Clubs is based in London which generate over 90% of such global premium volume.

1.5 PENSIONS

Globally, the ageing baby boom generation represents a ticking demographic time bomb for many countries, especially for those which have relied for far too long on expensive state-sponsored defined benefit pension systems. Over the past two decades the role of private pensions – especially employer-sponsored defined contribution plans – has grown as nations abandon bankrupt and unmanageable PAYG schemes. Many WTO members are considering how best to jettison PAYG safety nets and how public policy – including tax and fiscal policies – can best create viable, healthy private defined contribution pension and retirement savings programs.

This situation has created new and unique opportunities for insurers and pension and asset management firms to service a growing pensions market. Many governments increasingly realize that encouraging private pensions formation will not only help reduce future public expenditures to pay for the elderly, but private defined contribution savings are seen as an important element of macroeconomic strength. Unquestionably, funded private pensions can, and do, play a vital role in the development of the capital market.⁸

Demographic challenges for governments demand pension reform initiatives, which are under way providing opportunities for providers of insurance, pensions and asset management. Workable pension solutions can be found in defined contribution plans as Pay-as-you-go schemes become untenable as predicted by the World Bank. In the preamble to the International Organisation of Pension Supervisors (IOPS) Principles a clear case is made for sound pension schemes and their supervision – see the extract reproduced immediately below – and a good overview is given of how important pension provision is in the economy and to individuals.⁹

The response of the BCIMR governments is seen as mixed by the insurers, with only Mexico rated as active, Brazil and China as ‘mixed’ and India and Russia as passive. The insurers advocate that governments must take bold steps to enact privately run, tax-favoured, defined contribution plans, effective and transparent regulation and supervision, protect participants individual accounts and allow public-private partnerships to provide financial education and investment advice. They point out that tax incentives are essential to encourage employers to offer pension schemes and for individuals to participate. The employers’ involvement is vital for successful occupational pension systems and pensions should be portable as much as possible including across national borders. Pension funds should have reasonable latitude for their investments, taking into account the ‘prudent person standard’ principle, under which the pension managers should ensure that there are sufficient funds to benefit the pensioners.

Extract from the IOPS paper on its Principles.

2. The provision of pensions is of fundamental economic and social importance, ensuring the successful delivery of adequate retirement income. The effective supervision of pensions, and of the institutions that provide pension products and services, is required to ensure the protection of consumers – a necessary task with any financial product being sold to non-professionals. Pension supervision is required to achieve the degree of protection needed to support privately managed savings and is a means to help pensions adapt to market risks. Such risks can be particularly problematic with regard to pensions due to the unique characteristics of these financial products, such as:

- the long-term nature of the contract involved, and the subsequent requirement for incentives or even compulsion to overcome individual’s ‘myopia’ towards long-term savings;

⁸ The first two paragraphs were contributed by Stuart J Brahs.

⁹ “IOPS Principles of private pension provision”, IOPS, 7 December 2006.

- their coverage of a wide social and economic range of the population (particularly where incentives or compulsion are applied);
- the low risk tolerance of pension members and beneficiaries, as subsistence rather than discretionary savings is often involved;
- the complexity of the products, involving tax issues, assumptions over future salaries, longevity, difficulty in the valuation of assets and liabilities etc. – a complexity which is beyond the financial literacy of most investors and which gives rise to asymmetrical information between pension providers or financial intermediaries and consumers;
- limited competition and choice, with decisions often made collectively by employers or unions;
- their potential impact on financial market and economic stability given their large and increasing size relative to financial markets and countries' GDP;
- their 'social' as well as financial role, which is becoming more important as reforms in many countries have given an increasing role to private pensions (through tax incentives and other public policy), as aging populations are in some cases making social security an ever increasing burden on government resources, forcing public pensions to be reduced.

Other references for this chapter:

- "Insurance", City Business Series, IFSL, London, November 2005.
- "Annual Report 2005-2006", CEA, Paris, 2006
- "A growth business with strong momentum: Annual Review and Summary Financial Statement 2005", Prudential, London, 2006

Attachment on insurance trends in 2006 in the BCIMR countries**China and India**

Life insurance: rising household and personal income in China underlay the rise of 9.1% in life insurance premiums in China, a drop from 12% rate in 2005, caused by savings being invested instead in the bullish stock market. In comparison, life business in India grew by about 60%. The outlook in China will not favour life insurance due to the small rise in interest rates and continued bullish stock market, where in India there will be continued strong growth supported by the drive of the regulator to increase rural penetration.

Non-life insurance premiums rose strongly by almost 20% in China, supported by robust economic activity and implementation of the mandatory MTPL cover from July 2006. The State Council voiced high expectations for the sector to contribute in future to social development particularly for agricultural and health insurance. Strong growth in India of 17% was in line with impressive economic performance. The raised tax deduction limit for medical insurance premiums could help to keep growth high, with tariff liberalisation in early 2007 enhancing the trend.

Latin America: Brazil and Mexico

Life insurance: growth in 2006 in Latin America was 14% compared with a fall of 2% in 2005. The two largest markets of Mexico and Brazil experienced solid growth due to higher sales of savings-related products, with Brazil attaining 11%. This sector is expected to grow at a robust rate due to positive economic developments and increasing risk awareness.

Non-insurance premiums grew by 10% in 2006, up from 5% in 2005. Motor insurance was the common denominator underpinning growth. Property insurance showed positive developments in Mexico and Brazil

Russia

Life insurance premiums declined by 43% due to the continued decrease in short-term policies aimed at tax optimisation, whereas non-life premiums grew strongly by 15% reflecting a recovery of MTPL.

Statistical overview

Life Premium and Non-Life Volumes; GDP and Population in 2006

	Life US \$ million	% of total	World share %	Non-Life US \$ million	World share %	GDP US \$ billion	Population million
Brazil	13,699	45.1	0.62	16,691	1.10	1,067	188.9
Mexico	6,814	45.2	0.31	8,258	0.55	840	108.3
China	45,092	63.7	2.04	25,713	1.70	2,613	1,323.6
India	37,220	86.5	1.68	5,812	0.38	901	1,119.5
Russia	571	2.7	0.03	20,932	1.38	929	142.5

Source: "World insurance in 2006", Swiss Re, Sigma No. 4/2007

Total premium volumes in local currencies

	currency	2006 in millions	2005	2004	real change % 2006 2005	
Brazil	BRL	66,132	58,315	52,776	8.9	3.4
Mexico	MXN	164,275	140,204	138,589	13.1	-2.7
China	CNY	564,132	492,842	432,293	12.8	12.0
India	INR	1,960,843	1,213,547	970,859	52.6	19.9
Russia	RUB	602,100	490,600	471,580	11.6	-7.5

Total premium volumes in US \$ millions

	2006	2005	real change %	% share of World market
Brazil	30,390	23,497	8.85	0.82
Mexico	15,072	12,866	13.06	0.40
China	70,805	60,144	12.79	1.90
India	43,032	27,410	52.55	1.16
Russia	21,504	17,336	11.57	0.58

2 OVERVIEW OF GLOBAL INSURANCE REGULATION

2.1 Regulation of insurance services at the international level

2.1.1 International institutions primarily involved

The international bodies actively involved with regulatory issues for financial services include:

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

2.1.2 Need for cooperation between the international institutions

The need for cooperation between these institutions has been intensifying due to the globalisation trends in each of the financial services sectors, the rise of conglomerate players, particularly bancassurance, and the arrival of single regulators such as those in the UK, Japan and elsewhere.

Following international financial crises in the banking sector and on the currency and financial instruments exchanges, and the collapse of certain banks and management funds, against a background of enormously increasing financial flows in various dimensions and the growth of financial assets worldwide (the proportion of which being held by insurers is significant), finance ministers need coordinated advice on the risks of systemic collapse of the financial system and the causes of contamination between regions and different elements of the array of private sector institutions.

The IAIS is the newest of the three international financial services sector regulatory bodies, and although the weakest and least influential still, was early drawn into cooperation on selected issues with the Basel Committee of Banking Supervisors (the longest standing cooperation between financial services regulators, and still the most influential) and IOSCO, in the shape of the Joint Forum. Latterly the IAIS has grown in stature as it has become much more representative with over 130 national supervisors as members. These regulators mostly aim to follow the IAIS principles, arrived at by their peers.

2.1.3 Activities at the international level

2.1.3.1 International Monetary Fund

Standards & Codes¹⁰

The IMF and World Bank have endorsed internationally recognised standards and codes in 12 areas as important for their work and for which Reports on the Observance of Standards and Codes (ROSCs) are prepared. Standards in the areas of data, fiscal transparency, and monetary and financial policy transparency have been developed by the Fund, while others have been developed by other standard setting bodies including the World Bank, the Basel Committee on Banking Supervision, and the Financial Action Task Force (FATF).

¹⁰ IMF website, updated 8 March 2007

Reports on the Observance of Standards and Codes (ROSCs)

ROSCs are prepared and published at the request of the member country by the IMF and/or World Bank. Those ROSCs covering financial sector standards are usually prepared in the context of the Financial Sector Assessment Program (FSAP). In some cases, detailed assessments of countries' observance of standards are also published.

ROSCs summarize the extent to which countries observe certain internationally recognized standards and codes. The IMF has recognized 12 areas and associated standards as useful for the operational work of the Fund and the World Bank. These comprise accounting; auditing; anti-money laundering and countering the financing of terrorism (AML/CFT); banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation. Reports summarizing countries' observance of these standards are prepared and published at the request of the member country. They are used to help sharpen the institutions' policy discussions with national authorities, and in the private sector (including by rating agencies) for risk assessment. Short updates are produced regularly and new reports are produced every few years.

Financial Transparency Policies

The IMF adopted in 1999 the 'Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles', after consultations with the Bank for International Settlements, World Bank, Organization for Economic Cooperation and Development, national authorities, international and national financial agency experts, and academic experts.¹¹

The IMF 40 FSAP core principles include the IAIS Insurance Supervisory Principles. Financial institutions monitored include "Underwriting and placement of life insurance and other investment related insurance" and applies both to insurance undertakings and insurance intermediaries (agents and brokers). Notification excludes life policies with an annual premium of less than \$1,000 or a single premium of \$2,500. Insurance policies for pension schemes are exempted if there is no surrender value and cannot be used as collateral. Pensions and superannuation schemes are also exempt where the contributions are deductions from wages and the members' interests cannot be assigned. The insurance product, the premiums and the benefits are covered.

Framework for anti-money laundering efforts intended to be of universal application

In response to mounting concern over money laundering, the Financial Action Task Force on Money Laundering (FATF) was established by the G-7 Summit that was held in Paris in 1989. Recognising the threat posed to the banking system and to financial institutions, the G-7 Heads of State or Government and President of the European Commission convened the Task Force from the G-7 member States, the European Commission, and eight other countries.

The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing the action which had already been taken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering. In April 1990, less than one year after its creation, the FATF issued a report containing a set of Forty Recommendations, which provide a comprehensive plan of action needed to fight against money laundering.

¹¹ The Code and a supporting document are available at <http://www.imf.org/external/np/mae/mft/index.htm>).

During 1991 and 1992, the FATF expanded its membership from the original 16 to 28 members. In 2000 the FATF expanded to 31 members and in 2003 it expanded to its current 33 members.¹² The FATF has continued to examine the methods used to launder criminal proceeds and has completed two rounds of mutual evaluations of its member countries and jurisdictions. A third round of mutual evaluations has commenced.¹³ It has also updated the Forty Recommendations to reflect the changes which have occurred in money laundering and has sought to encourage other countries around the world to adopt anti-money laundering measures.

In 2001, the development of standards in the fight against terrorist financing was added to the mission of the FATF.

FATF has developed 40 Recommendations against money laundering and 8 Special Recommendations on combating terrorism financing. The FATF began a process to review and update the 40 Recommendations in 2002. The FATF, IMF and World Bank have produced an AML/CFT assessment methodology.

Since its creation the FATF has spearheaded the effort to adopt and implement measures designed to counter the use of the financial system by criminals. It established a series of recommendations in 1990, which were revised in 1996 and in 2003 to ensure that they remain up to date and relevant to the evolving threat of money laundering.

FATF Standards - Monitoring the Implementation of the Forty Recommendations

Financial Action Task Force member countries are strongly committed to the discipline of multilateral monitoring and peer review. The self-assessment exercise and the mutual evaluation procedure are the primary instruments by which the FATF monitors progress made by member governments in implementing the FATF Recommendations.

In the self-assessment exercise, every member country provides information on the status of its implementation of the Forty Recommendations and Nine Special Recommendations by responding each year to a standard questionnaire. This information is then compiled and analysed, and provides the basis for assessing the extent to which the Recommendations have been implemented, by both individual countries and the group as a whole.

The second element for monitoring the implementation of the Forty Recommendations is the mutual evaluation process. Each member country is examined in turn by the FATF on the basis of an on-site visit conducted by a team of three or four selected experts in the legal, financial and law enforcement fields from other member governments. The purpose of the visit is to draw up a report assessing the extent to which the evaluated country has moved forward in implementing an effective system to counter money laundering and to highlight areas in which further progress may still be required.

The mutual evaluation process is enhanced by the FATF's policy for dealing with members not in compliance with the Forty Recommendations. The measures contained in this policy represent a graduated approach aimed at reinforcing peer pressure on member governments to take action to tighten their anti-money laundering systems. The policy starts by requiring the country to deliver a progress report at plenary meetings. Further steps include a letter from the FATF President, or sending a high-level mission to the non-complying member country. The FATF can also apply Recommendation 21, which results in issuing a statement calling on financial institutions to give special attention to business relations and transactions with persons, companies and financial institutions domiciled in the non-complying country.

¹² All the members of FATF are either governments or official inter-governmental bodies.

¹³ For more on Mutual Evaluations see Monitoring the Implementation of the Forty Recommendations.

Then, as a final measure, the FATF membership of the country in question can be suspended.

2.1.3.2 World Bank

The World Bank, with its partner organizations, has developed Principles and Guidelines for Effective Insolvency and Creditor Rights Systems.

The Financial Sector Reform and Strengthening (FIRST) Initiative is a multi-donor grant facility providing technical assistance (TA) to promote financial sector strengthening.

FIRST was launched in 2002 by the Canadian International Development Agency (CIDA), the Department for International Development for the United Kingdom (DFID), the International Monetary Fund (IMF), the Ministry of Foreign Affairs of The Netherlands, the State Secretariat for Economic Affairs of Switzerland (SECO), the Swedish International Development Cooperation Agency (SIDA), and the World Bank.

The World Bank manages the FIRST Initiative on behalf of the donors. FIRST has been recently extended to 2012 with funding of \$100 million in total, based on its success in the first four years of its operations.

2.1.3.3 Multilateral Investment Guarantee Agency (MIGA)

“As a member of the World Bank Group, MIGA's mission is to promote foreign direct investment into developing countries to help support economic growth, reduce poverty, and improve people's lives.

“Foreign direct investors can play a critical role in reducing poverty, by building roads, for example, providing clean water and electricity, and above all, providing jobs. By taking on these tasks, the private sector can help economies grow and avert the need for governments to use funds better spent on acute social needs, while taking advantage of the opportunity to make profitable investments.

Concerns about investment environments and perceptions of political risk often inhibit foreign direct investment, with the majority of flows going to just a handful of countries and leaving the world's poorest economies largely ignored. MIGA addresses these concerns by providing three key services: political risk insurance for foreign investments in developing countries, technical assistance to improve investment climates and promote investment opportunities in developing countries, and dispute mediation services, to remove possible obstacles to future investment.”

MIGA complements the activities of other investment insurers and works with partners through its coinsurance and reinsurance programs. By doing so, it is able to expand the capacity of the political risk insurance industry to insure investments, as well as to encourage private sector insurers into transactions they would not have otherwise undertaken.

MIGA specializes in facilitating investments in high-risk, low-income countries - such as in Africa and conflict-affected areas. By partnering with the World Bank and others, MIGA is able to leverage finance for guarantee trust funds in these difficult or frontier markets. The agency also focuses on supporting complex infrastructure projects and promoting investments between developing countries.

Lack of long-term local funding is a major constraint for growth in developing countries. Banks normally have access to short-term funding through local deposits. However, long-

term funds tend to be scarce and international banks are less inclined to take on longer-term risks due to the inherent instability in emerging economies, issues concerning election results, provisioning requirements in accordance with Central Bank regulations, and many other considerations.

MIGA's political risk insurance can mitigate the political risks associated with investing in the financial sector in developing countries, and help banks to expand their lending operations. MIGA can cover cross-border medium- to long-term lending in the forms of equity, credit lines, bond issues, securitizations and other funding instruments such as investment funds, as well as programs for discounting of receivables or factoring.

MIGA also supports banks that are venturing for the first time into emerging markets, by providing political risk guarantees for either greenfield operations or acquisitions that may accompany an expansion. Another area in which MIGA has proven to be very effective is in capital markets transactions. For example, MIGA may be able to offer political risk insurance for a bond issue, an important source of long-term funding for many banks, contributing in some cases to a rating increase beyond the sovereign ceiling, hence lowering the cost of financing.

2.1.3.4 Basel Committee of Banking Supervisors (of the Bank for International Settlements)

The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques, with a view to promoting common understanding. At times, the Committee uses this common understanding to develop guidelines and supervisory standards in areas where they are considered desirable. In this regard, the Committee is best known for its international standards on capital adequacy; the Core Principles for Effective Banking Supervision; and the Concordat on cross-border banking supervision.

The Committee's members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. Countries are represented by their central bank and also by the authority with formal responsibility for the prudential supervision of banking business where this is not the central bank.

The Committee encourages contacts and cooperation among its members and other banking supervisory authorities. It circulates to supervisors throughout the world both published and unpublished papers providing guidance on banking supervisory matters. Contacts have been further strengthened by an International Conference of Banking Supervisors (ICBS) which takes place every two years.

The Committee's Secretariat is located at the Bank for International Settlements in Basel, Switzerland, and is staffed mainly by professional supervisors on temporary secondment from member institutions. In addition to undertaking the secretarial work for the Committee and its many expert sub-committees, it stands ready to give advice to supervisory authorities in all countries.

The Basel Committee on Banking Supervision endorsed the Core Principles for Effective Banking Supervision in September 1997. The Core Principles Methodology (October 1999) sets out detailed guidelines for the assessment of compliance with the core principles. For each principle there is a set of criteria (essential and additional) against which compliance is assessed.

Main Expert Sub-Committees

As of October 2006, the Committee has reorganised its work under four main sub-committees. These are the Accord Implementation Group, the Policy Development Group, the Accounting Task Force, and the International Liaison Group.

The Accord Implementation Group (AIG) was established to share information and thereby promote consistency in implementation of Basel II. While the AIG provides a forum for discussing members' approaches to implementing Basel II, it is not intended to mandate uniformity of application of the Revised Framework.

Currently the AIG has three subgroups that share information and discuss specific issues related to Basel II implementation. The Validation Subgroup (AIGV) explores issues related to the validation of systems used to generate the ratings and parameters that serve as inputs into the internal ratings-based approaches to credit risk. The Operational Risk Subgroup (AIGOR) addresses issues related primarily to banks' implementation of advanced measurement approaches for operational risk.

The Trading Book Subgroup (AIGTB) addresses issues regarding the implementation of the recommendations in the Committee's July 2005 paper, *The application of Basel II to trading activities and the treatment of double default effects*. A current focus of this group is the development of principles for the treatment of default risk in the trading book.

The Policy Development Group (PDG) replaces the Committee's former Capital Task Force. Its primary objective is to support the Committee by identifying and reviewing emerging supervisory issues and, where appropriate, proposing and developing policies that promote a sound banking system and high supervisory standards. Five working groups report to the PDG: the Risk Management and Modelling Group (RMMG), the Research Task Force (RTF), and recently established working groups on Liquidity and on the Definition of Capital, and a Basel II Capital Monitoring Group.

The RMMG serves as the Committee's point of contact with the industry on the latest advances in risk measurement and management.

The Research Task Force serves as a forum for research economists from member institutions to exchange information and engage in research projects on supervisory and financial stability issues. It also acts as a mechanism for facilitating communication between economists at member institutions and in the academic sector.

The Liquidity Group will serve as a forum for information exchange on national approaches to liquidity risk regulation and supervision. This work is intended to provide the Committee with a stock-taking of existing regulatory and supervisory standards for liquidity risk management.

The Definition of Capital Group will explore emerging trends in eligible capital instruments in member jurisdictions.

Lastly, in the course of implementation of Basel II, national supervisors are monitoring capital requirements to ensure that banks in their jurisdiction maintain a solid capital base throughout the economic cycle. The Basel Committee has established a Basel II Capital Monitoring Group that will from time to time share national experiences in monitoring capital requirements.

The Accounting Task Force (ATF) works to ensure that international accounting and auditing standards and practices promote sound risk management at financial institutions, support

market discipline through transparency, and reinforce the safety and soundness of the banking system. To fulfil this mission, the task force develops prudential reporting guidance and takes an active role in the development of international accounting and auditing standards.

Three working groups report to the ATF: the Conceptual Framework Issues Subgroup, the Financial Instruments Practices Subgroup, and the Audit Subgroup. The Conceptual Framework Issues Subgroup monitors and responds to the conceptual accounting framework project of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board in the United States.

The Financial Instruments Practices Subgroup examines implementation of international accounting standards related to financial instruments, and the links between accounting practices in this area and prudential supervision.

The Audit Subgroup promotes reliable financial information by exploring key audit issues from a banking supervision perspective. It focuses on responding to international audit standards-setting proposals, other issuances of the International Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants, and audit quality issues.

The newly established International Liaison Group (ILG) replaces the former Core Principles Liaison Group – which had focused considerably on the initial implementation and later revision of the 1997 ‘Core Principles for Effective Banking Supervision’ – and provides a forum for deepening the Committee's engagement with supervisors around the world on a broader range of issues. It gathers senior representatives from eight Committee member countries, 16 supervisory authorities that are not members of the Committee, the European Commission, the International Monetary Fund, the World Bank, and the Financial Stability Institute.

The Committee on the Global Financial System (CGFS) monitors developments in global financial markets for the central bank Governors of the G10 countries. It has a mandate to identify and assess potential sources of stress in global financial markets, to further the understanding of the structural underpinnings of financial markets, and to promote improvements to the functioning and stability of these markets. It fulfils this mandate by way of quarterly monitoring discussions among CGFS members, through coordinated longer-term efforts, including working groups involving central bank staff, and through the various reports that the CGFS publishes.

The CGFS, formerly known as the Euro-currency Standing Committee, was established in 1971 with a mandate to monitor international banking markets. Its initial focus was on the monetary policy implications of the rapid growth of off-shore deposit and lending markets, but attention increasingly shifted to financial stability questions and to broader issues related to structural change in the financial system. Reflecting this change in focus, the G10 Governors decided on 8 February 1999 to rename the Committee and to revise its mandate.

2.1.3.5 The Financial Stability Forum (FSF)

The FSF promotes international financial stability through enhanced information exchange and international cooperation in financial supervision and surveillance. It brings together on a regular basis national authorities responsible for financial stability in significant international financial centres, international financial institutions, international regulatory or supervisory bodies, and committees of central bank experts.

2.1.3.6 Coordination among standard setters

Formal channels for coordinating with supervisors of non-bank financial institutions include the Joint Forum, for which the Basel Committee Secretariat provides the secretariat function, and the Coordination Group.¹⁴ The Joint Forum comprises an equal number of senior insurance, bank and securities supervisors representing each supervisory constituency. Thirteen countries are represented: Australia, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. The EU Commission attends in an observer capacity.

The Joint Forum was established in 1996 to address issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates. The Coordination Group is a senior group of supervisory standard setters comprising the Chairmen and Secretaries General of the Basel Committee, the International Organization of Securities Commissions and the International Association of Insurance Supervisors, as well as the Joint Forum Chairman and Secretariat. The Coordination Group meets twice annually to exchange views on the priorities and key issues of interest to supervisory standard setters. The position of chairman and the secretariat function for the Coordination Group rotate among the member representatives of the three standard setters every two years.

The Joint Forum has issued papers which are a significant step forward in addressing some of the most important supervisory issues that arise from the continuing emergence of financial conglomerates and the blurring of distinctions between the banking, securities and insurance sectors.

A paper 'Regulatory and market differences: issues and observations' presented the findings of a review prompted by an industry roundtable in 2003 on the differences in the regulatory approaches to risk across the banking, securities and insurance sectors. Cross-sectoral convergence is expected to occur naturally as a result of a number of trends and developments highlighted in the paper, but it is recognised that cross-sectoral convergence is not desirable in every instance, there being in certain cases good reasons for differences in regulatory approaches to the same risk.

2.1.3.7 The Financial Stability Institute

The Bank for International Settlements and the Basel Committee on Banking Supervision jointly created the Financial Stability Institute (FSI) in 1999 to assist financial sector supervisors around the world in improving and strengthening their financial systems.

Objectives

The FSI's objectives are to:

- To promote sound supervisory standards and practices globally, and to support full implementation of these standards in all countries.
- To provide supervisors with the latest information on market products, practices and techniques to help them adapt to rapid innovations in the financial sector.
- To help supervisors develop solutions to their multiple challenges by sharing experiences in seminars, discussion forums and conferences.
- To assist supervisors in employing the practices and tools that will allow them to meet everyday demands and tackle more ambitious goals.

¹⁴ See Attachment A of this chapter for more detail on the Joint Forum and its mandate.

Main activities

The FSI achieves its objectives through the following main activities:

- Events for financial sector supervisors such as conferences, high level meetings, discussion forums, and seminars held in Switzerland and globally
- FSI Connect, a web-based information and learning resource for supervisors
- Publications such as occasional papers and a quarterly newsletter

The FSI also maintains a directory of courses for financial supervisors organised by various institutions.

2.1.3.8 International Organisation of Securities Commissions

IOSCO is a forum for cooperation between national securities regulators. Its recommendations are meant to be advisory, rather than binding on the membership:

- Objectives and Principles of Securities Regulation
- Disclosure Standards to Facilitate Cross-Border Offering and Initial Listings by Multinational Issuers.

A Task Force developed two parallel self-evaluation exercises for IOSCO members: (i) a high-level self-assessment based on the entire set of Principles; and (ii) a more detailed self-assessment based on those Principles relating specifically to the Regulator and the Issuer.

The Task Force also developed mechanisms for providing assistance to the international financial institutions and the OECD in their use of the Principles.

2.1.3.9 International Association of Insurance Supervisors

Established in 1994, the IAIS represents insurance regulators and supervisors in more than 130 countries, constituting 97% of the world's insurance premiums. It also has more than 100 observers. Its objectives are to:

- Cooperate to contribute to improved supervision of the insurance industry on a domestic as well as on an international level in order to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders
- Promote the development of well-regarded insurance markets
- Contribute to global financial stability

The IAIS is charged with developing internationally endorsed principles and standards on insurance supervision, and with assisting insurance supervisors in implementing those principles and standards through cooperation programs and training. The IAIS recommendations are advisory, rather than binding, on the membership.

In September 1997 the IAIS issued the Insurance Supervisory Principles, a compendium of principles, standards and guidance papers.¹⁵ A Task Force has been established to prepare a methodology for monitoring the implementation of the Principles which will be prepared in close collaboration with the international organizations engaged in surveillance activities. Three additional standards were issued in September 1998 relating to licensing, on-site inspections and supervision of derivatives.

¹⁵ See Attachment B to this chapter for an IAIS note on its Core Principles.

The IAIS has solicited assistance from the World Bank in distributing the principles, standards and guidance notes to insurance supervisors, and in promoting implementation of the basic standards.

Chair of the Executive Committee: The Chairman of the IAIS Executive Committee is Michel Flamée, Vice-Chair of the Belgian Banking, Finance and Insurance Commission. Walter Bell is Vice-Chair: he is Commissioner of the Alabama Department of Insurance and President of the National Association of Insurance Commissioners (NAIC).

Secretariat: Yoshihiro Kawai, Secretary General, supported by seven staff and four on secondment.

Reporting arrangements: Each year the IAIS holds a General Meeting during its Annual Conference. All members and observers are invited but only members can vote on resolutions. In addition to accepting the past year's financial statements and approving the budget for the coming year, members vote on nominations to the Executive Committee and adopt key documents.

Working parties: The IAIS has 16 committees and working parties. They meet on average three times a year. The main committees are the Executive Committee, the Technical Committee, the Emerging Markets Committee and the Budget Committee.

Document development process: IAIS documents are developed by subcommittees or working groups and approved by the parent committee, in most cases the Technical Committee. If documents have the status of standards, principles or guidance, they must be adopted by the membership at the General Meeting. The main working parties that are involved in the development of standards and other technical activities are:

- Accounting Subcommittee
- Solvency and Actuarial Issues Subcommittee
- Reinsurance and other forms of Risk Transfer Subcommittee
- Enhanced Disclosure Subcommittee
- Insurance Fraud Subcommittee
- Reinsurance Transparency Group

IAIS principles, standards and guidance papers: The IAIS is committed to developing standards that can be used by insurance supervision throughout the world. IAIS papers represent best practices, or targets, for supervisors to work towards; they can be implemented in a flexible manner depending on the circumstances within each jurisdiction.

The IAIS Standards focus on particular issues and describe best or most prudent practices. In some cases, standards set out best practices for a supervisory authority; in others, they describe the practices a well managed insurer would be expected to follow and thereby assist supervisors in assessing the practices that companies in their jurisdictions have in place.

Guidance papers are an adjunct to principles and standards, designed to assist supervisors and raise the effectiveness of supervision.

Standard implementation activities: Each year the IAIS, in collaboration with Financial Stability Institute (FSI) and other organisations, holds on average 15 regional seminars to foster implementation of standards and enhance cooperation among supervisors in the same region. The IAIS also develops case studies and textbooks on issues related to insurance supervision, in collaboration with the World Bank and FSI within the Task Force on the Core Curriculum Project.

2.1.3.10 The International Organisation of Pension Supervisors (IOPS)

The International Organisation of Pension Supervisors (IOPS) is an independent international body representing those involved in the supervision of private pension arrangements. The organisation currently has around 60 members and observers representing approximately 50 countries and territories worldwide - from Australia to Zambia - covering all levels of economic development and bringing together all types of pension and supervisory systems. (www.iopsweb.org)

The IOPS, formed in July 2004, was instigated by the International Network of Pension Regulators (INPRS), an informal network of regulators and supervisors. It was felt that a more formal, independent, body could better serve as a world-wide forum for policy dialogue and the exchange of information, as well as the standard setting body, promoting good practices in pension supervision.

The major goal of the IOPS is to improve the quality and effectiveness of the supervision of private pension systems throughout the world, thereby enhancing their development and operational efficiency, and allowing for the provision of a secure source of retirement income in as many countries as possible.

The aims and purposes of IOPS can be summarised as:

- serving as the standard-setting body on pension supervisory matters and regulating issues related to pension supervision, taking into account the variety of different private pension systems;
- promoting international co-operation on pension supervision and facilitating contact between pension supervisors and other relevant parties, including policy makers, researchers and the private sector;
- providing a worldwide forum for policy dialogue and exchange of information on pension supervision;
- participating in the work of relevant international bodies in the area of pensions, including joint activities to improve statistical collection and analysis;
- promoting, conducting and facilitating the distribution and communication of research, and collecting information in co-operation with relevant international bodies

The current President of the IOPS is Mr. John Ashcroft, strategic policy director of the Pensions Regulator in the UK, and the Vice President is Ms. Solange Berstein, Vice President of SAFF, Chile. The other members of the Executive Committee are drawn from pension's supervisors in Australia, the People's Republic of China, Chile, Germany, Hungary, Italy, Jordan, Kenya and Pakistan.

The Chair of the Technical Committee of IOPS is Mr Aerd Houben of De Nederlandsche Bank. The Vice-Chairman is Mr. Edward Odondo from the Retirement Benefits Authority of Kenya.

The organisation cooperates closely with other international organisations involved in pension supervision policy development and dialogue, including the OECD, World Bank, ISSA¹⁶, IAIS¹⁷ and IMF¹⁸.

¹⁶ International Social Security Association.

¹⁷ International Association of Insurance Supervisors.

¹⁸ International Monetary Fund.

2.1.3.11 EU Regulatory Institutions

Developments in the EU, due to its size, may have impacts on the situation in the BCIMR countries as time goes by. The chief factors would include:

- Concentration – economies of scale in large markets
- EU Financial Services Action Plan (FSAP) – 42 separate legislative measures – the recasting all insurance directives into one – proposal due in 2007
- Solvency II – risk-based supervisory regime
- Pan-European supervision culture: home-host supervisory responsibilities
- CEIOPS Committee of European Insurance and Occupational Pensions
 - Supervisors – common decision-making and enforcement procedures
- International Financial Reporting Standards (IFRS) adopted.

The EU supervisors and insurance sector also influences the policies and standards of the International Accounting Standards Board (IASB) and its supervisory trust.

In a paper tabled by John Cooke at the PROGRES International Seminar in 2006 he wrote as follows, under the heading “new and specific linkages between regulation and external trade in services.”

“A recent example, cited by a PROGRES speaker ¹⁹, occurs in the EU Reinsurance Directive, which includes an external dimension (Titles VI and VII) under which the Commission may submit proposals to the Council for possible agreements with third countries that seek to ensure “under conditions of equivalence of prudential regulation, effective market access for reinsurance undertakings in the territory of each contracting party to provide for mutual recognition of supervisory rules and practice on reinsurance” (Article 50, Title VI), as well as submitting periodic reports on the treatment of EU reinsurers in third countries.

He also referred to “the spread of a broader and deeper financial services regulatory agenda, focussing on international standard-setting”, implicitly raising the question of EU influence internationally, and wrote:

“The last decade or more has the advent of new bodies such as the Financial Stability Forum, as well as dramatic extensions in the activities of the Basel Committee (including Basel II), IOSCO, the International Accounting Standards Board and the International Association of Insurance Supervisors, quite apart from regional initiatives in financial services regulation such as the EU’s Financial Services Action Plan and its focus (for insurance) on Solvency II. All these, quite apart from absorbing the attention of regulators and supervisors, have implications for harmonisation and/or mutual recognition of regulatory regimes, with unpredictable effects on future regulatory approaches to market access and national treatment.”

Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

CEIOPS was established by the European Commission in November 2003 and is composed of high level representatives from the insurance and occupational pensions supervisory authorities of each EU Member State. Participating observers include the European Commission itself, and representatives from Norway, Iceland and Liechtenstein. Its role is to provide advice to the European Commission on the drafting of implementation measures for

¹⁹ Alastair Evans (Lloyd’s) on the EU Reinsurance Directive

framework directives and regulations on insurance and occupational pensions, and the establishment of supervisory standards, recommendations and guidelines to enhance convergent and effective application of the regulations and to facilitate cooperation between national supervisors. CEIOPS participates in the EU Economic and Financial Committee and Financial Services Committee, and reports regularly to the European Parliament.

There is a managing board, a Secretariat located in Frankfurt, and five working groups and three permanent committees. A Consultative Panel monitors the work programme and results, and acts as a 'sounding board' in support of the policy-making process. CEIOPS publishes all issued documents on its website, and conducts public consultations.

References:

FSAgov.uk/pages/about/what/international/eu/ceiops/index.shtml

www.ceiops.org

2.2 International accounting standards

2.2.1 International Accounting Standards Board (IASB)

In March 2001, the International Accounting Standards Committee (IASC) Foundation was formed as a not-for-profit corporation incorporated in the State of Delaware, US. The IASC Foundation is the parent entity of the International Accounting Standards Board, an independent accounting standard-setter based in London, UK.

On 1 April 2001, the International Accounting Standards Board (IASB) assumed accounting standard-setting responsibilities from its predecessor body, the International Accounting Standards Committee. This was the culmination of a restructuring based on the recommendations of the report *Recommendations on Shaping IASC for the Future*.

The IASB structure has the following main features: the IASC Foundation is an independent organisation having two main bodies, the Trustees and the IASB, as well as a Standards Advisory Council and the International Financial Reporting Interpretations Committee. The IASC Foundation Trustees appoint the IASB members, exercise oversight and raise the funds needed, but the IASB has sole responsibility for setting accounting standards.

The governance of the IASB and its related bodies is ultimately in the hands of the Trustees of the International Accounting Standards Committee (IASC) Foundation. There are 22 Trustees. The IASC Foundation's Constitution provides that the Trustees must show a firm commitment to the IASC Foundation and the IASB as a high quality global standard-setter, to be financially knowledgeable, and to have an ability to meet the time commitment. Each Trustee shall have an understanding of, and be sensitive to, international issues relevant to the success of an international organisation responsible for the development of high quality global accounting standards for use in the world's capital markets and by other users.

International Accounting Standards (IAS): A comprehensive set of standards has been completed and promulgated by the IASB. Membership in IASB is predominantly private sector and carries no requirement that IAS be used. Adoption of IAS is the decision of national authorities or, where relevant, self-regulatory organizations. Some stock exchanges require financial statements in accordance with IAS as a condition for listing.

2.2.2 International Federation of Accounts (IFAC)

International standards on auditing (ISAs) and audit practice statements (IAPs) have been formulated by IFAC through its International Auditing Practices Committee (IAPC). IAPC

will work with IOSCO on ISAs for cross-border offerings and reporting by foreign issuers as soon as IOSCO has completed the IASC endorsement mentioned above.

A significant number of IFAC members use the ISA as a basis for developing their own national standards. The standards developed by IFAC/IAPC have no legal force; members are simply expected to use best efforts to see that IFAC and IASC pronouncements are used nationally. However, IFAC does encourage members to undertake a self review of their domestic auditing practices to evaluate how well they compare with the ISA.

The Public Sector Committee of the IFAC is formulating accounting standards for financial reports by governments and public sector entities.

Attachment A: The Joint Forum***Background to the Joint Forum***

The Joint Forum was established in early 1996 under the aegis of the Basel Committee on Banking Supervision (Basel Committee), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to take forward the work of a predecessor group, the Tripartite Group, in examining supervisory issues relating to financial conglomerates. The Joint Forum comprises an equal number of senior bank, insurance and securities supervisors representing each supervisory constituency. 13 countries are represented in the Joint Forum: Australia, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. The EU Commission attends in an observer capacity. The Chairmanship of the Joint Forum rotates between the three parent organisations and is named for a two-year term. The current Chairman is Mr José María Roldán, General Director of Financial Regulation at the Bank of Spain.

The growing emergence of financial conglomerates and the blurring of distinctions between the activities of firms in each financial sector have heightened the need for cooperative efforts to improve the effectiveness of supervisory methods and approaches. The Basel Committee, IOSCO and IAIS consider the coming together of representatives of each supervisory constituency in the Joint Forum to be of great value in building the cooperative spirit necessary to address the supervisory challenges arising from financial conglomerates.

The Joint Forum's original mandate focused, primarily, on diversified financial firms with complex organisational and management structures whose large-scale activities cross national borders and sectoral boundaries. The Joint Forum believes that the lessons drawn and the guidance prepared could also apply to smaller conglomerates or conglomerates that operate domestically.

In carrying out its original mandate, the Joint Forum has, in its first stage (a) pursued practical means at domestic and international levels to facilitate the exchange of information between supervisors within their own sectors and between supervisors in different sectors, (b) investigated any legal or other barriers which could impede the exchange of information between supervisors within their own sectors and between supervisors in different sectors, (c) examined ways to enhance supervisory coordination, including the benefits and drawbacks of establishing criteria to identify and define the responsibilities of a coordinator, and (d) developed principles towards the more effective supervision of regulated firms within financial conglomerates.

The Joint Forum updated its mandate in 1999, adding an additional dimension focused on cross-sectoral issues as well as those issues related to financial conglomerates. It also cooperated with other international bodies on issues where it shares a common interest. In carrying out this new dimension of its original mandate, the Joint Forum has in the past year performed cross-sectoral comparisons on issues of common interest to the three parent committees. These included the Core Principles issued by the banking, insurance and securities sectors (following a proposal from the IMF and the World Bank through the Financial Stability Forum) and risk management systems and approaches to capital in the three sectors. Reports on these issues were published in 2001. The Joint Forum is about to finalise a cross-sectoral comparison of corporate governance and the use of audit and actuarial functions for supervisory purposes.

The Joint Forum continues to work in cooperation with other international bodies on issues where it shares a common interest.

The Joint Forum should follow a work plan that is consistent with and reflects the priorities of its parent organisations. Topics may not necessarily be taken up or finished in the same time frame.

A. Issues of common interest to the three parent committees

(1) The Joint Forum should study issues of common interest to the three financial sectors and develop guidance and principles and/or identify best practices, as appropriate, in particular for:

- Risk assessments and management, internal controls and capital;
- The use of the audit and actuarial functions in the supervision of regulated entities and corporate groups containing regulated entities;
- Corporate governance, including fit and proper tests;
- Outsourcing by regulated firms of functions and activities;
- Different definitions of banking, insurance and securities activities and the potential that they may lead to regulatory arbitrage; and
- Identifying the core principles of the banking, insurance and securities sectors that are common and understanding the differences where they arise.

(2) The Joint Forum has specific mandates as follows:

- To undertake further work on risk assessments and capital and, if appropriate, develop further guidance and principles and/or identify best practices, with special focus on the following areas:
 - Risk Aggregation. – Approaches used by firms to manage and aggregate risks across multiple businesses and risk categories (e.g. credit, market, insurance, operational risks, etc.) and approaches used by supervisors to address the challenges of firms whose activities span multiple businesses and risk categories (e.g. capital distribution in groups).
 - Operational Risk management. – Efforts and approaches that firms are making to address operational risks in all their businesses and globally. Approaches of firms that may take on transferred operational risks.
 - Credit risk management and transfer. – Promote supervisory information sharing on issues relevant to credit risk transfer and aggregation of these risks in the firm as a whole.
- Disclosure of Financial Risks. – Following up on the recommendations of the April 2001 Multidisciplinary Group on Enhanced Disclosure:
 - Consider further (1) the means of expressing vulnerability to risk concentrations in market, credit, and insurance risks; (2) credit quality disclosure; and (3) additional development of risk assessment concepts and methods, such as those relating to market liquidity risk and potential future credit exposures.
 - Evaluate (1) the degree to which regulated financial intermediaries have complied with the four key recommendations contained in the Fisher Report; and (2) the degree to which (generally unregulated) hedge funds have complied with the four key recommendations

- Cross-sectoral implications of extreme exogenous shocks. – Regulatory forbearance, cross-sectoral cooperation and co-ordination in emergency situations, prudential robustness and contingency planning.

B. Issues relating to financial conglomerates

(1) The Joint Forum should enable bank, insurance and securities supervisors to share information about issues arising from the implementation of the principles issued and techniques developed by the Joint Forum. These pertain to:

- coordination;
- supervisory information sharing;
- capital adequacy;
- fit and proper tests;
- intra-group transactions and exposures; and
- risk concentrations.

The work may involve developing best practices to give effect to the principles set out in the papers.

(2) The Joint Forum has specific mandates as follows:

- to study financial conglomerate structures that may impair effective supervision or otherwise be problematic, and, having regard to the findings of that study, if appropriate, develop guidance and principles and/or identify best practices; and
- to assess the appropriateness of group-wide methods of supervision, and, having regard to the findings of that assessment, if appropriate, develop guidance and principles and/or identify best practices.

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Attachment B: International Association of Insurance Supervisors Core Principles**Scope and coverage of the *Insurance core principles***

6. The *Insurance core principles* provide a globally-accepted framework for the regulation and supervision of the insurance sector. IAIS principles, standards and guidance papers expand on various aspects. They provide the basis for evaluating insurance legislation, and supervisory systems and procedures.

7. The principles apply to the supervision of insurers and reinsurers, whether private or government-controlled insurers that compete with private enterprises, wherever their business is conducted, including through e-commerce. The term insurer refers to both insurers and reinsurers. Where the principles do not apply to reinsurers (such as, consumer protection), this is indicated in the text. Conversely, the core principles do not normally apply to the supervision of intermediaries, however, where they do this is specifically indicated.

8. Insurance supervision within an individual jurisdiction may be the responsibility of more than one authority. For example, the body that sets out the legal framework for insurance supervision may be different from the body that implements it. In this document, the expectation is that the core principles are applied within the jurisdiction rather than necessarily by one supervisory authority. It is, however, essential that in situations where multiple authorities exist, coordination arrangements be established to ensure the implementation of the core principles within an accountable framework.

9. The supervisory authority must operate in a transparent and accountable manner. It needs legal authority to perform its tasks. It should be noted, however, that the possession of authority is not enough to demonstrate observance with a principle. The supervisory authority should exercise its authority in practice. Similarly it is not enough for the supervisory authority to set requirements; it should also ensure that these requirements are implemented. Having the necessary resources and capacity is essential for the supervisory authority to effectively implement the requirements.

10. The supervisor must recognise that transparency and accountability in all its functions contribute to its legitimacy and credibility, and the efficiency and stability of the market. A critical element of transparency is for supervisors to provide the opportunity for meaningful public consultation on the development of supervisory policies, and in the establishment of new and amended rules and regulations. To further ensure the proper and efficient operation of the market, supervisors should establish clear timelines for public consultation and action, where appropriate.

Implementation and assessment

11. The *Insurance core principles* can be used to establish or enhance a jurisdiction's supervisory framework. They can also serve as the basis for assessing the existing supervisory framework and in so doing may identify weaknesses, some of which could affect policyholder protection and market stability. In order to ensure that the core principles are interpreted and implemented in a consistent manner by insurance supervisory authorities, each principle is followed by an explanatory note and criteria. Annex 1 contains a list of IAIS principles, standards and guidance documents, as well as selected codes, that expand on some of the core principles. This list will be updated as new principles, standards and guidance are developed. Annex 2 sets out factors that should be considered when using or implementing these principles and describes how observance should be evaluated.

12. The criteria, which must be implemented both in form and in practice, consist of two distinct groupings:

(i) essential criteria, or those components that are intrinsic to the implementation of the core principle. All the essential elements should be met for a supervisory authority to demonstrate “observed” status for each principle.

(ii) advanced criteria, or those components that are considered to improve on the essential criteria and thus enhance the supervisory regime. Advanced criteria are not used for assessing observance with a principle, rather they are used when commenting on a jurisdiction’s supervisory framework and making recommendations.

13. While implementing the criteria in a jurisdiction, and when carrying out the assessment, it is important to take into account the domestic context, industry, structure and stage of development of the financial system and overall macroeconomic conditions. The ways and means of implementation will vary across jurisdictions, and while good implementation practices should be kept in mind, there is no mandated method of implementation. For example, in some jurisdictions the supervisory authority may, within clear limits and following a consultative process, be able to issue guidelines or establish regulations that insurers must follow, whereas in other jurisdictions these powers may reside with the legislature.

14. For a core principle to be regarded as being “observed” the essential criteria must be met without any significant shortcomings although there may be instances, where one can demonstrate that the principles have been observed through different means other than those identified in the criteria. Conversely, owing to the specific conditions in individual jurisdictions, the criteria identified in this document may not always be sufficient to achieve the objective of the specific principle and therefore additional elements may have to be taken into account.

3 OVERVIEW OF GLOBAL TRADE ISSUES

This chapter necessarily cannot be a text book on trade issues, nor even be a digest of the wide range of potential material, and therefore the selection of what to include and to highlight, is subjectively guided by the aim of finding relevance to insurance services. It also has to be relatively brief.

3.1 GATT and the World Trade Organisation

3.1.1 The GATT “Uruguay Round” trade negotiations

The General Agreement on Tariffs and Trade (GATT) trade negotiations, begun in Punta del Este, Uruguay in September 1986 (the “Uruguay Round”) were finally concluded in December 1993 and the Ministerial Meeting in Marrakech in April 1994 approved the creation of the World Trade Organisation (WTO) and as one its main pillars, the General Agreement on Trade in Services (GATS).

From the late 1970s a handful of services multinational companies in the US, including in banking and insurance, had pressed their government to recognise services in the US trade laws and then to press for the same at the multilateral level. They met broad resistance, and the GATT Ministerial Meetings of 1982 and 1984 could not agree on a way forward, only that service sector studies should be tabled by Members on a voluntary basis.²⁰ As the significance of services in the economy and in trade became clearer, by the 1986 Ministerial there was enough support to negotiate on services, but only on a legally separate, if parallel, track to the GATT negotiations on merchandise trade, and so the Group of Negotiations on Services (GNS) was formed. Initially the US Treasury and some other finance ministries did not want financial services as an integral part of any future agreement, but as a separate element, and it took a decade for this division to be finally resolved.

At the outset, the private sector pressed for four general principles to be included in the agreement as general obligations: most favoured nation (MFN) treatment, national treatment (ie the two forms of non-discrimination), transparency and the right of establishment. However, this was too strong a mixture for the developing countries, and after tough bargaining at the 1988 Ministerial in Montreal, they obtained the concession that only MFN and transparency should be general obligations, though with some built in exemptions and exceptions for MFN and a weak form of transparency. The application of national treatment, although recognised as a principle, was left to governmental discretion and the right of establishment was not adopted in any form. To fill this gap the artificial construct of market access was placed in the framework of what was later to become the GATS. Market access is not itself a principle and this has created some ambiguity which persists to this day.²¹ Thus the developing countries were accepted as full Members of GATS even if they gave no national treatment initially and only accepted minimal access in one or two sectors or sub-sectors and even so with limitations: a fully flexible “bottom up” approach to the acceptance of liberalisation obligations. This was made even more flexible by differentiating on the degree of market access between the four different ways (or modes) of supplying services. This contrasts with the structure of certain bilateral and plurilateral free trade agreements, concluded since 1988, which have a “top down” approach with lists of specific exceptions, though none of which has proceeded as far as the EU Internal Market.

²⁰ Among the first to table national studies were Canada, the US and the UK.

²¹ As OECD puts it, explaining the GATS structure and the scheduling of specific commitments: “ [] under the Article XX:2 any measures inconsistent with both Article XVI (market access) and Article XVII (national treatment) are scheduled in the market access column of the schedule. Moreover, most of the entries in the national treatment column are highly correlated with those in the market access column so that liberal market access commitments are frequently accompanied by full national treatment commitments, and vice versa.” DAF/AS/WD(2003)15, 2 June 2003, Para.17, page 8.

3.1.2 The UK LOTIS Committee and the US Coalition of Service Industries

As part of the private sector advocacy activities, the Liberalisation of Trade in Services (LOTIS) Committee of the then Committee on Invisible Exports was formed in late 1981²², and the US Coalition of Service Industries in the Spring of 1982. The US CSI formed a 'Financial Services Group' which during the Uruguay Round issued a paper "Financial Services in the Uruguay Round: negotiating objectives and key issues" (January 1990), proposing the elimination of "a significant number of financial services barriers" and the provision of "guarantees against the introduction of new barriers" and the establishment of "effective machinery for enforcement and continued liberalisation". It included a detailed note on definitions and coverage of financial services activities and products. Significantly it added that: "Any provision for prudential considerations should be narrowly drawn [] so as not to encourage abuses that would undermine the overall effectiveness of the agreement." This is such a sensitive subject that it has not been revisited in any depth at the CTS since the inception of the GATS.

3.1.3 Conclusion of the Uruguay Round

Once the contentious Uruguay Round negotiations on agriculture and other merchandise had been finally concluded in 1993, (following a bleak failure in Brussels in 1991 - when the draft wording for the nascent GATS was full of square brackets), towards the end there was the surprising consensus to create the WTO to comprise the GATT, GATS and TRIPS (and various other specific agreements). However, the market access could only be signed off by leaving the position open (ie not concluded) on four major service sectors: telecommunications, financial services, maritime transport and most of air transport. The latter two have not yet been resolved despite the passage of 14 more years, but notably there was a major breakthrough for telecommunications in April 1997²³ and further for financial services in December 1997, and the provisions of the latter agreement entered into force in 1999. The key to obtaining treasury/finance ministry agreement to the inclusion of financial services was that the regulators retained full discretion over regulations to protect their economies from systemic financial sector risks – what we now call the 'prudential carve-out'. The GATS Annex on Financial Services (see Annex 2 for its full text) includes the following provision:

"§ 2 (a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement."

These ministries had also insisted in the Uruguay Round on their own definitions of financial services, placed in the GATS Annex, which was not constrained by the UN Provisional Central Product Classification-based listing applied to all sectors.

3.1.4 Committee on Trade in Financial Services

Such was the importance attached to financial services that the Council for Trade in Services of the GATS immediately set up its Committee on Trade in Financial Services, as provided for in the Marrakech agreements of April 1994. It "is mandated to provide a forum for

²² The present author was a founding member, advocating the positions of the consultancy sector, and served on LOTIS until 1995, when he moved to live in Spain.

²³ The fourth protocol of the GATS entered into force in 1998.

technical discussions, to conduct studies on measures of Members and to conduct examinations of any technical matters affecting trade in services in the financial sector.” It has discussed a range of technical issues, including those covered in a paper by the Secretariat, for example the distinction between Modes 1 and 2 for financial services, cross-border solicitation and marketing, classifications, scheduling clarification, consistency of schedules with the MFN Exemptions, and phasing in staged liberalisation of financial services commitments.²⁴ The Secretariat offered technical assistance on scheduling techniques for developing country Members.

A later paper by the Secretariat “A brief analysis of cases of ‘ad hoc scheduling’ in past services negotiations”²⁵ for the GATS Committee on Specific Commitments pointed out that as of June 1996, 19 Members had followed the classification for financial services in the Annex on Financial Services, and 33 the classification of the GNS/W/120,²⁶ and discussed the differences between them and the UN Provisional Central Product Classification. The insurance services at issue are accidental and health, reinsurance and retrocession, broking and agency services, and auxiliary services such as “consultancy, actuarial, risk assessment and claim settlement services.”

3.1.5 The “Understanding on Commitments in Financial Services”

Some 40 countries have agreed to implement a high standard of commitments inscribed in a further document agreed at the end of the Uruguay Round, the “Understanding on Commitments in Financial Services” (see Annex 4), though some have reservations on part, which they attach to their schedules of specific commitments. They continue to urge others to accept its commitments. The Understanding includes a standstill on conditions and limitations, the elimination of monopoly rights, full MNF and national treatment, cross-border supply of specified services, the right of establishment and the ability to offer any new financial service desired. It also provides, in the case of enterprises already established, for the temporary entry of certain senior and specialist categories of staff, and also of specialists in computer services, telecommunications services and accounts of financial services suppliers and actuarial and legal specialists, if there are no qualified personnel available locally.

3.1.6 Negotiations on services liberalisation

The GATS includes in its Article XIX the following provision:

“§ 1. In pursuance of the objectives of this Agreement, Members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement and periodically thereafter, with a view to achieving a progressively higher level of liberalization. Such negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. This process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.”

Thus as mandated, further negotiations on the liberalisation on international trade in services began in January 2000, and this has been conducted in “Special Sessions’ of the Council on Trade in Services of the GATS. At the WTO Ministerial Meeting in December 2001 held in Doha, Qatar, it was agreed to subsume the GATS negotiations into the Doha Development Agenda round of WTO trade negotiations as part of a so-called ‘single undertaking’.

²⁴ WTO document by the Secretariat: “Technical issues concerning financial services schedules”. S/FIN/W/9, 29 July 1996 (§ 1).

²⁵ WTO document S/CSC/W/11, 9 October 1997 – see Section III, page 3.

²⁶ WTO document by the Secretariat: “Services Sectoral Classification List”, MTN.GNS/W/120, 10 July 1991.

3.1.7 The WTO “Doha Development Agenda” round of trade negotiations

In the “Ministerial Declaration” (WT/MIN(01)/DEC/W/1, 14 November 2001), the instructions for the services negotiations were as follows:

SERVICES

15. The negotiations on trade in services shall be conducted with a view to promoting the economic growth of all trading partners and the development of developing and least-developed countries. We recognize the work already undertaken in the negotiations, initiated in January 2000 under Article XIX of the General Agreement on Trade in Services, and the large number of proposals submitted by Members on a wide range of sectors and several horizontal issues, as well as on movement of natural persons. We reaffirm the Guidelines and Procedures for the Negotiations adopted by the Council for Trade in Services on 28 March 2001 as the basis for continuing the negotiations, with a view to achieving the objectives of the General Agreement on Trade in Services, as stipulated in the Preamble, Article IV and Article XIX of that Agreement. Participants shall submit initial requests for specific commitments by 30 June 2002 and initial offers by 31 March 2003.

Thus the services negotiations are based mostly on the confidential bilateral ‘request and offer’ process, as provided for in § 11 of the “Guidelines and Procedures for the Negotiations on Trade in Services” (S/L/93, 29 March 2001).

The following is an extract from this WTO document:

III. MODALITIES AND PROCEDURES

8. The negotiations shall be conducted in Special Sessions of the Council for Trade in Services, which will report on a regular basis to the General Council, in accordance with decisions taken by the General Council.

9. Negotiations shall be transparent and open to all Members and acceding States and separate customs territories according to Decisions taken in this regard by the General Council.

10. The starting point for the negotiation of specific commitments shall be the current schedules, without prejudice to the content of requests.

11. Liberalization shall be advanced through bilateral, plurilateral or multilateral negotiations. The main method of negotiation shall be the request-offer approach.

12. There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in Article IV.

13. Based on multilaterally agreed criteria, account shall be taken and credit shall be given in the negotiations for autonomous liberalization undertaken by Members since previous negotiations. Members shall endeavour to develop such criteria prior to the start of negotiation of specific commitments.

By the time of the next WTO Ministerial Meeting in Cancun in 2003 little progress had been made in the services negotiations, and that meeting anyhow broke up without any results. At the Ministerial Meeting in Hong Kong in December 2005 there was progress evident due to the persistence of the Chairman of the Special Sessions of the Council for Trade in Services

of the GATS. This became clear when the Ministerial Declaration was issued (WT/MIN(05)/DEC, 22 December 2005) with the following paragraphs setting out the modalities for the services negotiations:

SERVICES NEGOTIATIONS

25. The negotiations on trade in services shall proceed to their conclusion with a view to promoting the economic growth of all trading partners and the development of developing and least-developed countries, and with due respect for the right of Members to regulate. In this regard, we recall and reaffirm the objectives and principles stipulated in the GATS, the Doha Ministerial Declaration, the Guidelines and Procedures for the Negotiations on Trade in Services adopted by the Special Session of the Council for Trade in Services on 28 March 2001 and the Modalities for the Special Treatment for Least-Developed Country Members in the Negotiations on Trade in Services adopted on 3 September 2003, as well as Annex C of the Decision adopted by the General Council on 1 August 2004.

26. We urge all Members to participate actively in these negotiations towards achieving a progressively higher level of liberalization of trade in services, with appropriate flexibility for individual developing countries as provided for in Article XIX of the GATS. Negotiations shall have regard to the size of economies of individual Members, both overall and in individual sectors. We recognize the particular economic situation of LDCs, including the difficulties they face, and acknowledge that they are not expected to undertake new commitments.

27. We are determined to intensify the negotiations in accordance with the above principles and the Objectives, Approaches and Timelines set out in Annex C to this document with a view to expanding the sectoral and modal coverage of commitments and improving their quality. In this regard, particular attention will be given to sectors and modes of supply of export interest to developing countries.

The Annex C referred to in paragraph 27, is given in full in Annex 5 of the present paper. It gives guidance on the level of liberalisation commitments expected of Members under the four modes of supply and on the removal of MFN exemptions. For example in Modes 1 and 2 it aims for “commitments at existing levels of market access on a non-discriminatory basis across sectors of interest to Members [] the removal of existing requirements of commercial presence” and “commitments in Mode 2 where commitments on Mode 1 exist”. In Mode 3 it suggests “commitments on enhanced levels of foreign equity participation [] removal or substantial reduction of economic needs tests” and “greater flexibility on the types of legal entity permitted.” In Mode 4 it suggests de-linking commitments from commercial presence and improving commitments “on the categories of Contractual Services Suppliers, Independent Professional and Others” and improved commitments “on the categories of Intra-corporate Transferees and Business Visitors.”

The 2005 Annex C also requires “clarity, certainty, comparability and coherence in the scheduling and classification of commitments through adherence to, *inter alia*, the Scheduling Guidelines.”²⁷ It further recorded agreement “to intensify and expedite the request-offer negotiations, which shall remain the main method of negotiation, with a view to securing substantial commitments.” This would be done by pursuing the negotiations “on a plurilateral basis” which includes that: “Any Member or group of Members may present requests or collective requests to other Members in any specific sector or mode of supply, identifying the objectives for the negotiations in that sector of mode of supply.” [§ 7 (a)]

²⁷ WTO document “Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services”, S/L/92, 26 March 2001. As it is 40 pages long: it is not attached as an Annex below.

At the time of writing the present paper, most WTO Members have received confidential bilateral requests but not all have made initial offers. Offers are made public, but there is not space here to describe them. Members are urging each other to table revised offers in 2007 or even revised versions of earlier revised offers.

UNCTAD summed up the position as follows:²⁸

43. *In the current round of negotiations, the offers submitted so far indicate that there has not been a substantial change in the overall picture/pattern of commitments. Out of 69 offers, 30 contain some sort of improvements in relation to insurance services, either by including new subsectors or by making improvements to existing commitments. One expert pointed out that, in general, offers are minimal and fall short of what could be achieved (i.e. considering what the current national-level practice already allows). It was also pointed out that during the Uruguay Round, developed countries made relatively deeper commitments (especially on Mode 3). Also accession countries have made deep commitments. In the current round of negotiations further and deeper commitments have been sought specifically in cross-border trade in insurance services.*

3.1.8 Collective request of financial services

In addition in March 2006 a “Financial Services Collective Request” was tabled by Canada on behalf of eight countries, itself and the EU. It is “intended to complement the ongoing bilateral request-offer negotiations and the specificity of bilateral requests” (see Annex 6 below for the full text). It requested that Members “Use the agreed definitions in the GATS Annex on Financial Services for scheduling commitments” and in Modes 1, 2 and 3 to implement the main features of the “Understanding”, although this document was not referred to.

3.1.9 Recently Acceded Members (‘RAMs’)

It is notable that the 30 or so WTO Members that have acceded since 1995 have mostly made GATS commitments that match, in general or even exceed those of developed countries, including for financial services. They have formed the RAMs Group to advocate that other Members should recognise this in the request-offer negotiations and indeed should improve their specific commitments to match those of the RAMs. They have not proposed anything specific in relation to insurance services.

3.1.10 Good Friends of Services Group

The Good Friends of Services Group of WTO Members, including the Quad, Switzerland, Australia, New Zealand and Hong Kong are a coherent core of the wider Friends of Services grouping pressing for a successful outcome to the services negotiations. In late 2000 and in 2001 they had led the way in making detailed proposals for increased liberalisation of financial services, as did also Norway and South Korea. Later Colombia and Cuba tabled papers too. The WTO Secretariat issued a “Synopsis of Negotiating Proposals” in the summer of 2001, which included an eight page section on financial services.²⁹

²⁸ UNCTAD/DITC/TNCD/2006/1, 19 April 2006.

²⁹ See WTO document with the reference: Job(01)63, 3 May 2001, pp 63-70.

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There are still deep divisions between WTO Members in the major negotiations on agricultural subsidies and merchandise tariffs. As a result the negotiations in the Council for Trade in Services Special Sessions have been almost marking time, with convergence on key issues not yet apparent. This includes the extent of fresh liberalisation for the main service sectors where the advanced economies and the 'Recently Acceding Members' have a higher level of specific commitments than most developing countries.

The majority of current offers for liberalisation date from early 2006. The plurilateral request on insurance services also dates from then: it seeks liberalisation to the high level of the Understanding on Commitments in Financial Services. (See Annexes 4 and 6 for the full wordings of the Understanding and Request, respectively.)

There appears to be deadlock on the extent of commitments under Mode 4 for the movement of semi-skilled and unskilled workers. Firstly there is the principle: are all the workers suppliers of services under the Mode 4 definition, or are they employees of firms supplying services and not strictly covered? Secondly is their movement possibly envisaged under the "Annex on the Movement of Natural Persons Supplying Services under the Agreement"? Thus in practice negotiations would be on the categories of occupation to be designated for permitted entry.

Negotiations on the GATS framework issues have also stalled, particularly attempting to find consensus on Emergency Safeguard Measures and dealing fully with subsidies and government procurement. Progress does seem evident on disciplines for domestic regulation, but only by watering them down and avoiding the two key issues of necessity and prior comment.

The most that can be expected for specific commitments in the insurance sector would be to bind current autonomous liberalisation levels, and any further liberalisation will have to arise in Regional Trade Agreements, which so far have not begun to address the key challenges where developing countries are involved.

Proposals by the private sector for a Model Schedule for specific commitments on insurance services have not been picked up by the services negotiators. Some observers suggest that negotiators should consider specific disciplines for domestic regulations related to insurance services, presumably in the next 'successive' round of services negotiations mandated under GATS Article XIX *Negotiation of Specific Commitments* in Part IV *Progressive Liberalisation*. Others have suggested that UNCTAD should develop practical means and advice for developing countries on how local insurers can successfully stand up to foreign competition, rather than seek protection for its own sake.

Many observers now say that the time to successfully conclude the Doha Round in 2007 or early 2008 has run out, there being simply too much detailed work still remaining, even if consensus were to be reached on the overall parameters. Further, as the US President's Trade Promotion Agreement has expired, and as the 2008 presidential and congressional election fever has begun early, it appears almost certain that a special extension of the TPA for the Doha results would no longer be possible, and it would have to await a new President to pick it up in 2009 or later.

3.1.11 The WTO Dispute Settlement Understanding (DSU).

GATS Articles XXII *Consultation* and XXIII *Dispute Settlement and Enforcement* provide that for any consultations concerning the operation of the GATS and for any disputes “The Dispute Settlement Understanding (DSU) shall apply to such consultations” and “In the event an agreement cannot be reached between the Members concerned, Article 22 of the DSU shall apply” respectively. Initially consultations should be conducted to resolve such concerns, and failing agreement, a Disputes Panel should be set up to hear and decide the case.

It is noteworthy that the Annex on Financial Services in its paragraph 4 states: “Panels for disputes on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial service under dispute.”

If a Panel decision is disputed, an appeal can be made to the standing Appellate Body and its decisions are then upheld should the WTO Members sitting as the Dispute Settlement Body adopt the Appellate Body’s report, unless “the DSB decides by consensus not to adopt the report within 30 days following its circulation to the Members.”³⁰ All rulings have so far been adopted by the WTO Members, without dispute.

Most trade disputes are resolved by the WTO dispute mechanism, and the number of cases dealt with has been growing. According to the WTO Legal Affairs Division by early 2003 many disputes were resolved without formal consultations, and most that go to formal consultations were resolved without going to a Panel. In only 40 percent of the disputes under formal consultations had there been a Panel established.³¹

To date no cases related to financial services have been referred to a Dispute Panel.

It is notable that the WTO is the only multilateral body related to trade with such a dispute settlement mechanism. This is not found at OECD, which relies on peer pressure, or at UNCTAD.

3.1.12 The WTO Trade Policy Review Mechanism (TPRM)

The purpose of the TPRM is to “contribute to improved adherence by all Members to rules, disciplines and commitments made under the Multilateral Trade Agreements, and where applicable, the Plurilateral Trade Agreements, and hence to the smoother functioning of the multilateral trading system, by achieving greater transparency in, and understanding of, the trade policies and practices of Members. [] It is not, however, intended to serve as a basis for the enforcement of specific obligations under the Agreements or for dispute settlement procedures, or to impose new policy commitments on Members.”³²

The periodicity of these reviews is related to the share in world trade of a country: three Members and the EU are reviewed every two years, the next 16 every four years, and the rest every six years, unless a longer period is agreed for LDCs. As noted in Chapter 4 below, Brazil was last reviewed in 2004, China in 2006 (as an exception, so another is currently being prepared by the WTO Secretariat), India in 2002 with the next in 2007 and Mexico in 2002 with the next early in 2008.

³⁰ See Article 14 of the Understanding on page 419 of “The results of the Uruguay Round of multilateral trade negotiations – the legal texts”, GATT Secretariat, June 1994.

³¹ “The consultations of WTO Dispute Settlement”, James Bacchus, address to the IBA, Geneva, 20 March 2003.

³² Annex 3, Trade Policy Review Mechanism, (§ A (i)), page 434 of “The results of the Uruguay Round of multilateral trade negotiations – the legal texts”, GATT Secretariat, June 1994.

Although the information available for these reviews on the insurance sector has been increasing when compared with a few years ago, the WTO reports suffer from being prepared by staff in the TPRM Division who are not conversant with financial services. The Secretariat plans to improve future reports by arranging for specialists in the Trade in Services Division to do the primary drafting of the sections on financial services.

3.2 Work at OECD on insurance issues

3.2.1 OECD Insurance Committee

Since its inception more than 35 years ago, a main component of the mandate of the Insurance Committee has been to work towards the liberalisation of the establishment, investment and the cross-border operations of insurance companies. It works in cooperation with the Committee on Capital Movements and Invisible Transactions (which is responsible for the OECD Codes of Liberalisation) and the Trade Committee for related conceptual issues.³³

“The Committee promotes transparency on obstacles to international transactions involving insurance and private pensions, in particular by identifying and analysing such obstacles.” One of its publications is “Insurance regulation and supervision in Asia and Latin America”.

In the OECD Department of Insurance, activities have focussed on the liberalisation of insurance markets, private pensions, private health insurance, governance, financial education, mitigation and compensation of large-scale risks including terrorism risks, monitoring of insurance market and its regulatory framework, dissemination of statistical data and co-operation with non-member economies. However, most of the work has not been directed at the GATS negotiations.

In the Trade Directorate during 2002 some work was done on “Managing request-offer negotiations under the GATS”. The paper “Follow up to ‘Managing request-offer negotiations under the GATS’: the case on insurance services” aims to produce checklists of “immediate operational use in the context of the GATS request-offer negotiations.”³⁴ As a capacity building tool it “could also yield useful insights into a range of issues arising at the interface of domestic regulation and services trade and investment liberalisation.”

The introduction points out that:

“§ 4. [] Any liberalisation also needs to be underpinned by a sound regulatory environment, and of the sequencing of any regulatory reform necessary to safeguard key policy objectives and to provide high quality, efficient regulation appropriate for a liberalised market. This process itself requires consultation and coordination with various constituencies both domestic and foreign, public and private.”

“§ 5. [] To make meaningful negotiating offers, Members need to feel confident in their own ability to manage the regulatory and economic implications. They also need to take a broad view of other relevant horizontal or other sectoral commitments that affect the insurance sector in addition to assessing multiple effects of the particular commitments in the insurance sector.”

³³ See Box 4.1, page 20 of OECD Secretariat document: DAF/AS/WD(2003)15, 2 June 2003.

³⁴ DAF/AS/WD(2003)15, 2 June 2003. This is an exercise in conjunction with UNCTAD – which is looking at energy and construction services.

The part on the background related to the international nature of insurance services, points out:

“§ 9. Some classes of insurance tend to be international. Insurance linked to transports such as marine and aviation and to trade in goods are inherently international. The huge risks associated with natural catastrophes and large industrial plants require diversification of cover in the international market; reinsurance is typically an international service. As risks come in different sizes and forms, no individual country has the insurance capacity necessary to efficiently cover all of the risks present in the country.”

“§ 10. Prudential regulation and supervision play an important role at the various levels to ensure policy objectives including protection of policyholders and investors, given the diverse nature of risks and relevant stakeholders. One particularly important feature of the insurance sector is that it provides products which not only cover large risks, but which may include long-term responsibilities. This time-frame, and the extent of the required investment, greatly increases the value of the guarantee of a stable regulatory and policy environment. For this reason, the insurance industry has attached high importance to binding commitments under the GATS.”

The paper then goes on to quote Professor Harold D Skipper Jr from his paper “Foreign Insurers in Emerging Markets: Issues and Concerns”, International Insurance Foundation, 1997, on how efficient insurance services can contribute to economic development. The six headings are:

1. Business facilitation
2. Reduced uncertainty for individuals
3. Risk management services for businesses and individuals
4. Risk management through risk pooling
5. More efficient allocation of a country’s capital
6. Mobilisation of national savings.

The OECD paper continues so as to demonstrate how “the GATS affords WTO Members considerable flexibility in making commitments.”

Referring to the GATS Annex on Financial Services it is noted that “insurance and insurance related activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government fall outside the scope of the GATS. [] and if a WTO Member allows these activities to be conducted by its financial service suppliers in competition with a public entity or a financial service supplier, these activities will fall under the GATS.” (§ 19) It also points out that “prudential measures falling within the scope of the Article XVI and XVII of the GATS need not be listed as limitations on market access and national treatment in a WTO Member’s schedule” (§ 20).

As for the Understanding on Financial Services, the paper notes that it is not an integral part of the GATS, and although it includes “far-reaching rules and disciplines [] it was not designed to set limits on the scope of any future financial liberalisation” (§ 21). Usually such voluntary adherence to the norms of the Understanding is inscribed in the head note of the section on financial services in Members’ schedules, and thus forms part of the binding obligations. Some developing countries have noted reservations against parts of the Understanding (§ 22).

Again quoting Professor Harold Skipper, the paper lists the following potential benefits of liberalising insurance services (in § 29):

1. Improvements in customer services and value

2. Additional external financial capital
3. Increased domestic savings
4. Tax revenue
5. Transfer of technological and managerial know-how
6. Creation of beneficial domestic spillovers
7. Improvements in the quality of insurance regulation.

The reasons adduced (in § 30) by governments that reserve the provision of insurance services to national entities include:

- National policy reasons, such as national security and economic diversification
- Social reasons related to financial security and quality of life
- Cream-skimming, anti-competitive practices, or market concentration issues, that may ensue from the entry of foreign companies, or overly fierce competition of dominant players leading to the exit of weaker local firms
- Infant industry arguments – inexperienced local firms need shelter from foreign competition
- Balance of payments concerns.

Under the heading “Regulatory issues: required regulatory framework to be adjusted or regulatory reform efforts to be undertaken” the paper states that:

“An effective insurance regulatory framework is crucial for addressing a fundamental market information deficit, namely that an insurance consumer has no means of forming a judgement of the long term soundness of an insurance provider. It is also the key to assuaging concerns about open markets and foreign participation. Regulatory reform efforts are fundamental to ensure a better regulatory framework with effective prudential regulation that gives confidence to all stakeholders. Far from entailing deregulation, liberalised markets generally require a degree of re-regulation, or regulatory reform to ensure both that the benefits of liberalisation are reaped (eg in the creation of a genuinely competitive market) and that important policy objectives (eg consumer protection) remain realised via efficient and effective regulation” (§ 35).

“An adequate system for monitoring operations – such as: effective reporting and accounting practices; and continuous monitoring of capital adequacy, solvency, reserves and investment – should also be in place. While those prudential regulations for consumer protection are of primary importance, other consumer related measures – such as: public complaints processing; consumer education and information; and guarantee funds to protect consumer interests in case of insolvency with due consideration to the risk of moral hazard and to their limitation – are also worth taking into account. [] There should be a shift from coordinated or imposed product-control and price-control, to a system where rates are determined by market forces. Abuse of dominant power or universal services issues should also be addressed. Admission of new domestic and often foreign participation in the market, both at direct and reinsurance level should be encouraged. [] A supervisory authority independent from industry or suppliers may enhance the effectiveness of regulations and supervision. [] Another aspect of transparency requires that all interested parties have the opportunity to be aware of and to comment on proposed regulations and that methods to challenge regulatory decisions be available. In crafting proposed insurance laws and regulations, the authority should: make such proposals easily available to the public; invite comments on the proposals; and allow sufficient time for interested parties to comment” (§ 37).

In 2000 the OECD Insurance Committee endorsed its “Framework of Insurance Market Liberalisation” (see Annex 8 below for the full text).

3.3 Work at UNCTAD on insurance issues

“Insurance has been on the work programme of UNCTAD since its inception in 1964. Over the years and in direct response to the needs of developing countries, activities related to the insurance sector have become an institutionalised part of UNCTAD and one of its mainstays. The objective of the Insurance Programme is to help, in particular developing countries, establish competitive and well regulated insurance markets. It conducts its work through producing analytical work and conducting technical cooperation.”³⁵

Furthermore, the objective of UNCTAD “is to improve access for a large part of the population to insurance services and to mobilise investible resources from this sector. Assistance is provided to insurance supervisory authorities in the establishment of legal and supervisory insurance frameworks; training is organised and information provided on insurance markets to government officials, regional associations and managers of insurance concerns. Software to assist in insurance company management has been developed.”

A study by the UNCTAD Secretariat was tabled at the Standing Committee on Developing Services Sectors meeting on 13 November 1995 which set out issues for the establishment of effective insurance regulation and supervision: “Review of critical areas with regard to insurance legislation, regulation and supervision. – Establishment of effective insurance regulatory and supervisory systems.”

The mandate in the area of insurance is contained in the 2000-2004 UNCTAD Plan of Action which was approved at UNCTAD’s Tenth Session in February 2000 in Bangkok (see UNCTAD document TD/390, 21 September 2000). The following are the parts that refer to insurance:

(iii) Banking and insurance

154. UNCTAD should carry out analytical and technical assistance work to help regulators and relevant industry associations in upgrading the regulatory and institutional framework for this sector to adapt to international and best practices and to requirements under WTO/GATS.

(iv) Services for micro-enterprises

155. UNCTAD should continue its analytical and technical assistance work on the development of financial infrastructures and services addressing the needs of micro-enterprise, including in the fields of micro credit, insurance and saving.

D. Service infrastructure for development and trade efficiency and human resources development

148. UNCTAD should continue to assist developing countries and countries in transition in building up a service infrastructure in the areas of customs, transportation, banking, insurance and tourism with a view to improving their competitiveness in the international market place.

In the “Activities Report” of UNCTAD’s Division on Investment, Technology and Enterprise Development for 2001, the focus is on the quality of output to assist “developing countries to be more adequately prepared in order to compete in an environment of increasing globalisation and rapid technological change” (page 3). Its “interactive approach in

³⁵ UNCTAD web site: <http://r0.unctad.org/insuranceprogramme/about.html>.

programme implementation” is pursued “at three levels ie research and policy analysis, inter-governmental deliberation and technical assistance”. It carried out workshops on “Development of Competitive Insurance Markets” in about 50 countries in Africa, Asia (including China and India) and the Caribbean region (page 26).

In June 2001 for the fifth session of the Committee for Trade, Industry and Enterprise Development the Secretariat tabled a paper: “Important features of the service sector and trade in services in transition economies – financial services in transition economies”.³⁶ This described some of the “dramatic changes during the transition period” in the financial sector.

Noting that the insurance sector seemed even less developed than the banking sector in went on: “In 1999, in transition economies as a whole the ‘average insurance penetration’, measured by total insurance premiums as percentage of GDP, was estimated at 1.7 per cent for non-life and 0.7 per cent for life insurance. In the same year, in western Europe these figures stood at 3.0 per cent and 5.0 per cent respectively.” (They were quoting Swiss Re figures from SIGMA, No. 1/2001).

In November 2001 a three-day workshop attended by heads of Insurance Supervisory Authorities of African countries was held in Libreville, Gabon, on the subject of “Motor Insurance Issues Relating to Liberalisation and Trade Negotiations” because “Motor insurance, a prevailing business in African insurance markets, is in many countries posing serious concerns to the industry and to regulatory authorities. In many cases, inadequate rates, harsh price competition, imbalances in market structures, deficiencies in legal frameworks and judiciary practices and lack in supervisory efficiency are bring serious instability to insurance markets.” It was hoped to “discuss possible remedial measures based on experiences of countries that have improved the situation in their motor insurance markets.”

In addition, the introduction stated: “there is now a consensus among negotiators that if negotiations in the area of financial services are to resume, regulators should be part of the national delegations. This implies that supervisory authorities will have to assess the situation of their domestic markets, and build with other governmental bodies, possible positions/scenarios for the negotiations.”

On 24 November 2005, there was an ad-hoc one day meeting on “Trade and Development Aspects of Insurance Services and Regulatory Frameworks”. Before this workshop the Secretariat circulated a paper “Trade and Development Aspects of Insurance Services and Regulatory Frameworks” (UNCTAD/DITC/TNCD/2005/17, undated) which gave “an overview of the global insurance market and emerging trends; the importance of the insurance sector for economic development; the significance and elements of an effective regulatory framework; development issues arising from insurance services liberalisation; the importance of insurance as a public good; and the implications of GATS negotiations for the insurance sector and areas of potential export interest for developing countries.”

The report on this workshop (UNCTAD/DITC/TNCD/2006/1, 19 April 2006), stated that: “Insurance experts from governments, regulators, trade negotiators, representatives of the private sector, international organisations and civil society were invited to put forward their views on how to assure development gains from the insurance sector. Particular focus was placed on how Governments of developed and developing countries could play an active role, at the national level and in multilateral negotiations, in maximising benefits from trade in insurance services.” One of the presentations was a case study commissioned by UNCTAD on the trade, regulatory and development concerns of the Chinese insurance market.

³⁶ TRADE/2001/1/Add.1, 1 May 2001.

The following excerpts are of interest:

8. Other trends include the increasing use of technology and the Internet, and the increasing disaggregation of insurance services that are provided. Attention was drawn to the fact that the latter would allow developing countries to capture specific, disaggregated processes as areas with export potential. Other key factors which can facilitate the integration of developing countries into the global insurance marketplace include development by domestic insurance suppliers of the expertise necessary for successfully engaging in the international market (essentially by building human capital and know-how), and development of micro insurance.

26. The role of the Government is not confined to that of regulator and supervisor of insurance services. Rather, as experts pointed out, the *Government plays a very important role as a facilitator, including by ensuring access to insurance services as well as overcoming obstacles in the development of the insurance services sector*. This is done by coordinating and setting out a financial services policy with national development objectives in mind, creating an enabling environment through appropriate legislation, ensuring cooperation among all stakeholders and policymakers (industry, insurers, consumers, tax authorities, judicial authorities) and, more broadly, ensuring effective engagement at the multilateral level both at the WTO and in international standard-setting processes. Other examples of government engagement include the establishment of public-private partnerships, for example in the area of data exchange, management and reporting systems.

49. It was pointed out, in the Indian context, that the objective of trade policymaking in the insurance sector is closely linked to the achievement of sustainable development within the sector. The spin-off effects of this approach are to ensure that insurance services have a wider reach (particularly to the rural population) and that equity and regulatory capabilities are strengthened. In this regard, liberalization and reform should be concomitant, especially for insurance where the regulatory capabilities of countries are very different.

Broadly, globalization highlights challenges related to financial stability and the need to focus on macroeconomic aspects. However, there is not yet a clear recipe for the appropriate pacing and sequencing of reforms while liberalization (autonomously and at the national level) is proceeding. The recognition that liberalization alone is not enough may be one of the reasons for the hesitation of some countries in the context of the liberalization of insurance services.

[Extract from § 52]

Some suggest that a gradual approach may avoid the most painful of the transition experiences and failures and generate more sequenced and carefully paced reforms of laws, regulations and insurance enterprises. At the same time, it was pointed out that gradual reforms run the risk of being captured by vested interest groups, a challenge which the WTO framework can help to address.

[Extract from § 53]

At the conclusion of the workshop there was a long list of possible activities and actions which UNCTAD might undertake to build on their earlier work and support the achievement of the Millennium Development Goals. These included:

- (c) Facilitate the assessment of insurance services at the subsectoral level. This would assist developing countries, particularly LDCs, in formulating domestic policy options and in defining negotiating positions and strategies in multilateral, regional and bilateral trade negotiations;
- (e) Identify the regulatory challenges arising from the global/international nature of trade in insurance services, including in terms of cooperation, monitoring and enforcement, as well as possible responses at the national and international levels;
- (g) Identify measures that Governments/regulators can take to improve domestic efficiency and to address supply capacity constraints in developing countries' insurance markets. Related to this would be an identification of the exact nature of the role of Governments, both as regulators and as providers of insurance services;
- (l) Analyse the impact of the GATS and the ongoing negotiations to liberalize services trade (including negotiations on domestic regulation) and how they reflect current realities. Such an analysis could discuss the impact that current negotiations could have on the insurance sector, as well as the development challenges arising from recent suggestions about complementary and other approaches;
- (n) Provide for key technical assistance and capacity building, satisfying the needs of developing countries in terms of assistance with international trade in insurance services;
- (p) Assist in revising national legislation in line with international commitments, including through a model law on insurance legislation to provide guidelines for developing countries (for example, as suggested in the context of the United Republic of Tanzania).

A paper presented by an UNCTAD official, based on the documentation of the relative importance of the largest insurance companies in the world and changes that may have occurred in the past fifteen years, together with the identification of some of the factors that may explain the increased internationalisation and location of insurance groups, concluded as follows:³⁷

“The results of this study have two important implications. First, the results indicate that location-specific advantages such as size, education and cultural distance, do provide an explanation of the internationalisation of insurance firms. Second, they show that good governance, as hypothesised, has a strong impact on the choice of countries by insurance firms.

In the last slide of his presentation the IMF speaker at the November 2005 conference, listed three issues of importance:³⁸

- “Solvency standard is needed both as an economic requirement as well as a regulatory and supervisory tool for insurance market

³⁷ “Players and driving forces in world insurance services: location and governance”, J Francois Outreville, UNCTAD, Geneva.

³⁸ “Insurance services: development and liberalisation – some observations”, Udaibir S Das, Division Chief, Monetary and Financial Systems Department, IMF, Washington DC

- Upgrade risk management capabilities, ensure adequate regulatory framework, and promote market discipline
- All this will need a consistent and stable macroeconomic and financial sector.”

Provided that liberalisation is promoted against the backdrop of a solid set of prudent supervision – the recent shift towards solvency-based supervision in main emerging markets is in this line of approach – consumer protection, competition, as well as proper disclosure of information, the opening up of the insurance markets should bring long-term benefits to the countries. The privatisation of the social security system and excellent growth perspectives will open new opportunities for foreign insurers.”

3.4 FREE TRADE AGREEMENTS AND FINANCIAL SERVICES

For the purposes of this study, only regional FTAs are considered, not the bilateral FTAs entered into by China, India and Mexico. Brazil has no such bilaterals.

3.4.1 GATS Provisions.

In order to respect their GATS obligations, WTO Members of free trade agreements have to comply with Article V *Economic Integration*. The full wording is as follows:

1. This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement, provided that such an agreement:

- (a) has substantial sectoral coverage³⁹, and
- (b) provides for the absence or elimination of substantially all discrimination, in the sense of Article XVII, between or among the parties, in the sectors covered under subparagraph (a), through:
 - (i) elimination of existing discriminatory measures, and/or
 - (ii) prohibition of new or more discriminatory measures, either at the entry into force of that agreement or on the basis of a reasonable time-frame, except for measures permitted under Articles XI, XII, XIV and XIV bis.

2. In evaluating whether the conditions under paragraph 1(b) are met, consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned.

3. (a) Where developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors.

(b) Notwithstanding paragraph 6, in the case of an agreement of the type referred to in paragraph 1 involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement.

³⁹ This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply. [Note by JA: these footnote numbers are those of the present paper, not those from the GATS.]

4. Any agreement referred to in paragraph 1 shall be designed to facilitate trade between the parties to the agreement and shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services within the respective sectors or subsectors compared to the level applicable prior to such an agreement.

5. If, in the conclusion, enlargement or any significant modification of any agreement under paragraph 1, a Member intends to withdraw or modify a specific commitment inconsistently with the terms and conditions set out in its Schedule, it shall provide at least 90 days advance notice of such modification or withdrawal and the procedure set forth in paragraphs 2, 3 and 4 of Article XXI shall apply.

6. A service supplier of any other Member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.

7. (a) Members which are parties to any agreement referred to in paragraph 1 shall promptly notify any such agreement and any enlargement or any significant modification of that agreement to the Council for Trade in Services. They shall also make available to the Council such relevant information as may be requested by it. The Council may establish a working party to examine such an agreement or enlargement or modification of that agreement and to report to the Council on its consistency with this Article.

(b) Members which are parties to any agreement referred to in paragraph 1 which is implemented on the basis of a time-frame shall report periodically to the Council for Trade in Services on its implementation. The Council may establish a working party to examine such reports if it deems such a working party necessary.

(c) Based on the reports of the working parties referred to in subparagraphs (a) and (b), the Council may make recommendations to the parties as it deems appropriate.

8. A Member which is a party to any agreement referred to in paragraph 1 may not seek compensation for trade benefits that may accrue to any other Member from such agreement.

Article V bis Labour Markets Integration Agreements

This Agreement shall not prevent any of its Members from being a party to an agreement establishing full integration⁴⁰ of the labour markets between or among the parties to such an agreement, provided that such an agreement:

- (a) exempts citizens of parties to the agreement from requirements concerning residency and work permits;
- (b) is notified to the Council for Trade in Services.

⁴⁰ Typically, such integration provides citizens of the parties concerned with a right of free entry to the employment markets of the parties and includes measures concerning conditions of pay, other conditions of employment and social benefits.

3.4.2 Regional FTAs

At present China and India are not party to regional FTAs currently conditioning services, though China is on the way to an agreement with ASEAN, and India is a member of SAFTA, which has yet to address services trade.

3.4.2.1 Commonwealth of Independent States

Russia is a member of the Commonwealth of Independent States (CIS) grouping of former USSR republics, formed in 1991, and in "September 1993 the Heads of the CIS States signed an Agreement on the creation of Economic Union to form common economic space grounded on free movement of goods, services, labour force, capital; to elaborate coordinated monetary, tax, price, customs, external economic policy; to bring together methods of regulating economic activity and create favourable conditions for the development of direct production relations."

Presumably the WTO accession negotiations will have to take on board how Russia's commitments under the CIS Economic Union square up to its WTO commitments, as no doubt had to be faced in the cases of other former USSR republics, such as the Ukraine, Moldova and the Kyrgyz Republic.

3.4.2.2 NAFTA

Mexico is a member of NAFTA under which it has ceded the right of non-establishment to companies based in Canada and the US. The NAFTA investment provisions are markedly GATS-plus, under the separate investment chapter.⁴¹ The commitments on the mobility of labour are limited. Little progress has been made on mutual recognition.

Although NAFTA is looked upon as a strong top-down, negative listing, instrument of liberalisation in fact it has a number of flexibilities, or weaknesses: there are systematic loopholes and exclusions, lack of time frames and no provision for future negotiations.⁴² By and large the regulatory situation at inception was frozen and the differences compared to GATS commitments had more to do with timing rather than content.

3.4.2.3 MERCOSUR

Brazil is a member of the Mercosur FTA, which is a very ambitious institution for full liberalisation. At the outset it incorporated no MFN Exemptions (unlike the GATS), though members can introduce more restrictive measures in future. There is no provision for rules on Domestic Regulation, nor on S&D treatment. The commitments on the movement of workers are not ambitious, although under the Montevideo Protocol there is a ten-year deadline for full intra-zone liberalisation, with annual negotiations meanwhile. However, this deadline has not yet come into effect under the protocol.⁴³

⁴¹ The EU-Mexico FTA also has a separate chapter on investment.

⁴² For a detailed analysis of these issues, see "Regional trade agreements and their impact on services trade", by Mario Marconini, Senior Associate, ICTSD. This can be accessed on www.ictsd.org.

⁴³ Brazil has no bilateral FTAs. The EU-Mercosur FTA, which also has a separate chapter on investment, has become stuck.

4 OVERVIEW OF THE POSITION IN THE BCIMR COUNTRIES

Key barriers to market access and doing business: a brief summary

BRAZIL

The chief market access barriers are the ban on direct branching, the continued state monopoly over reinsurance, the restrictions on MAT insurance, and on types of legal entity and the limitations on the proportion of foreign workers in foreign affiliates.

Once established in the market, the controls on foreign exchange, dividends sent abroad, profit remittances and capital repatriation are notable restrictions on doing business. There are also licensing limitations on the number and frequency of new products.

CHINA

The chief market access barriers are the 50% foreign equity limit for life insurance, the reinsurance cession restrictions and the ban on associations of underwriters and on foreign brokers.

As foreign-owned insurers are prohibited from writing "statutory" insurance this acts as a major market access barrier because motor third party liability accounts for more than 50% of the total Chinese non-life market and policyholders generally insure related motor risks (such as fire, theft, loss or damage to the vehicle) with the domestic insurer.

Once established in the market, foreign firms are required to have higher capitalisation, and are restricted on their investments and the use of foreign exchange funds, which together comprise significant limitations on doing business. There are also the lengthy approval processes for branching, discriminatory licensing of sub-branching and the lack of clarity in the division of regulatory authority between national and provincial officials and agencies.

INDIA

The main market access barriers are the equity cap of 26% on foreign ownership, the prohibition on life insurance and pension provision by foreign suppliers and on cross-border MAT (except for freight insurance). There is also the prohibition on associations of underwriters and on insurance intermediaries, and the monopoly on reinsurance for non-life.

Once established in the market, the restriction on repatriation of earnings to foreign shareholders and the ban on the remittance of funds abroad for insurance by nationals restrict business operations.

MEXICO

The 20% equity cap on individual foreign holding, the prohibition on branching and cross-border supply, discriminatory mandatory reinsurance cessions, and the prohibition on obtaining cover abroad, constitute significant market access barriers. There is also the requirement for foreign investment to be in locally quoted neutral shares. Foreign insurers are prohibited from providing insurance for state-owned or state-affiliated enterprises. Foreign insurers are not permitted to insure residential risks.

The imposition of a nominated joint venture partner can constitute a problem for doing business, as can the inability to use the home company name for products. Only local companies can use banks for distribution, and there are restrictions on foreign activity in the pensions sector. Furthermore, operations involving annuities, in accordance with Social Security laws and health insurance, can only be carried out by specifically authorised companies, and mandatory deposits are imposed on foreign undertakings proportional to the percentage of premiums received. When insurance companies hold working assets in foreign currencies, 8% is added to the gross solvency margin requirement. The licensing of

new products is supposed only to ensure compliance with the law, but in practice the authorities have full discretionary powers to approve or reject the policy text.

RUSSIA

The chief market access barriers are the prohibition on branching and the restrictions on writing life business. The foreign equity cap at 25% of total investment in insurance sector means that some foreign firms are unable to secure management control. In addition participation in joint ventures is capped at 49% for life insurance, mandatory insurance and state procurement.

Managing directors and finance directors must be resident.

Following Russia's accession to the WTO, which could be some way off, there would be phased-in improvements to these limitations during the first five years, though for branching the delay would be nine years. It is hoped that Russia will 'grandfather' the conditions for firms which are established at the date of accession.

Doing business will be significantly impacted beneficially if Russia keeps to its commitment to approximate its legislation with that of the EU, including for banking law and other financial services, though this may take time to be phased in, given that Russia is still in transition to a full market economy.

4.1 INTRODUCTION

In this chapter the position of each BCIMR country is described under the following headings:

1. **General background:** A brief overview of the general economy is given with extracts from the WTO Trade Policy Review Mechanism documents where relevant. Extracts also appear in the later sections as appropriate.⁴⁴
2. **Financial Services:** A brief overview is given of the general condition of financial services as a background to the next section on insurance services.
3. **Insurance Services:** An overview of the insurance market, with relevant material from various sources is quoted to give a picture of the key aspects of the situation in the market, including from the WTO Trade Policy Review documents.
4. **The Regulation of Insurance Services:** A description is given of the current regulations governing the supply and consumption of insurance services.
5. **GATS Specific Commitments for Insurance Services:** An overview is given of the specific commitments bound at present. Comments on the significant commercial constraints for insurers taken from the Financial Leaders Working Group document "Trade Barriers in Insurance" are included. The current offer under the WTO DDA negotiations (whether initial or revised) is also briefly described.

The full schedules are given in Annex 1. Inserted, as appropriate in each section is a record of the EC requests tabled during the Doha Round of WTO negotiations. Many other countries have also submitted requests. Not all are in the public domain and it would anyhow be too unwieldy to incorporate them. The EC request, being systematic, can be taken as a proxy of demands for further liberalisation. The WTO

⁴⁴ On a matter of timing, the results of the next reviews for China and India will not be ready until late 2007, and that for Mexico in 2008. The WTO Secretariat makes use of information supplied by governments as well as material identified through their own researches.

access negotiations for the Russian Federation are ongoing and meanwhile its proposed schedule of specific commitments remains confidential.

6. Distribution: An overview of the current state of the distribution for insurance services is given.
7. Support Professions: This section covers any information on actuarial, accounting and other professional support services.
8. Consumer Awareness: A brief comment is given of the current state of the population in general of the benefits of insurance.

References are made throughout to the following documents which are included in the Annexes to the present study paper (as indicated):

Annex on Article II Exemptions (Annex 2)
Annex on Financial Services (Annex 3)
Understanding on Commitments in Financial Services (Annex 4)
Hong Kong Ministerial Declaration, Annex C (Annex 5)
Collective request on financial services (Annex 6)
FLWG Model Schedule on insurance commitments (Annex 7)
OECD Framework for insurance market liberalisation (Annex 8)

Note:

In Annex 1 the schedules on specific commitments for insurance services sets out the material in the following order:

Insurance sub-sector as defined in each case
 MFN Exemptions
 EC Request for their removal
 Modes of supply (GATS Article I)
 Market access limitations (GATS Article XVI)
 EC Request for their removal
 National Treatment limitations (GATS Article XVII)
 EC Request for their removal
 Additional Commitments (GATS Article XVIII)

Definitions of the standard scheduling terms, such as “None” and “Unbound” can be found in the GATS ‘scheduling guidelines’, together with other terms and acronyms such as acquired rights, labour market tests and ENTs.⁴⁵

⁴⁵ “Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services (GATS)”, WTO document: S/L/92, 26 March 2001.

4.2: BRAZIL

4.2.1 GENERAL BACKGROUND

"If Brazil is to achieve the same kind of economic dynamism as its emerging market competitors in Asia and Europe, the president must address two structural problems: Brazil's absurdly unfair social security system and its antiquated labour laws. [], stated the leader article in the Financial Times on 7 February 2007, headed: "Lula's timid reforms", and it continued "[I]nvestment in the infrastructure is desperately needed. It surely makes sense to improve the quality of roads and ports so that exporters can take full advantage of buoyant international demand, especially for highly competitive agricultural products [] and valuable raw materials."

Earlier in a Financial Times article on 29 September 2006, J Wheatley and R Lapper wrote:

"Economic stability, the Bolsa Familia, a rising national minimum wage, stable and even falling food prices and a dramatic expansion in consumer credit⁴⁶ are among the reasons why Mr Lula da Silva appears to be heading for a decisive victory on Sunday in the presidential election []⁴⁷. Healthy current account surpluses have allowed Brazil to pay off external debts. The strengthening currency – the Real has gained 60 per cent in value against the US dollar under the Lula administration – has underpinned price stability and benefited the poor. [] The national minimum wage has increased by 26 per cent in real terms under the Lula government. [] spending on the public-sector payroll will be 5.1 per cent this year. [][public spending] reached 39 per cent this year [of GDP]. This is roughly double the level of competing developing countries and [] similar to that of developed countries such as the UK and Germany – which finance comprehensive social welfare provision that Brazilians can only dream of.

"Spending ineffectively also means that the government has less money available for roads, ports, power generation and other physical infrastructure that help promote growth. For the same reason, the government has been unable to improve the quality of public services. Education is almost universal but teaching standards are poor. Regulation, too, leaves much to be desired, with investors frequently complaining of a lack of transparency or arbitrary decisions by officials. Little has been done to ease the complexity of doing business.

"According to the World Economic Forum's survey published [in September 2006], Brazil ranks as the 83rd most competitive country in the world, nine positions lower than in 2005, and behind all three bigger emerging economies – China, India and Russia – with which it is sometimes compared."

[An accompanying chart showing real GDP growth, puts China at the top with about 10% in the period 2003-06, India next at over 8%, Russia in the 6-7% range and Brazil at the bottom in the 1-3% range.]

An assessment made in 2005⁴⁸ reported that: "Brazil's economy grew rapidly in 2004, due to continued disciplined economic policy and favourable external conditions. GDP grew by 4.9%, driven by booming exports and accelerating consumer demand. [] Growth should be about 3.5% in 2005, and improve slightly in 2006. After a modest rise in early 2005, inflation fell sharply later in the year in response to tightening monetary policy and a strong appreciation in the Real against the US dollar in nominal terms, the Real gained 13%

⁴⁶ Later it refers to: "an increase in consumer borrowing, especially in the form of instalment schemes offered by retailers."

⁴⁷ In this they were proved right.

⁴⁸ In the 2005 Reactions edition "New developments in the Latin American insurance markets", published by Euromoney Plc.

between January and September. Inflation should be similar to last year's rate of 6.6% and is expected to abate further in 2006."

The WTO Trade Policy Review Mechanism of 2004 for Brazil⁴⁹ had shown that:

§157 The contribution of services to GDP declined slightly between 1998 and 2002, when they accounted for almost 60% of GDP. The most important subsectors during that period continued to be public administration (27.5% of GDP in services) and housing rents (19.1%); however, finance (13%), commerce (13%) and communications (4.6%), were the fastest growing. The services sector, including government services, absorbs some two thirds of the labour force. The role of the State in the sector has continued to diminish since Brazil's last Review, as a continuation of the privatization process, particularly in telecommunications, financial services, and port and airport services. Also, efforts have been undertaken to enhance the effectiveness of supervision, particularly in financial services, through tight prudential standards.

Brazil has long had a deficit in the commercial services account, with the figures for 2000 and 2005 being US\$ 7.2 billion and 7.4 billion respectively.⁵⁰

4.2.2 FINANCIAL SERVICES

The WTO TPRM 2004 report found that:

§166 Financial services accounted for 7.7% of GDP in 2002, up from 5.4% in 2000. Brazil runs a traditional trade deficit in financial services: in 2003, excluding insurance services, the deficit reached US\$ 383 million, with exports totalling US\$ 363 million and imports of US\$ 745 million. This was higher than the 2001 deficit (US\$ 307 million), due to an increase in imports while exports remained stable. Trade in insurance services also posts a traditional deficit; this reached US\$ 436 million in 2003, a significant increase over 2001 (US\$ 275 million), as imports increased substantially, from US\$ 455 million to US\$ 560 million, while exports declined.⁵¹

The "Report on Observance of Standards and Codes", Financial Action Task Force on Money Laundering, 2004, stated that:

§3 Brazilian financial institutions operating in the domestic market are in general diversified, dynamic, and competitive. Brazil has approximately 168 multiple and commercial banks with total assets of approximately USD 349 billion and equity of approximately USD 49 billion. There were also 45 financing companies, 18 savings and loan companies, 9 mortgage companies, 40 savings and loan associations, 58 leasing companies, and 1,381 co-operatives. As of November 2003, Brazil had 149 security brokers and 145 security dealers. In 2002, there were 120 insurance companies, 18 companies selling capitalisation securities, 77 companies in the area of complementary open pension funds and 78,500 insurance brokers.

§4 Foreign exchange may be carried out only by banks and other authorised exchange brokers authorised by the Central Bank of Brazil (*Banco Central do Brasil - BACEN*), including 43 exchange brokerage companies, 268 travel agencies and 8 hotels authorised to carry out foreign exchange transactions. Foreign money remittance can only be performed through the banking system, either directly by authorised banks or through a customer of a bank on a contractual basis. Currently only one bank – Banco do Brasil – has such a contract (with Western Union)."

⁴⁹ WTO document: WT/TPR/S/140, 1 November 2004: Chapter 7

⁵⁰ The 2000 figure is from the TPRM document (footnote 4), and the 2005 figure is from "International Trade Statistics 2006", WTO, Geneva, 2006 (Table 1.8 on page 20).

⁵¹ Central Bank of Brazil.

4.2.3 INSURANCE SERVICES

The WTO TPRM 2004 report found that:

§201 Insurance activities accounted for an estimated 3.4% of GDP in 2003, up from to 2.9% in 1998. The total market value of premiums, investment plan income, and receipts from open private pension contributions was around R\$ 51.2 billion (some US\$ 17.5 billion) in 2003, up from R\$ 26.2 billion in 1998.⁵² Adding pension funds, this total rises to R\$ 290.8 billion, up from R\$ 121.2 billion in 1998. Brazil ranked 22nd worldwide in terms of the size of its insurance market in 2002. In December 2003, there were 130 insurance companies (of which 14 were health insurance companies), 15 investment plan companies, and 29 open private pension fund societies in operation; there were 360 closed private pension funds. The insurance business also includes the complementary pension regime, which comprises funded occupational and personal pension plans privately managed by open and closed pension funds and insurance companies.

§202 In April 2004, 35.1% of premiums corresponded to life insurance, 22.3% were for motor vehicles, and 25.5% for health; the rest were for fire, transportation, and other risks. Some 33.2% of all premiums were generated by foreign-controlled insurers in 2003, up from 25% in 1998 and just 4.2% in 1994. Foreign enterprises accounted for 10% of investment plans in the insurance business, in 2003, and 35.9% of all contributions in open private pension funds. The value of reinsurance was R\$2.9 billion in 2003; 55% of this value was transferred to the external market as retrocession (reinsurance to cover other reinsurance operations). Closed private pension funds had accumulated assets of US\$82.2 billion in 2003.

The website of the Brazilian insurance regulator (SUSEP)⁵³ gives the following detail:

The market supervised by SUSEP is composed by almost 170 companies, 71% of which are insurance companies, 17% are entities exclusively dedicated to offering open private pension schemes and 12% percent are companies exclusively dedicated to offering capitalization plans. Some Life insurance companies may also offer open private pension schemes

Insurance premiums in Brazil are concentrated on three lines of businesses: life, automotive (including compulsory insurance for third party liability – DPVAT) and health insurance. Together they account for approximately 80 per cent of the total premium revenues.

At the end of 2005, the total insurance premiums had reached R\$ 62.6 billions (US\$ 25.7 billions) and the technical provisions, R\$ 77.9 billions (US\$ 33.2 billions).

The economic reforms introduced by the Brazilian government in the last years, mainly the economic stabilization plan, as well as the deregulation process, the opening of the market to foreign insurers and the privatization program had a profound effect on the insurance market, which in the last years evolved from a mere participation of 0.8% in the GDP in 1994 to 2.63% in 2005. Considering capitalization and open private pension schemes, this percentage achieved 3.38%.

The economic stability brought back also the possibility of adoption of the national currency as a trustworthy value reference. In this way, the investment-making

⁵² The National Federation of Insurance Services Providers (FENASEG) online information. Available at: <http://www.fenaseg.org.br/>.

⁵³ SUSEP online information. Available at: <http://www.susep.org.br/>.

decision process performed by economic agents became more transparent, increasing confidence and overall credibility in the system. The increase of the competitiveness and the new opportunities of business as well as the search for operational results, instead of financial results, imposed to the companies the need for more efficiency. Mergers and acquisitions were stimulated, promoting the market consolidation process and operational and scale gains for the companies, resulting in lower premiums rates and expansion of activities. The opening of the market to foreign participants in 1996 has permitted the transfer of capital and the introduction of new products, technologies and knowledge that helped to enhance the performance of the industry.

If no changes affect the current scenery, the perspectives indicate that the growth of the Brazilian insurance market should remain proportional to the GDP's growth percentage.

Regarding specifically to life lines (capitalization-structured products) and pension segments a great expansion could be observed, especially considering the recent performance of two products: the VGBL ("Vida Gerador de Benefícios Livres" or Redeemable Life Insurance) and the PGBL ("Plano Gerador de Benefícios Livres" or Plan Generator of Benefits).

Created in 2001, the VGBL is a life surrender benefit product that unites the outliving character of the annuity with the investment-oriented feature of the variable life insurance, which has been benefited from the stabilized economic outlook more conducive to longer-term savings. The PGBL, precursor of VGBL, is a private pension plan created in 1997 and inspired in the American 401-K. Both have special tax benefits.

By the end of 2005, VGBL total premiums had reached R\$ 11.7 billion (US\$ 4.8 billion) and R\$ 28.74 billion (US\$ 12.28 billion) in provisions (funds), representing 63.7% of all life insurance premiums in that year. In the other hand, the PGBL continued its great performance since its launching, achieving R\$ 4.12 billions (US\$ 1.7billion) in premiums and R\$ 21.39 billions (US\$ 9.14 billion) in provisions (funds)

In general, this perspectives points to a more mature insurance market with great probabilities of growth within the next years. In this way, the opening of the reinsurance market will play a significant role. The bill of a Complementary Law sent to the Congress in March 2005 is now being discussed.

In this context, it is expected that property and casualty lines, in which reinsurance tools are more intensive, have consistent and expressive qualitative and quantitative upgrades, considering that the Brazilian market will have access to new technologies and capital resources.

Finally, potential niches can be observed and exploited in the Brazilian Market, like micro-insurance and internal credit lines. On the other hand, government policies' effects on income distribution and welfare will promote a positive impact on the Brazilian insurance market.

The Reactions publication⁵⁴ gave the following description of the insurance market:

“Non-life insurance market returned to growth. The Brazilian non-life market, the largest in the region, grew by 6.5% in real terms in 2004 with premium volume amounting to US\$ 7.2 bn. Growth was driven by strong increases in motor, engineering and accident premiums, and even stronger growth in marine and credit and surety, which compensated for declines in property, liability and aviation. [] The insurance market should continue to benefit from economic growth in 2005. [] During the first half of 2005, non-life premium volume increased, driven by the largest line of business – motor – while premiums in other lines remained broadly stable.”

“The Brazilian insurance market remains largely untapped, given its size and potential. [] Among the main factors contributing to low insurance penetration in Brazil are its relatively low income per capita, which limits the consumption of insurance products; poor income distribution; the limited marketing and advertisement budget (as a way of improving knowledge of the industry), and; the still-closed reinsurance market.”

“Total premium volume reached Brazilian Reais (BrR) 37.3 bn (US\$ 12.7bn), [] having grown by an average 12% per year in the past eight years. However, this growth pattern was not enough to produce a significant increase in the industry’s participation in the GDP. That participation reached 2.55% in 2004, while by comparison it reached 6% in Spain, 8% in Germany, and 9% in the US.”

“In contrast to other markets, most Brazilian insurance companies are multi-line companies offering pension-plan products and health, life, and property & casualty insurance. The distribution of premiums per line of business has changed significantly during the past five years, shifting the balance towards life insurance products, mainly Vida Garantidor de Beneficios Livres (VGBL).

“The top six insurers and their affiliated companies control about 66% of premium production, including the health market. The consolidation trend in the industry may increase competition. Also the mergers and acquisitions in the banking sector will shape the consolidation process in the insurance industry.

“The market participation of financial conglomerates in insurance is expected to remain strong, in light of the competitive advantage offered by the banking distribution channel. Foreign insurers will also become increasingly important players, given their interest in tapping a large potential market []. The Brazilian market poses a challenging environment for insurers, since volatility and economic instability affect the companies/investment portfolios and their insurance growth prospects.”

An insurance broker⁵⁵ thinks that multinationals should expect to benefit from the new system. “Following approval of new regulations and operational guidelines, we expect to see a greater proportion of the risks in Brazil being reinsured by global programs, which may allow a reduction in premium rates. A clear picture will only emerge, however, once full regulations are established.”

⁵⁴ “New developments in the Latin American insurance markets”, published by Euromoney Plc., 2005

⁵⁵ Sergio Barroso de Mello, of Pellon & Asscoiados, in ‘Insurance Day’ on 14 July 2006

4.2.4 THE REGULATION OF INSURANCE SERVICES

The Brazilian insurance regime includes a web of restrictions, many of which act as very significant barriers to market entry.⁵⁶ It remains of high importance for these to be removed. Amendments to the Constitution in 1995 opened the insurance sector to foreign investment and removed the distinction between the treatment of foreign and national capital. Privatisation of workers compensation insurance has long been pending. But current regulations prevent the development of traditional agency forces, and labour law restrictions exclude traditional agents from selling life insurance, and permitted only for brokers and banks.

Foreign exchange controls require the approval of the Central Bank for the repatriation of profit and capital.

Brazil has still not privatised its State monopoly reinsurer (IRB). Removal of the monopoly was decided in principle by the law approved in December 1999 (Lei 9932/99). However, the National Congress has not yet adopted the legislation. Prior to the privatisation of the IRB, the reinsurance market should be de-monopolized in the interim period before that legislation is implemented.

The authorities have proposed that, after the new legislation is adopted, a new regime for reinsurance (offering some foreign market access) should be put in place. But the proposed new regime for reinsurance would limit cross-border reinsurance cessions to 10% of total reinsurance placements. Furthermore, for two years after the privatisation of IRB, insurance companies will have to offer 60% of cessions to the new IRB (or a new state reinsurer) preferentially and with a restriction on cession abroad. In addition, a minimum deposit of US \$5 million will be required of those reinsurers establishing in the Brazilian market. This requirement will present a barrier to entry and will, in particular, affect established insurance companies, who will effectively have to set up as reinsurers in order to access their world-wide Group financial capacity.

The following extracts from “Report on Observance of Standards and Codes”, by the Financial Action Task Force on Money Laundering, 2004, describe some key regulatory elements.

“28 Brazil has designated the appropriate competent authorities to supervise financial institutions. The National Monetary Council (CMN) is the main decision-making authority for the national financial system and consists of the Minister of Finance, the Minister of Planning and Budget, and the President of the Central Bank of Brazil.[]

“29 [] The Superintendence of Private Insurance (Superintendencia de Seguros Privados – SUSEP) regulates and supervises the insurance market, capitalisation companies and reinsurance for prudential and AML purposes. []

“31 Law 9613/98 creates a generally comprehensive framework of anti-money laundering requirements for a wide range of financial institutions. The law makes general requirements for customer identification, record-keeping, and suspicious transaction reporting, which are to be specified and enforced by the existing supervisory agencies.”

“33 The requirements for verification of the identity of the direct customer are comprehensive. In addition, financial institutions are required to verify the identity of the owner and controller of legal entities. [] For insurance, the identification requirement

⁵⁶ The first four paragraphs are taken from the Financial Leaders Working Group report.

currently only extends to third-party payments exceeding BRL 10,000 (approximately USD 3,500) or to guarantee insurance contracts regardless of thresholds. []”

This Financial Action Task Force Report also made two recommendations specifically including insurance:

“48 [] Brazil should consider a clearer obligation to identify the ultimate beneficiary of accounts, especially for legal entities, and for the insurance sector regardless of the amount. [] Brazil should amend its regulations for securities and insurance to require the reporting of all suspicious transactions regardless of a threshold. []”

On the SUSEP website there is further detail:

The National Private Insurance System

The Brazilian National Private Insurance System, regulated by the Decree-law No. 73, of November 21st, 1966, is constituted by the:

National Council of Private Insurance (CNSP);
Superintendence of Private Insurance (SUSEP);
Brazil's Reinsurance Institute (IRB Brasil Re);
Insurance Companies; and
Insurance Brokers.

CNSP

The National Council of Private Insurance (CNSP) is the system's deliberative body and it is responsible for the settlement of the Brazilian Government policies' guidelines and directives for insurance and capitalization companies and open private pension entities in Brazil.

The Chairman of the Council is the Minister of Finance or his representative, usually the SUSEP's Superintendent, who is also the Vice-Chairman. Representatives of Central Bank, Ministry of Justice, Ministry of Social Security and of the Brazilian Securities Exchange Commission (CVM) also have a seat at the Council.

In this way, SUSEP plays a key role within CNSP, since all the rules issued by the Council are elaborated by SUSEP and have its prior approval.

SUSEP

The Superintendence of Private Insurance (SUSEP), an autarchy created by the Decree-law No. 73/66 directly linked to the Ministry of Finance, is the executive body of the politics delineated by the CNSP and is also the insurance commissioner, responsible for the supervision and control of the insurance, open private pension funds and capitalization markets in Brazil. Aiming toward the consonance with international standards, the strengthening of the public's confidence in the system and the development of a sound insurance market, SUSEP has been engaged in the modernization of supervisory and regulatory procedures.

SUSEP is managed by a Managing Council formed by the Superintendent, appointed by the Minister of Finance, and four Directors. This Council, whose chairman is the Superintendent, has authority to establish SUSEP's general policies for the regulation and compliance with CNSP's resolutions by enacting rules within its area of competence.

However SUSEP's supervisory authority does not cover all segments of the insurance, private pension and capitalization industry: currently, a federal state-controlled company created by Decree-law No. 73/66 to regulate and promote the development of reinsurance, coinsurance and retrocession in Brazil, the IRB Brasil Re (Instituto de Resseguros do Brasil), still controls the reinsurance businesses; the ANS - National Agency of Supplementary Health (Agência Nacional Saúde) is the supervisory authority for the health insurance and the SPC - Secretariat of Complementary Pensions (Secretaria de Previdência Complementar) supervises the closed private pension funds.

However, in conclusion SUSEP states that:

In 2003 SUSEP has started a modernization process based in international standards adopted in the most developed markets, notably the IAIS Core Principles. The idea resides not only in introducing innovation concepts in the Brazilian insurance market but prepare it for the reinsurance opening.

Since the beginning of this process, more than 500 rules were revised and a great number were published, focusing mainly in corporate governance and internal controls, accountability of directors, the strengthening of the roles of actuaries and auditors and the certification of employees.

Also, a great number of changes were made in order to stimulate consumers' saving plans as, for instance: (i) a new tax regime that encourages the maintenance of pension plans resources in the long term; (ii) shield's provisions in order to protect the policyholders' interest; (iii) the possibility of using these provisions as guarantees in housing financing; (iv) the possibility of updating biometric tables during the deferral period in order to reduce actuarial risks.

Once can conclude that the government is allowing moves to more open risk based systems. Also, because it sees that insurance can help its developmental aims, lower capital adequacy requirements are permitted in the poorer regions.

What the SUSEP website does not indicate is that there is no insurance Ombudsman.

The WTO TPRM 2004 report described the evolution of this regulatory system as follows:

§203 The national insurance system is composed of the National Council of Private Insurance (CNSP), the Superintendence of Private Insurance (SUSEP), the Brazilian Reinsurance Institute (IRB BRASIL Re), private insurance companies, and authorized brokers. SUSEP, an autonomous body linked to the Ministry of Finance, is responsible for the control and supervision of insurance, open private pension funds, and capitalization (investment plans) operations. SUSEP executes the policy laid down by the CNSP, which is the main body responsible for policies for the private insurance industry and for the regulation of the national insurance system. The CNSP is also responsible for fixing the characteristics of the different insurance contracts. IRB BRASIL Re is responsible for reinsurance activities. In January 2000, Law No. 9,961/00 transferred the supervision of the health insurance business to the National Health Agency (ANS), linked to the Ministry of Health. The National Social Security Institute (INSS), hierarchically linked to the Ministry of Social Security, is the sole authorized supplier of worker's compensation insurance.

§205 The provision of insurance services in Brazil is governed by Decree Law No. 73 of 21 November 1966, as modified by Decree No. 60,459 of 13 March 1967, Law No. 261 of 28 February 1967, Law No. 10,190 of 14 February 2001, and Complementary Law No. 109 of 29 May 2001. CNSP Resolutions and SUSEP Circulars regulate the industry's day-to-day

activities. Insurance companies that provide only health insurance are subject to ANS regulations.

§206 Law No. 10,190, of 14 February 2001 amended some provisions of Decree Law No. 73/66, in particular those with respect to bankruptcy and the calculation of total equity. The new law clarifies bankruptcy procedures and establishes that insurance companies are to benefit from bankruptcy provisions in cases of non-judicially decided liquidations only when assets are not sufficient to cover the payment of at least half of the company's debts. With respect to the calculation of total equity, Law No. 10,190/2001 mandated that the value of insurance companies' total equity be at least equal to that of non-operational liabilities (defined as those not covered by guarantees), and gave insurance companies a year to adjust to the new requirements.

§207 Insurance companies may not engage in other financial activities, but do not need to specialize in a specific line of insurance, they may be composite (life and non-life); the only exceptions apply to the export credit insurance company, which must be specialized, life insurance companies authorized to deal in open pension funds, health insurance companies, and the reinsurance company. Foreign insurance companies providing insurance of any kind are required to be incorporated under Brazilian law, in the form of a "*sociedade anônima*" (corporation).⁵⁷

In respect of the reinsurance monopoly, there have been two evolutionary developments recently. Firstly, in an article by Sergio Barroso de Mello,⁵⁸ the following picture was given:

"Brazil is South America's largest insurance market."

" [] The new policy of risk placement abroad issued by the IRB through Circular PRESI-011/2005 is not an opening per se but it promotes a certain level of freedom to local insurers and international reinsurers, finally allowing for the execution of direct reinsurance contracts. Local insurers are now allowed to get quotation and reinsurance support from the international market for risks that are not supported by IRB's automatic contracts. This means that, in practice, insurers are free to prepare their reinsurance plans, with their preferred reinsurer, for risks in which IRB does not have automatic contracts available. There is, however, an obligation to notify IRB so that IRB can authorise the operation. However it will no longer necessarily retain the risk retention in its own portfolio. The new law also establishes some objective criteria for the selection of reinsurers. Thus, for example, the IRB can only authorise reinsurance plans in which the selected reinsurance companies have a minimum rating, pursuant to the classification performed by one of the following risk classification companies: Standard & Poor's (S&P); Moody's; and AM Best. In addition to the rating requirement, there is also a collateral requirement: the international reinsurance company must have net assets equivalent to \$100m."

Secondly, the following is a quotation from the Willis, International Alert, January 2007, Issue 21⁵⁹:

"The Brazilian state reinsurance monopoly – one of the few remaining reinsurance monopolies in the world – is expected to come to an end. In the first days of 2007, the president of Brazil signed a bill, first drafted in 1996 and amended periodically over the past ten years, to open the reinsurance market. New regulations outlined in the law are not without restrictions, and many details must be worked out before a new system emerges.

⁵⁷ WTO document GATS/SC/13 /Suppl.3, 26 February 1998.

⁵⁸ "Brazil takes steps to open up its reinsurance market" by Sergio Barroso de Mello, of Pellon & Asscoiados, in 'Insurance Day' on 14 July 2006,

⁵⁹ Available on their website www.willis.com.

Although this process may take considerable time, the opening of the reinsurance market in Brazil appears imminent.

“The law creates a new regulatory body that will supervise insurance and reinsurance activity, taking this responsibility away from the IRB Brasil Resseguros SA (IRB), which for the past decade has been the only local reinsurer in Brazil.”

“Three categories of reinsurers will be recognised by the new regulatory body:

- **Local reinsurer** – A reinsurer domiciled in Brazil, organised as a stock company to exclusively carry reinsurance and retrocession
- **Admitted reinsurer** – A reinsurer domiciled in a foreign country, with representative offices in Brazil
- **Occasional reinsurer** – A reinsurer domiciled in a foreign country with no representative offices in Brazil

“Local reinsurers, including the IRB, will have preference over companies in the two other categories. All insurers will have to reinsure at least 60 percent of their reinsurable business with local reinsurers. This limit will fall to 40 percent three years after the law goes into effect. The limit will be then reviewed three years after that date.

“The law originally passed by the Brazilian House and Senate included rules about the preferential treatment to be accorded local reinsurers and to a lesser extent admitted reinsurers, but much of this was struck from the law by President Luiz Inácio Lula de Silva for being too detailed.

“The new regulatory body will apply strict rules regarding the acceptance of foreign-domiciled reinsurers. Occasional reinsurers must not be located in tax havens, in countries where the income tax is below 20 percent or in countries that protect the names of shareholders or company owners.

“The law also includes a provision that confirms that only local reinsurers will be allowed to reinsure endowment insurances and supplementary pension plans.”

“Work to Be Done

A series of issues still need further discussion.

- Limits and conditions for retrocession
- Advantages accorded admitted reinsurers over occasional reinsurers
- Conditions under which local reinsurers will have to follow terms of admitted and occasional reinsurers
- Procedures for registration of reinsurers
- Operational rules for reinsurers and reinsurance brokers”

4.2.5 BOLSA FAMILIA AND PENSIONS

The Financial Times article by Wheatley and Lapper (29 September 2006) stated that:

“The number of families receiving benefits from the Bolsa Familia has risen from 3.6m in 2003 to 11.1m – about 44m people. [] [Lula’s government] has not tackled the INSS, the much more problematic public system for private-sector workers. Spending on the INSS rose from 6.5 per cent of gross domestic product in 2002 to an estimated 7.8 per cent this year – dwarfing the 0.4 per cent of GDP spent on income transfer programmes such as Bolsa Familia.”

The WTO TPRM 2004 report noted that:

§204 Closed complementary private pension entities are supervised by the State Secretariat for Pension Funds (SPC), an agency subordinated to the Ministry of Social Security. The SPC licenses pension entities and supervises their compliance with regulations. Main regulatory decisions are made by the National Board of Complementary Pensions (CGPC), linked to the Ministry of Social Security and comprising members from Government, and employers' representatives, participants of pension funds, and pension fund representatives.

The Leader article, already noted, in the Financial Times on 7 February 2007, also said:

[T]his would have been time to begin a long overdue reform of labour laws, some of which date from the 1930s. Designed to protect the less well-off, these often end up benefiting selected groups of elite workers in state industries and the public sector and deprive the poor of any access to formal labour markets at all.

As a result the system of pension provision remains deeply flawed. Many workers still retire in their early 50s. For many privileged groups, such as the military and judiciary, generous benefits extend to family members and through generations. Reform in both areas is on the back burner.”

4.2.6 GATS SPECIFIC COMMITMENTS FOR INSURANCE SERVICES

The WTO Trade Policy Review report for Brazil⁶⁰ describes the specific commitments of Brazil resulting from the Uruguay Round, which entered into effect on 1 January 1995.

§159 Brazil's specific commitments under the General Agreement on Trade in Services (GATS) cover, at least partially: business services, communication services, construction and related engineering services, distribution services, financial services, tourism and travel related services, and transport services. Brazil scheduled horizontal market access limitations regarding the movement of natural persons, investment, commercial presence, and subsidies. With respect to the movement of natural persons, market access is guaranteed only to specialized technicians, highly qualified professionals, and managers and directors working under temporary contracts. Special conditions apply to the appointment of managers to affiliates of foreign companies. Brazil has also retained the right to require foreign companies wishing to supply a service to be organized as a legal entity as foreseen by Brazilian law. Most commitments are in mode 3 (commercial presence); there is no commitment on cross-border supply.

§161 (part) Brazil participated in the WTO negotiations on financial services and in the negotiations on basic telecommunications. However, as of August 2004, Brazil had not ratified the Fifth Protocol on Financial Services, nor the Fourth Protocol on basic telecommunications services. [⁶¹]

§208 With respect to foreign commercial presence, Brazilian law mandates that there must be reciprocity regarding market access for insurance operations. Also, the establishment of a life or non-life insurance foreign company requires an act from the Minister of Finance, preceded by prior approval from SUSEP. Since July 2004, authorizations are granted directly by the SUSEP. Once a foreign company is authorized to operate in Brazil, national treatment is granted.

⁶⁰ WTO document: WT/TPR/S/140, 1 November 2004: Chapter 7

⁶¹ The ratifications had still not been made by August 2007.

§209 Minimum capital requirements vary according to the region of operation and the type of activity. There are no barriers to the internal trade of insurance services as long as a company complies with these minimum capital requirements. In accordance with Resolution CNSP No. 73/2002, insurance companies must maintain capital not lower than R\$ 1.2 million in fixed capital, plus a variable amount up to R\$ 6 million if the company intends to operate in the whole country. The minimum requirements for investment plans are R\$ 1.8 million, and R\$ 10.8 million, after adding the variable amount and if the company wishes to operate in the whole of Brazil, respectively.⁶²

§210 Insurance brokers must be registered at the SUSEP. Pre-approval is required only for brokers wishing to sell non-life insurance. In general, new insurance products do not have to be pre-approved by the SUSEP, but information about them must be submitted to it; the SUSEP undertakes an analysis that might lead to recommendations to modify the product. However, life insurance products that offer long-term savings and annuities, capitalization plans, and open pension products require prior approval from the SUSEP. The SUSEP may forbid the commercialization of any product considered incompatible with the industry's regulatory framework or specific provisions thereof, or deemed to be not technically feasible or badly structured.

§211 Cross-border supply of insurance services is not allowed. The IRB may, however, authorize insurance to be bought outside Brazil if coverage is not available in the country, the risk is deemed not convenient to the national interest, or if the insurance is for vessels with Special Brazilian Registry (REB), provided the price is lower outside Brazil.

§212 Although the monopoly on reinsurance operations was eliminated in 1996 through Amendment No. 13 to the Brazilian Constitution, and regulations establishing conditions of operation for new reinsurers in Brazil were issued in January 2000, the reinsurance market continues to be a monopoly of IRB-Brasil Resseguros. After the legal end of the monopoly in reinsurance, the wholly government-owned IRB was transformed into a corporation by Provisional Measure No. 1,578, of 18 June 1997, later converted into Law No. 9,932/99.⁶³ IRB was included in the privatization programme in December 1997. In December 1999, its assets were transferred to the SUSEP by Law No. 9,482/99. However, this action was considered unconstitutional by the Supreme Federal Tribunal, in October 2002, and the privatization of IRB was suspended. The January 2000 Resolution, allowing foreign-based reinsurance companies to sell reinsurance services in the country, directly or through brokers, to become effective upon privatization of IRB, was left temporarily ineffective.

This WTO report then went on to describe the current GATS negotiations.

§162 Brazil is an active participant in the current negotiations on services. In July 2004, Brazil tabled an initial offer.⁶⁴ The offer is conditional on other WTO Members making substantive and satisfactory offers in areas of interest to Brazil in the Doha Work Programme, particularly in agriculture, as well as in sectors and modes of supply in the GATS negotiations where Brazil has indicated its interests. The offer is also conditional on the outcome of the negotiations on rule-making under GATS Article VI:4 (Domestic Regulation), Article X (Emergency Safeguard Measures), and Article XV (Subsidies).

§163 (part) As a member of MERCOSUR, Brazil participates in the ongoing services negotiations within the regional grouping, which envisage free trade in services ten years after entry into force of the Protocol of Montevideo. As at May 2004, MERCOSUR Members

⁶² SUSEP online information: available at: <http://www.susep.gov.br/menumercado/capitalmin.asp>.

⁶³ IRB – Brazil Resseguros online information. Available at: http://www.irb-brasilre.com.br/quemsomos_frame.htm.

⁶⁴ WTO document TN/S/O/BRA, 21 July 2004.

were in the process of preparing their lists of specific commitments for liberalization in the context of the fifth round of negotiations.

§167 In its offer in the extended negotiations on financial services, Brazil included a new provision to allow the incorporation in Brazil of all insurance and insurance-related services and financial institutions, subject to the enactment of a presidential decree.⁶⁵ Restrictions regarding the provision of auxiliary insurance services by foreigners were liberalized. Limitations on national treatment for the installation of automatic teller machines, and the minimum requirements for paid-up capital were eliminated. Brazil also made commitments regarding provision of services by non-financial institutions.⁶⁶ As noted, Brazil has not yet ratified the Fifth Protocol to the GATS; the ratification process is still pending in Congress.

The EU – Mercosur Association Agreement is currently being negotiated and it will cover services, including insurance, and investment, as well as a range of other issues. However, they reached deadlock in October 2004, and are now linked to the outcome of the WTO DDA negotiations and in particular the question of modalities for market access. There is thus nothing that can yet be predicted as to the impact of this FTA on future access for foreign insurers to the Brazilian insurance market.

The Financial Leaders Working Group⁶⁷ listed a summary of the detailed issues as follows:

An initial aim is to secure Brazilian ratification of the GATS Fifth Protocol.

Market Access in Modes 1 and 2

Brazil does not:

- Permit cross border sales for reinsurance, MAT insurance and insurance services (including brokerage and agency) on behalf of both domestic and foreign clients.
- Bind any commitments for cross-border and consumption abroad in MAT insurance, reinsurance or other insurance services (including brokers and agency), except for freight and vessels.
- Grant right of first refusal privileges to foreign or domestic reinsurers.
- Offer freedom of form for reinsurance and freedom of reinsurance contract forms.
- Allow non-resident insurers to insure imported goods or goods in transit.

Brazil further:

- Imposes restrictions on MAT insurance.
- Requires an economic needs test that restricts direct insurance contracts with foreign insurers to cases where risks can not be covered by domestic insurers or the risk is against the national interest. In addition, approval by the Superintendecia de Seguros Privados (SUSEP) is required before the contract is signed.
- Requires submission of detailed information on the contract and approval by SUSEP when an insurance contract is concluded in foreign currency, except for contracts on maritime shipping, aviation, goods in international transit and export credit.
- Imposes prohibitive taxation (effectively double taxation) on fees of services rendered abroad. This leads to systematic refusal by agents abroad to render services to Brazilian clients.
- Maintains State monopolies on
 - o workers' compensation insurance, and
 - o reinsurance.

⁶⁵ Financial institutions include multiple banks, commercial banks, investment banks, consumer finance companies, real estate finance companies, leasing companies, brokers, and dealers.

⁶⁶ WTO documents GATS/SC/13, 15 April 1994 and GATS/SC/13/Suppl.3, 26 February 1998.

⁶⁷ "Trade Barriers in Insurance", FLWG, 1 December 2005.

Market Access in Mode 3

Brazil requires:

- A Presidential decree for the establishment of a commercial presence.
- Incorporation under Brazilian Law to establish a commercial presence.
- Exclusive service supplier arrangements or monopolies for reinsurance that prevent full and open competition (IRB).
- Mandatory cessions for reinsurance of 100% to IRB.

Brazil does not:

- Allow direct branching.
- Apply full liberalisation on insurance intermediation and services auxiliary to insurance.

Market Access in Mode 4

- A business entity which has more than three employees is obliged to hire Brazilian employees, and these nationals must comprise more than two thirds of its total employees.

National Treatment

Brazil imposes:

- Restrictive conditions and limitations on monetary transfers by insurers and insurance intermediaries.
- A special 2% tax on premiums ceded to foreign reinsurance undertakings.
- A requirement of minimum funds ranging from US\$ 100-150m for the creation of a reinsurance undertaking.

Comparison with FLWG Best Practices in Insurance**A. Transparency**

- Brazil has no transparent, publicly available, non-discriminatory rules and procedures to govern the identification and handling of financially troubled institutions, including disclosure.

B. Solvency and Prudential Focus

- There are burdensome limitations on the number and frequency of new product and service introductions, and
- Restrictions on the payment of dividends by foreign insurance providers.

C. Insurance Monopolies

- It is unclear whether the state monopolies in reinsurance and workers compensation have wider implications for regulatory best practice.

D. Independent Regulatory Authority

- There is an Independent Regulatory Authority, which accords with best practice.

Significant fields in which Brazil has not yet made any commitments include:

- Cross-border provision and transfer of financial information
- Pension fund management (Mode 3).

Initial conditional offer

(WTO document TN/S/O/BRA, 21 July 2004) (The original is in English.)

Horizontal Commitments

The changes together constitute “a technical refinement that does not alter the scope of substance of an existing commitment.”

Specific Commitments for Insurance services

The bindings have been recast to align with the GNS W/120 list and CPC classification codes, and some restrictions would be removed for life insurance, agencies and brokers, as detailed in the Annex to this report.

An experienced observer considers that Brazil’s largest single shortcoming in the WTO DDA talks is its refusal to even consider binding current practices in insurance or other financial services. Foreign companies find the Brazilian market to be open – including the ability, in most instances, to acquire 100 percent ownership – and a reasonably effective and transparent regulatory system. Important progress has been made in the past year in opening the reinsurance market.

The same cannot be said for the private pension system and, specifically, the opposition of the current Lula regime to undertake meaningful pension reforms. In 2006 an eclectic mix of some 90 different entities, including academics, former government officials and financial services industry representatives and associations proposed to strengthen the mandatory supplementary pensions and provide for group pension leverage. The Lula Government has ignored this proposal and, although there is market access for foreign insurance, asset management and pension providers, their ability to expand their markets is effectively limited.

Note: The “Annex on Specific Commitments”, to the present report, lists for each BCIMR country the GATS specific commitments and current offer under the WTO DDA negotiations (whether initial or revised).

4.2.7 DISTRIBUTION

The main impediment to growth is that distribution is exclusively through licensed intermediaries.

Life insurance is dominated by the banks which extend cover for credit granted.

4.2.8 SUPPORT PROFESSIONS

It seems that the actuarial tables in use are old.

The accounting profession is not well developed in relation to insurance.

4.2.9 CONSUMER AWARENESS

There appears to be little financial planning awareness on the part of consumers in general.

4.3: CHINA PRC

(ie excludes Hong Kong, China, Macau and Taiwan)

More attention is given to China in this chapter than to the other four economies, partly because of the sheer scale of its potential insurance market, and partly because the 'behind-the-border' constraints in the market are of general analytical interest, given the largely liberal market access commitments made by China upon accession to the GATS, and now that the five-year phasing-in period is over.

With reference to the unattributed material, the author was briefed informally about the behind-the-border issues in the insurance market of China, but it is his own responsibility if any of this has not been correctly interpreted.

4.3.1 GENERAL BACKGROUND

A recent article on "Regional development in China" forms a good opening on the economic policies of the government of China.⁶⁸

"The 11th government five-year programme seeks to (1) carry forward the development of the western region; (2) implement the strategy of rejuvenating northeast China; (3) energetically promote the rise of the central region; and (4) encourage the eastern region to play a leading role in the country's development." The authors see this as a much more balanced programme as between the regions. "Beijing expects [the eastern region] to keep on moving ahead and lead the country so that its development could trickle down to the less developed regions. In the meantime, the Central Government has adjusted its focus from south to north along the coast. The relatively backward Binhai district of Tianjin has been asked to develop into a window and showcase for north China with the same status of Shenzhen in the 1980s and Pudong in the 1990s. As a late comer, it is foreseeable that Tianjin will benefit from a more favourable policy from the Central Government in the coming years than Shanghai and Guangdong. The fact is, this new district has been chosen by the Central Government as an experimental site for the opening up of China's financial sector and Renminbi's convertibility, partly at the expense of Shanghai and Hong Kong." Compared with the focus on development of the coastal developed areas, "for the most part of the west and some of the central regions, another five years of the waiting seems a more likely prospect."

The Five-Year Plan seeks to address the twin problems of an economy perceived as being too dependent on external demand, and the social consequences of the widening wealth gap, by pursuing a shift in production from industry to services, facilitating the development of domestic consumer demand, and discouraging internal investment for the purposes of producing exports. Such a fundamental macroeconomic adjustment presents enormous challenges. Government subsidisation of energy, land, and other resources continues to encourage investment in fixed assets, which expanded by 30 percent in the first half of 2006. Indeed, a recent analysis by the World Bank indicates that although China's economy grew by 10.9 percent in the first half of 2006 – including a ten-year high of 11.3 percent in the second quarter – growth has continued "along familiar, largely imbalanced patterns," with the growth in manufacturing outpacing the growth in services and the growth in exports outpacing the growth in imports. "The desired shift in production from industry towards services, more reliance on domestic demand, more equally shared growth, and more environmentally sustainable growth that are aimed for in the 11th Five-Year Plan has yet to begin," the Bank reported.⁶⁹

⁶⁸ "Developing different regions" by Wenhui ZHU and Olive WANG, Hong Kong Polytechnic University, December 2006.

⁶⁹ See "China Quarterly Update," The World Bank, August 2006 and November 2006.

In May 2005, an IMF piece had highlighted the following issues:

The exchange rate policy is uncertain – a fixed rate reduces the room for manoeuvre for monetary policy. Capital inflows keep interest rates low, and in effect subsidise the capital of banks and companies, and neither the state-controlled entities nor the banks respond to market incentives.

Reform and development of the financial services sector is essential to ensure domestic demand to underpin sustainable economic growth and employment. Liberalisation of interest rates would enable commercially-based lending decisions by banks by assessing risks more carefully. This could reduce excessive cycle swings and reduce the need for domestic precautionary savings, and reduce misdirected investment.

Broadening of equity and bond markets is needed, giving savers a wider range of opportunities and companies alternative sources of funding.

There is a need to reform old domestic-oriented state companies

Accession to the World Trade Organisation has stimulated exports, rapid productivity growth and a good infrastructure have played key roles in export growth

The Financial Times correspondent in Asia, Guy de Jonquieres, writing on 8 February 2007, highlighted the following points:

“In China, a tougher line of foreign investment approvals has been followed by an edict that companies in ‘strategic’ sectors, many with market monopolies, will remain firmly in state hands. [] the political drive for market-oriented reform is flagging. China’s current top leaders are less committed than their predecessors to bold liberalisation, which is also increasingly contested from within and outside the Communist party. [] developing Asia still needs inward investment to provide vital technology and skills. In some sectors, such as financial services, they are often transferred and diffused more effectively by means of cross-border mergers and acquisitions than through greenfield projects.”

On 18 January 2007 he had pointed out that the stock market capitalisation had reached \$1,000 bn, or a rise of 120% in the index during 2006. This related to 1,400 listed companies, in many of which the quality of management was poor, and there is weak disclosure and weak accounting standards. One third of the capitalisation is accounted for by seven state-controlled banks, and indeed half by value belongs to the State.

The demographic long-term picture was reported on by Messrs N Howe and R Jackson in the Financial Times of 9 February 2007:

“Even some large developing countries are due to see a decline: China after 2030 and Mexico after 2050. [] We believe [] that population decline will pose massive fiscal, economic and geopolitical challenges that leaders have hardly begun to grasp. [] When it comes to security and global influence, size matters. [] It also makes a difference whether your nation expects to be much larger 50 years from now (such as India) or much smaller (such as Russia). [] The record is clear: virtually every rising power in history has also been a demographically expanding power.”

Three other articles in the Financial Times paint a useful picture of conditions in China, for those wishing to assess the downsides as well as the upsides.

“China’s industrial policy should think small” by Guy de Jonquieres, 2 September 2006.

“Yasheng Huang of the MIT Sloane Management School argues in a forthcoming paper that China’s economic reforms differ fundamentally from those in transition economies such as Russia and Central Europe. Their goal was to institute capitalism: China’s is to preserve socialism. Instead of mass privatisations, China has opted for selective liberalisation that has favoured foreign investors over local entrepreneurs. It allows state industries to be used to serve social objectives dear to China’s rules, notably stable employment. It also provides a lever for promoting industrial rationalisation by forcing mergers in sectors where reckless over-investment, abetted by local governments, has created fragmentation and excess capacity. These policies may have some impact now. But they are storing up future problems. China is full of stories of state-ordained mergers that have failed to integrate managements or reduce surplus capacity. [] the commanding heights beloved by government planners can turn into costly economic sink holes. [] the promising engine of China’s future industrial development is not its state sector but its millions of nimble privately-owned companies. [] Yet the country’s industrial policy conspires to hem them in at every turn. Official restrictions, formal and informal, restrict their access to bank credit; [] they benefit little from state-sponsored research and development programmes; [the] environmental record is poor. But those failings say as much about distortions in China’s markets and shortcomings in its laws as about the companies themselves.”

“Chinese workers are subsidising their government in the amount of the interest on China’s holding of US assets. Its rising middle and upper-class will inevitably want more say in the political process. Will the government be able to use the earnings on its reserves to placate this group, for example with tax breaks and other preferential treatment? The increasing disparity between rural and urban incomes will also have to be addressed. Improving the distribution of gains from increased global production inter-dependence in both the US and China might offer the best way to sustain the system. Gradual democratisation and heightened protection of worker rights in China would ease tension from that country’s explosive growth.”

By J Kregel and W Milberg, Financial Times, 5 September 2006.

“Will Hutton advances five fundamental and, in my view, fundamentally correct propositions. Firstly, for all its manifest achievements, the Chinese attempt to marry a Communist party-state with the market is unsustainable. [] This is not a viable new model but an ultimately dysfunctional hybrid. The consequences include rampant corruption, an absence of globally competitive Chinese companies, chronic waste of resources, rampant environmental degradation and soaring inequality. Above all, the monopoly over power of an ideologically bankrupt Communist party is inconsistent with the pluralism of opinion, security of property and vibrant competition on which a dynamic economy depends. As a result, Chinese development remains parasitic on know-how and institutions developed elsewhere.”

Despite such remarkable progress, the structure and pace of China’s economic growth has produced significant problems, both economic and social. The country’s fixed investment- and export-driven development – more factories to produce more goods for world markets – has left China vulnerable to economic slowdown elsewhere in the world (particularly in the United States), and to rising energy, materials, and labour costs. The manufacturing and export focus of the economy has also led to widening disparities between rich and poor, made worse by the closing or privatisation of state-owned enterprises, which had provided most healthcare services in China. There are, in effect, two Chinas – a wealthy elite and a developing middle class along the coast, and 800 million poor in the central and western interior.⁷⁰ The worsening wealth gap and the resulting social dichotomy have led to

⁷⁰ According to an unpublished report by the World Bank that has been shared with the Chinese government, from 2001 to 2003, as China’s economy expanded by nearly 10 percent a year, average incomes of the poorest

increasing political instability. Reports indicate that as many as 100 significant incidents of protest occur in China every day.

The WTO Trade Policy Review report of 2006 gave the following picture:

§146 The tertiary sector in China accounted for some 32% of GDP in 2004, the most recent year for which data are available (although this was revised in January 2006 to 41%).⁷¹ In 2003, the major services activities were wholesale and retail trade and catering services (23.6% of the total), finance and insurance (16.5%), and social services (12.5%). These were also the main service activities in 2000; however, while the shares of wholesale and retail trade and catering services and finance and insurance have declined slightly, that of social services has risen. According to data released in January 2006, China has adjusted its GDP upward: it appears that most of this revision is due to the inclusion of services, including small businesses that tend to be privately owned. The sector, nevertheless, remains relatively small compared with other developing countries, the new data showing its contribution to be almost 41% of GDP in 2004. Further liberalisation of services may contribute to absorbing excess labour in other sectors of the economy, notably agriculture.

§147 China is a net importer of services. It maintains a negative services trade balance amounting to some 0.5% of GDP. The main exports of services in 2004 included: tourism, which accounted for some 41% of receipts, and transportation, which was around 19% of receipts. The main services imports in 2004 also involved transportation and tourism (34% and 26.5%, respectively), but also increasingly insurance, which accounted for 8.5% of payments in 2004 up from 6.5% in 1998.⁷²

[Figures given at a MOFCOM press conference on 30 December 2006 showed that in 2005 services exports and imports were US\$ 74 billion and 83 billion respectively, of which the private sector contributed US\$ 40 billion and 46 billion. Sales of non-financial majority-owned foreign affiliates in China totalled US\$ 74 billion in 2005. - JA]

§148 In general, services are characterised by state involvement through SOEs and restrictions on private-sector involvement. Both are gradually being liberalised although there are foreign investment equity restrictions or prohibitions for most services. In certain services activities, particularly wholesale and retail, catering, real estate, storage, and transport, there appears to be a sizeable private sector presence, although this is difficult to measure due to the small scale of the operators.⁷³ In liberalising services, China has tended to follow closely its commitments under the GATS rather than liberalise autonomously, although its GATS commitments tend, in general, to be more extensive than those of other developing countries.

10 percent of Chinese households fell by 2.5 percent. See "In China, Growth at Whose Cost," *The Wall Street Journal*, November 22, 2006.

⁷¹ The tertiary sector refers to all economic activities other than the primary sector (agriculture, forestry, animal husbandry and fishery) and the secondary sector (mining and quarrying, manufacturing, production and supply of electricity, water and gas, and construction).

⁷² There may be a discrepancy between data on trade in services and the contribution of services (the tertiary sector) to GDP as the data on trade in services is from the balance of payments. The use of balance-of-payments data may also tend to underestimate trade in services, as their coverage is more limited in scope than that of the GATS (for example, mode 3 is not usually covered by balance-of-payments data).

⁷³ *Economist*, 14 January 2006, pp. 61-62; and China Daily Online. Available at: http://english.people.com.cn/200512/20/eng20051220_229482.html [23 January 2006].

In its Special Report on China, the Financial Times of 12 December 2006, commenting on the statistics that GDP probably grew by over 10% in 2006 for the third year running, wrote:

“a figure that many foreign investment bank economists think understates the true pace of development. China has spawned a new caste of millionaires, an emerging middle class centred in large cities on the coast, alongside a struggling and increasingly fractious rural underclass and urban poor. China’s rapid development remains a curious mixture of the unstoppable and the unsustainable. The rich-poor gap has grown so quickly in recent years that the country is now more unequal than the US and Russia, an astounding development, given that two decades ago the country was one of the most equal – even if that did mean poor. Increase in outlays on health and education have been stymied by Beijing’s deep distrust of the provincial and city leaders who will be responsible for delivering such services. They worry that local leaders will spend the money inefficiently, or in some cases, divert funds into their own pockets. The administration’s limited mandate outside Beijing also makes it difficult to enforce its own environmental rules anyway.”

Later in the same report, it went on to say that:

“domestic private companies remain constrained by the need to work with powerful provincial governments and the state-owned enterprises that dominate all the key sectors of the economy. Asked why the private sector could not be unleashed for the benefit of all, the economist replied: ‘It would be good for the economy, but not for the party.’”

Overall 70% of the increase in gross savings was generated by increased profitability of corporate income. In 2004 32% of household disposable income was saved, and private consumption was 40% of GDP.

In the Financial Times of 29 January 2007, J Plender wrote that China’s

“official reserves have recently topped \$1,000 bn, equivalent to 40 per cent of gross domestic product, much of which is invested in US bonds. One snag for China is that the return on this portfolio is much less than could be earned at home on, say, badly needed infrastructure investment. [the intervention to sterilise the funds involves] curbing the banks’ ability to lend. So funds then bypass the banking system and feed into the stock market, creating asset price inflation, and in due course into consumer inflation.”

The following are extracts from an IMF Policy Discussion Paper, by Prasad and Rajan, March 2006 (PDP/06/3)

“China has achieved tremendous economic progress in the last three decades, but there is much work to be done to make the economy resilient to large shocks, ensure the sustainability of its growth, and translate this growth into corresponding improvements in the economic welfare of its citizens.”

“First, China is rapidly moving from a command economy to a private-sector-led one, with the private sector’s share in GDP now estimated to be one-half to two-thirds. [] Second, from being a relatively closed economy before the 1980s (in recent history), China has become very open to trade and more integrated into global financial markets. [] Rising average incomes mask increasing disparities in income, especially between the rural and urban areas. Increasing integration with the global economy has made China more dependent on external demand and more vulnerable to external shocks.”

M Wolf, writing in the Financial Times on 18 October 2006 reported that in 2004 China’s GDP per head was 2.5 times that of India (at market prices) while household consumption was only 2/3 higher, so the government should spend more on health, education welfare, and pensions, especially in the poorest areas.

Minxin Pei writing in the Financial Times on 29 September 2006 noted the following points: the Shanghai pensions scandal reveals how pervasive official corruption is a lethal threat to survival of the Communist Party; the Country Magistrates are an increasing percentage of cases. Corruption is also pervasive in banking and financial services, and more generally it corrodes critical public institutions, the courts, law enforcement and public pensions administration, undermines property rights public confidence and social stability. It dramatically increases systemic risks and is responsible for numerous environmental, public health and public safety disasters.

4.3.2 FINANCIAL SERVICES

As a financial sector becomes more developed and sophisticated, capital formation becomes more effective, efficient, and diverse, broadening the availability of investment capital and lowering costs. A more developed and sophisticated financial sector also increases the means and expertise for mitigating risk – from derivatives instruments used by businesses to avoid price and interest rate risks, to insurance products that help mitigate the risk of accidents and natural disasters. Financial services liberalisation promotes opportunity, social justice, and stability by broadening the range of empowering savings and investment alternatives and by facilitating the development of insurance and retirement security products – all of which fosters the growth of a stable middle class, freeing governmental resources to concentrate on society's neediest. Finally, the depth and flexibility of the financial sector is critical to the broader economy's resilience – its ability to weather, absorb, and move beyond the inevitable difficulties and adjustments experienced by any dynamic economy. For all these reasons, an effective, efficient, and sophisticated financial sector is the essential basis upon which the growth and vitality of all other sectors of the economy depend. It is the "force multiplier" for progress and development, amplifying and extending the underlying strengths of a growing economy.

The critical importance of an efficient, open, and competitive financial system to the achievement of China's economic plan is clear. Creating the millions of new jobs that China will need each year requires maintaining exceptional rates of economic growth, which in turn will increasingly depend on an effective system for mobilising and productively allocating investment capital. At present, China's weak banking system intermediates nearly 75 percent of the economy's total capital, compared to about half in other emerging economies and less than 20 percent in developed economies. Despite some improvements in recent years, Chinese banks' credit analysis, loan pricing, risk management, internal controls, and corporate governance practices remain inadequate. A major obstacle to better lending based on rigorous and impartial analysis has been the lack of a national credit information service to provide the information necessary for banks to competently evaluate individual loan applicants. Meanwhile, China's equity and bond markets are among the smallest and least developed in the world. More fully developed capital markets would provide healthy competition to banks and facilitate the development and growth of alternative retail savings products such as mutual funds, pensions, and life insurance products. And by broadening the range of funding alternatives for emerging companies, more developed capital markets would greatly enhance the flexibility and, therefore, the stability of the Chinese economy.

Facilitating the desired transition to a more services-based economy will require that competitively priced capital and credit be channelled to the most promising emerging service businesses, and that the array of financial products and services emerging businesses require – loans, letters of credit, accounts management services, asset management, and insurance products – be made available. At present, state-owned enterprises, though contributing only a quarter of China's GDP, receive more than a third of bank credit and account for nearly all equity and bond issues. Private enterprises, the most productive of China's economy and the engine of future growth and job creation, account for only 27

percent of bank loan balances. More developed capital markets would enhance access to bank capital by smaller businesses and consumers – banks' natural customer base – who are too often crowded out by large companies forced to rely on banks for funding.

Finally, increasing domestic demand by activating the Chinese consumer requires the availability of financial products and services – personal loans, credit cards, mortgages, pensions, insurance products, and insurance intermediary services – that will encourage and facilitate consumption.

With regard to financial services, there have been, and continue to be, a number of procedural and regulatory issues that have frustrated foreign financial institutions as they have sought to take full advantage of China's commitments. For example, in 2002 the People's Bank of China (PBOC) issued working capital requirements and other prudential rules for foreign banks that far exceeded international norms. Chinese authorities have also been slow to act on foreign banks' applications and continue to permit foreign banks to open only one branch every 12 months. Similar problems have been experienced by foreign insurance companies, such as the approval of new branches on a strictly sequential basis rather than the concurrent approval enjoyed by Chinese insurance providers. In addition, in December of 2005 the China Securities Regulatory Commission (CSRC) imposed a de facto moratorium on foreign investments in Chinese securities firms.

It should be acknowledged that in addition to working to meet its WTO commitments, China has also taken important steps to liberalise the financial sector and to improve financial regulation. For example:

- the China Banking Regulatory Commission (CBRC) was established in April of 2003 to oversee all banks in China, investigate illegal banking operations, and punish violations of law;

The classical argument for liberalisation runs as follows: the fastest and most effective way to address the current deficiencies of China's financial sector is to expand foreign institution participation. Foreign institutions bring world-class expertise and best practices with regard to products and services, credit analysis, risk management, internal controls, and corporate governance. In addition, the competition brought by foreign institutions would accelerate the adoption of such techniques and methodologies by domestic financial institutions.

However, observers also point out that despite the achievements to date, China's financial sector still faces serious challenges:

- the stock of nonperforming loans on banks' balance sheets remains high;
- banks are undercapitalised and lending practices, risk management techniques, new product development, internal controls, and corporate governance practices remain inadequate;
- prudential supervision and regulation of the financial sector is opaque, applied inconsistently, and lags behind international best practices; and,
- China's equity and bond markets remain small and underdeveloped.

Observers also say that the China Securities Regulatory Commission (CSRC) continues to limit foreign ownership of Chinese asset management companies to 49 percent, and since December of 2005 has imposed a de facto moratorium on foreign investments in Chinese securities firms. The moratorium is inconsistent with the letter, and is certainly a violation of the spirit, of China's WTO commitments. Foreign life insurance companies remain limited to 50 percent ownership in joint ventures and to 25 percent equity ownership of existing domestic companies.

China has been urged to permit the supply of financial services on a cross-border basis, particularly when such services are provided to institutional investors and other sophisticated clients. For example, in order to properly mitigate large commercial risks such as marine, aviation, and transportation risk, insurance and reinsurance brokers require broad access to the global insurance markets.

4.3.3 INSURANCE SERVICES

By 2006 there were 93 insurance institutions in China, of which 35 were property insurers, 42 life insurers and 5 reinsurers, with nearly two million employees in total, or 40% of the financial sector workers.⁷⁴

Insurance premiums grew at a rate of 25% per annum during the 'Tenth Five-Year' planning period. Total premiums rose from RMB 211 billion in 2001 to RMB 493 billion in 2005, representing RMB 379 per head and 2.7% of GDP, of which RMB 324 billion was for life, RMB 123 billion for property and health and health and accident RMB 45 billion,. Assets of insurers by the end of 2005 amounted to RMB 1.5 trillion, of which RMB 359 billion was held in treasury bonds, RMB 179 billion in financial bonds and RMB 121 billion in equities.

By November 2006 there were 47 foreign insurance institutions in China from 15 countries, with 121 offices, and having a share of the market of just over 4%. However, their share was over 18% in Beijing and Shanghai.

The 'Eleventh Five-Year' national plan for the insurance sector envisages that by 2010 the insurance penetration rate will be 4% and density at RMB 750 per head, with total sector assets of RMB 5 trillion. The plan aims to strengthen reinsurance and intermediaries, and to improve regulatory capability, corporate governance, solvency levels, internal controls and risk prevention management.

The insurance market in China is highly concentrated and it is probable that just a few insurers control it – in 2000 just five firms accounted for over 98% of the market. Mergers and acquisitions among the small firms might promote more competition.⁷⁵

"By the end of 2004, 17 foreign insurers (including thirteen P&C insurers, one life insurer, and three reinsurers) from 8 countries/regions set up their branches and/or subsidiaries in China. Another 20 life insurers from 12 countries/regions accessed Chinese insurance market by setting up joint ventures in China. The foreign insurers had about 1.2 percent of the non-life insurance market and 2.6 percent of the life insurance market in 2004. There were 188 representative offices established by 124 foreign insurance institutions from 18 countries/regions in China. The total assets of foreign insurers reached RMB 29.4 billion at the end of 2004, 2.5 percent of that of China's insurance industry." In Shanghai "the market share of foreign companies reached 15 percent."

Whereas China is the 11th largest insurance market (in 2004) the relatively tiny island of Taiwan is the 13th largest, ahead of Australia (12th), Switzerland (14th) and Belgium (15th), for example.⁷⁶ When it comes to insurance penetration (insurance premiums as a share of GDP) in 2004 Taiwan was in second place behind South Africa, ahead of the UK (3rd), Japan (5th) and the US (10th). However its level of premiums per head (or insurance density) did not

⁷⁴ "China Trade in Services Report 2006", Ministry of Commerce, Beijing, February 2007.

⁷⁵ "The opening of China's insurance market" by Wei Zheng, Peking University, Beijing, November 2005.

⁷⁶ "Some comparisons between Taiwan and China", M Wolf, Financial Times, 5 September 2006. Taiwan (formerly Formosa) is referred to at the WTO as 'The Special Customs Territory of Taiwan, Penghu, Kinmen and Matsu'. Comparison between the insurance situation between Taiwan and the Peoples' Republic of China is illuminating.

place Taiwan in the first ten globally, where Switzerland is No 1, UK No 2, Ireland No 3, Japan No 4 and the US No 5.

Historically the Chinese insurance market has been dominated by the People's Insurance Company of China (PICC) until its monopoly was ended in 1988. With effect from December 2004 the geographical limits on foreign insurers were removed, and it is expected that foreign life companies will be permitted to provide group health, pension and annuity products, at present only provided by life insurers.

In 2004 26 non-life and 28 life insurers had total premiums of US\$ 52 billion, of which 13.5 billion, 25%, was accounted for by non-life covers. Pricing is extremely competitive with most policies being basic in form. They are mainly annual policies, with standard PICC wording with one to two year maximum periods for claim notification, though some European standard wording is becoming more common.

PICC was founded in 1949, in which the AIG Group has a 20% stake, and it has about 58% of the non-life domestic market, and three other major companies have a further 25%. There are fourteen major foreign firms offering non-life cover, and Lloyd's of London received a licence in 2005. There are over 215 loss adjuster firms, but many lack expertise and fail to adopt international practice. In 2002 foreign brokers were allowed to enter the market but only as part of joint-ventures.

China is the world's 11th largest insurance market by total premium volume (as noted 8th by life insurance⁷⁷), up from 16th in 2000, with premium volumes of almost \$ 62 billion. The gross annual premiums collected from insurance policies increased 14% in 2005. The gross annual premiums collected from insurance policies from January to November 2006 increased 5% compared to the whole year of 2005. Gross premiums collected by all life insurance companies were approximately \$ 47 billion Jan.-Nov. 2006; foreign life insurers' market share was 5.63%.

There were a total of 44 life insurance companies by the end of November 2006. (19 domestic and 25 foreign). The top 10 life insurance companies had an aggregate market share of 96.21% by the end of November 2006, a decrease of 1.79% from 2005. Per capita life insurance spending was approximately \$ 35.88 for the 11 months of 2006.

Although the Chinese insurance market continues tremendous annual growth, per capita insurance consumption in China still has room to grow from the current US\$ 35 per year to the global average of US\$ 220 per year.

Increasing insurance annuity, pension and related product consumption could better direct and focus China's high savings through financial risk transfer, increasing economic efficiency and freeing capital for other important uses. Another important outcome of making more financial products and services available is that it helps transform China's former government role as ultimate provider re: the social safety net, to a new role as facilitator, supporter, and regulator of a wider range of financial service products and services. This is the focus of China's ongoing financial sector reforms.

In July 2006 the European Insurance Committee noted that "foreign joint ventures are still some way off from posting profits given China's high capitalisation requirements and the fact that foreign joint ventures still only account for less than 2 percent of the national market.

⁷⁷ The American Council of Life Insurers reported in 2006 that China is the world's 8th largest life insurance market.

Still, China will remain an attractive market for foreign insurance companies for a number of reasons:

- At 40%, China has one of the highest personal savings rate in Asia. This would indicate a huge potential for personal-retirement savings and protection insurance.
- Insurance has played and will continue to play an important role in channelling funds into much needed state infrastructure projects as the Chinese economy continues to expand.
- China's population is ageing fast, the government has recognised that private firms will play an essential role in creating a viable pensions system for China. By 2030, the number of retired people in China will have more than doubled as a percentage of the working population. Whereas today there are 10 workers to every retired person, in 2030 there will be only 4 workers to every retired person.
- Total insurance penetration (premiums per GDP) at 3.3% is still very low, compared to an 8.1% world average."

The WTO Trade Policy Review report of 2006 stated that:

§182 China's insurance industry at the end of 2004 comprised 80 institutions providing insurance services. Of these, 40 are Chinese companies, including six holding companies (with 16 subsidiaries)⁷⁸, and 32 insurance companies; there are also two insurance asset management companies. In addition, there are 37 foreign providers, most of which seem to be branches, with some joint ventures; the foreign insurance providers were subject to geographic restrictions until the end of 2004 and they may not write compulsory insurance, such as motor third party liability.⁷⁹ Under the Insurance Law, an insurer may not conduct property and life insurance under the same legal entity, and must operate within the business scope authorised by the regulator. The current legislation permits the establishment of insurance brokers; at end June 2005, there were 234 insurance brokers in China, of which four are foreign-owned (or joint ventures with foreign investment).

§183 Domestic companies had a market share of almost 100% until recently, although concentration in the market had dropped to 97.7% by the end of 2004. According to the authorities, the combined share of the three biggest non-life insurers (China People's Property and Casualty Insurance Company, China Pacific Property Insurance Company, and China PingAn Property Insurance Company) dropped from 89.3% to 79.9% and the combined share of the three largest life insurers (China Life Insurance Company, PingAn Life Insurance Company and China Pacific Life Insurance Company) dropped from 86.6% to 83.2%. The largest Chinese non-life insurance company is the China People's Property and Casualty Insurance Company Limited (PICC), the former state monopoly founded in 1949.⁸⁰ It currently has around 58% of the domestic market and continues to be majority-owned by the State (around 69% by PICC Holding Company, 14.5% by AIG, and the rest by the public). The China Pacific Insurance Holding Company, established in 1991, holds around 12% of the market; and the China PingAn Insurance Company of China, established in 1998, has around 10%. The Huatai Insurance Company, established in 1996, is owned principally by 54 Chinese companies across various industries, and ACE Insurance Company Limited.⁸¹

⁷⁸ The six holding companies are China People's Insurance Holding Company (PICC); China Life Insurance (Group) Company; China Reinsurance (Group) Company; China Insurance Holding Company; China Pacific Insurance (Group) Company Limited; and China PingAn Insurance (Group) Company Limited.

⁷⁹ China Internet Information Centre. Available at: <http://www.china.org.cn/english/BAT/129805.htm>, [6 July 2005].

⁸⁰ The company was originally formed as "Unibank", a department of the People's Bank of China. During the period up to 1985, there was essentially no insurance industry in China and the sector was revived in 1985 through the establishment of Unibank as an independent company, the PICC.

⁸¹ Willis Pudong Insurance Brokers Ltd. (2004).

In 2004, foreign non-life insurance companies accounted for around 1.22% of non-life insurance premiums in China, while foreign life insurance companies had a 2.64% share of the life insurance market.

§184 In 2004, total insurance premium income was Y 431.8 billion, up 11.3% from the previous year; insurance premiums in China are around 3.4% of GDP. Recent growth rates in premiums have been high: total insurance premium income (Y 388 billion) in 2003 increased by around 27% over the previous year. According to information provided by the authorities, insurance premiums received by foreign insurance companies in 2004 increased by 52% and 45%, respectively, for general and life, over the previous year.

The IMF China Quarterly Update of May 2007 reported that during the period 2005-7 Ping An and China Life launched IPOs and listed the new shares on the stock exchange.

Professor Wei Zhang in Beijing⁸² has written as follows:

“The growth potential of the Chinese insurance market is great because the penetration level at about 2% is still very low compared with G7 countries at about 9% of GDP (the latter markets, however, are largely saturated). [] The insurance premium volume in 1980 was 0.46 billion RMB and it grew to 431.81 billion RMB in 2004, with the average annual growth rate being over 30%.”

“By the end of 2004 the total assets of foreign insurers were about 2.5% of the country total and market share somewhat less at 2.3%. However, the property market share was only 1.2% while life proportion was 3%, and in the cities of Shanghai and Guangzhou it may be as high as 15%, with the foreign firms growing fast in the whole market. Overall the insurance market grew at an average rate of about 30% between 1980 and 2004, but still lags behind many other countries. In 2004 it accounted for 1.6% of the world market and ranked 11th in the world by size, but the penetration rate of 3.26%, compared with the world average level of 7.85% ranked it 42nd worldwide.

“There has been product and service innovation in addition to faster growth due to the entry of foreign firms as well as increased capital, and improved management and offer closer to customers’ demands. Such foreign practices have become models for domestic insurers, which will have to improve their governance systems and risk management rules.”

The professor also quoted the following statistics:

Comparisons in 2004:	amount	position	world rank
Total insurance premiums	52.2 \$bn	1.61 %	11
Insurance density per capita	40.2 \$	502 \$ world	72
Insurance penetration/ GDP	3.26 %	7.85 % ”	42

Between 2000 and 2005 in China:

Gross Domestic Investment rose from	33.7 % of GDP to	41.2 %
Gross savings rose from	37.9	49.5
Corporate savings rose from	22.1	30.2
Household savings rose from	12.9	16.8

[Quoted by M Wolf, FT, 4 October 2006]

⁸² “The opening of China’s insurance market”, Professor Wei Zheng, Vice-Chair, Dept. of Risk Management and Insurance, School of Economics, Peking University, Beijing. November 2005, Geneva.

Other sources indicate that by 2006 there were 41 foreign insurers with 97 offices, and 191 representative offices of 130 foreign insurers.

This picture of the market was given by Professor Wei Zheng:

“Foreign insurance firms were allowed to set up representative offices in the early 1980s and in 1992 they were allowed to open offices starting in Shanghai and progressively to other major cities and since 2005 there have been no restrictions. This programme was committed upon accession to the WTO in 2001 so that branches and joint ventures offering non-life cover were permitted with a foreign equity cap of 51% and of 50% for life policies and initially for brokers, but the latter has been 100% since 2005. There were no restrictions on reinsurance providers, and now China Re, the national provider, no longer has mandatory proportion. There is no access to mandatory motor car third-party liability insurance however.”

Speaking in March 2006, Dai Fengju, President of the Insurance Institute of China,

“warned that China’s reinsurance suffered from low capitalisation, insufficient technical support and a shortage of suitable staff. This led them being unable to meet market demand for cover.” Mr Dai recommended that “China Re be transformed from a state-run operation into a joint-stock company. It should then ally with foreign partners to improve its operational capacities.” China Re has about a 90% domestic market share, but is capitalised at only 390 million Yuan. [Insurance Day Asia, 9 March 2006]

In conclusion, China’s market is considered under served but rapidly developing, both in terms of business model (distribution, products) and in terms of regulation and tax policy, because of the vast population, high savings, and sustained growth rates.

4.3.4 THE REGULATION OF INSURANCE SERVICES

The WTO Trade Policy Review report of 2006 described the regulatory position.

§185 The first comprehensive law on insurance, the Insurance Law, was enacted in June 1995 and updated in October 2002. The law aims to regulate all commercial insurance activities in China (excluding social security insurance).⁸³ In addition to the Insurance Law, several rules and regulations governing the conduct of insurance activities have been issued by the China Insurance Regulatory Commission (CIRC), the sector’s regulator (see below).

§186 Under the law, all insurance companies providing insurance services in China must be registered, and all legal persons or organisations in China requiring coverage in China must purchase it from an insurance company registered in China.⁸⁴

§187 The insurance market in China is regulated by the China Insurance Regulatory Commission (CIRC), under the State Council. The CIRC was created in 1998, and took charge of insurance-related regulation previously carried out by the PBC. The CIRC is responsible for registering new insurance providers, as well as new products and activities. Under Chapter IV of the Law, insurers may engage in property insurance (insurance against loss or damage to property, liability insurance, and credit insurance) or insurance of the person (including life insurance, health, and accident and injury insurance). Under Article 92,

⁸³ The Law covers insurance contracts relating to people and property; insurance companies, agents and brokers; insurance sector supervision and regulations; and legal responsibilities of agents.

⁸⁴ Article 7 of the Law states: “Any legal persons or other organisations within the territory of the People’s Republic of China that need insurance coverage within the People’s Republic of China shall for the purposes thereof apply to insurance companies established within the territory of the People’s Republic of China”.

no insurer can concurrently provide both property and personal insurance services, although an insurance company engaged in property insurance may, upon approval from the CIRC, provide short-term health and accidental injury insurance.

§188 The CIRC is required to take into consideration "the development of the insurance industry and the need for fair competition" when making its decision to grant a licence.⁸⁵ According to the CIRC, the goal is "to promote the sustainable, sound and fast development of the insurance industry and to ensure fair competition". It aims to do so, based on WTO rules, by providing market access in line with China's economic and regional development goals. Thus, priority will be given to applicants wishing to provide insurance services in central, western, and north-eastern China or in agriculture, health, and pensions. In addition, the authorities point out that the higher degree of competition in the market as a result of different types of insurance providers, and new insurance products, requires a high level of supervisory and regulatory capability; market access in this case would have to take into consideration the regulatory ability of the CIRC. [⁸⁶]

§189 Under the Insurance Law, an insurer may establish either as a limited liability company or a wholly state-owned company; it must have a minimum of Y 200 million in registered capital (of which 20% must be deposited with an approved guarantee fund), qualified management, a sound organisational structure, and sufficient facilities.⁸⁷ Under the "Rules on Administration of Insurance Brokerages" and the "Rules on Administration of Insurance Agencies", insurance brokers may establish as partnerships, limited liability companies, and joint-stock limited companies. The minimum registered capital requirement is Y 5 million for limited liability companies, and Y 10 million for joint-stock limited companies. They must also submit 20% of their capital as a guarantee or to purchase professional liability insurance.

§190 Foreign insurance companies are permitted to enter the market as 100% foreign-owned subsidiaries for non-life insurance and up to 50% foreign-owned for life insurance; according to the authorities, there are no plans to lift this restriction. In order to obtain a licence, they must fulfil the following requirements: no less than 30 years of experience in the insurance business; no less than two years since the establishment of a first representative agency in China; no less than US\$5 billion in gross assets at the end of the year prior to application; a sound supervision system in the home country; adequate solvency by the standards established in the home country; approval of the application by the authorities in the home country; and other prudential conditions established by the CIRC, including sound corporate governance, a good risk management system, complete internal control, effective management information system, and good performance, including no record of illegal behaviour. The minimum registered capital of a joint-venture insurance company should not be less than Y 200 million. In addition, 20% of the actual paid-up capital of a joint venture should be set aside as guarantee. Foreign insurers wishing to set up wholly owned branches in China must deposit no less than Y 200 million as operating capital; after establishment, branches are required to submit 20% of their capital as a guarantee to be deposited in a bank designated by the CIRC. Under China's GATS schedule, foreign insurance companies were required to cede 20% of all primary risk insurance for non-life, personal accident, and health insurance business to an appointed Chinese reinsurance company. The share was to drop each year and be removed by December 2005.

⁸⁵ Article 72 of the Insurance Law.

⁸⁶ "CIRC is an independent body, and the regulatory system is on the way to becoming more transparent, equitable and effective. Though some observers see it is still old-fashioned, and the Provincial offices even more so." Professor Wei Zheng.

⁸⁷ Articles 70, 72, 73, and 79 of the Insurance Law.

§191 Once an insurer is approved to provide a certain insurance service in China, any changes in its activities must first be approved by the CIRC.⁸⁸ The Insurance Law includes a statutory reserve requirement and a solvency requirement. Article 98 states that an insurance company must maintain "a minimum solvency commensurate with the size of its business".⁸⁹ For insurance companies providing property insurance, premiums retained for the current year may not exceed four times the combined total of their paid-up capital and their accumulated fund, while the liability borne by an insurance company for each single insured event may not exceed 10% of the combined total of its paid-up capital and accumulated fund.⁹⁰ Under Article 105 of the Insurance Law, investment of insurance company assets is limited to savings in banks, government, financial and corporate bonds, securities investment funds and "others specified by the State Council".⁹¹ Insurance brokers' licences are granted for two years; the licence is not renewed if it is found that certain conditions are not fulfilled, including no business during the six months before applying for renewal, internal operational difficulties, and failure of senior staff to meet the requirements of the "Rules on Administration of Insurance Brokerages". In addition, the senior managers and staff are subject to qualification requirements, including a local written examination to get a "Qualification Certificate for Insurance Industry Personnel" unless the staff has at least three years work experience in management; following establishment, no less than two persons in senior management (or equivalent to at least half of the brokerage's total number of employees) must obtain the Qualification Certificate.

§192 Corporate legal persons "or other organisations permitted by laws and administrative regulations" may invest in insurance companies. However, with the exception of insurance shareholding companies and insurance companies approved by the CIRC, such investment should not exceed 20% of the company's shares. In addition, the total shares held by overseas shareholders should be less than 25% of the company's total shares; if this shareholding exceeds 25% the company becomes a "foreign invested insurance company" and is subject to the laws regulating such companies.⁹²

§193 Supervision and inspection is carried out through a combination of on-site and off-site regulations under Chapter V of the Insurance Law and Chapter VIII of the "Rules on Administration of Insurance Companies". Under Chapter V of the Insurance Law, insurance clauses and premium rates "that have a bearing on the interests of the public", for compulsory insurance and for "newly developed life insurance", must be submitted to the CIRC for examination and approval; insurance clauses and premium rates for all other types of insurance must be submitted to the CIRC for their records. Article 108 of the Law requires the regulator to "establish a sound indicator system for supervision and control over the solvency of insurance companies" and shall have, under Article 109 the authority to inspect the business and financial records as well as the employment of funds by the company. Further details of the procedures to conduct on- and off-site inspections are in the "Rules on Administration of Insurance Companies"; no copy of the rules was available to the Secretariat in English.

⁸⁸ Changes in activities include the formation of branch offices, a change in the name of the company or the business premises, and changes in registered capital, scope of the business or in investors holding more than 10% of the company's shares.

⁸⁹ According to Article 85 of the "Regulations Governing Insurance Companies", Decree of China Insurance Regulatory Commission (No. 3 of 2004), "the CIRC specifies and adjusts the standard of minimum quota of solvency of insurance".

⁹⁰ Articles 99 and 100 of the Insurance Law.

⁹¹ Chapter V of the "Regulations Governing Insurance Companies", Decree of China Insurance Regulatory Commission (No. 3 of 2004). Available at: <http://tpwebapp.tdctrade.com/> [19 April 2005]. The authorities state that once the State Council has given its approval the insurance company may invest through other channels. For example, in 1999 insurance companies were permitted to invest in securities investment funds; and in 2004 they were permitted to invest in foreign stock exchanges.

⁹² Chapter I, Section 5 of the "Regulations Governing Insurance Companies".

The following excerpt is taken from and UNCTAD report:⁹³

40. China's accession to the WTO prompted the establishment of a series of new legal frameworks, including as regards so-called foreign funded insurance companies, insurance agents, brokers and reinsurance. In pursuing its regulatory objectives, the CIRC covers a broad array of issues and uses a series of regulatory tools. The latter include the following: *the regulation of market entry*, where the CIRC has loosened formerly strict limitations on market access and areas of operation (this has led to an increase in the number of foreign insurance companies); *the regulation of clauses and premium rates*, where despite a loosening of formerly strict limitations on clauses and premium rates, insurers are still required to obtain prior approval for certain insurance products (e.g. mandatory insurance products, products recognized as being in the public interest and life insurance carrying death protection); *the regulation of insurance investment*, where a 1995 law placed strict requirements on insurance investments (with the goal of ensuring the solvency of the insurance companies); *the regulation of market behaviour* (regarding sales, marketing, insurance agents, advertisement, policy dividends, investment returns, misrepresentation, biased comparison between products etc.); and *the regulation of insurance solvency*, which requires companies to ensure a certain, calculated solvency margin or the regulation of foreign-funded insurance companies.

The original Insurance law was dated 1 October 1995, and the National Peoples' Congress approved revisions that entered into force on 1 January 2003. This law regulates all insurance activities in China and covers:

- Insurance contracts covering People and Property
- Insurance companies, and Intermediaries (agents, brokers and loss adjusters)
- Insurance industry Supervision and Regulations
- Legal responsibilities

The insurance regulatory authority, the China Insurance Regulatory Commission (CIRC), was established in November 1998 and assumed the role previously discharged by the People's Bank of China. CIRC has published rules and regulations governing how insurance companies and intermediaries conduct business.

The key measures include:

- Temporary foreign exchange regulations for insurance business – policies have to be in local currency, except where there are interests abroad that need cover. Only authorised insurance companies can transact business in foreign currencies
- Compulsory insurance must be written by locally established insurers
- The Social Security Scheme is compulsory and administered by the State – rates and benefits vary by city and province, and foreigners are not included: it is standard practice to top up the benefits
- From 1 January 2004, work-related injury insurance is compulsory, as is bodily injury insurance for construction workers
- Local policies must be issued, and non-admitted insurance is prohibited
- From 1 December 2005 at least 50% of all permitted reinsurance, both facultative and treaty, must first be offered to at least two of the six locally licensed reinsurers, and the amount of any one risk so accepted must not exceed 80% of the original sum

⁹³ UNCTAD/DITC/TNCD/2006/1, 19 April 2006.

insured: the new rules also covered the related activities of brokers that handle such business

- Insured business must be within the area of the licence – only a few insurers have nationwide licences, though certain large risks may be covered abroad, and consolidated master policies can be under certain conditions: master policies cannot be issued for motor, credit, bond or nuclear risks
- Fire-fighting and safety regulations have to be complied with for valid cover

Until 1 July 2006, no insurance lines were subject to tariff rating - however, on that date the Automobile Road Accident Liability Compulsory Insurance Regulations came into force and now Road Accident Liability policies to cover third-party liability may only be sold by authorised Chinese companies, under standard terms and conditions, and they cannot refuse cover. The driver and passengers are not covered and additional insurance is needed for them and for increased limits of indemnity, legal costs and types of liability other than the set death/disablement, medical expenses and property damages.

The IMF Policy Discussion Paper, by Prasad and Rajan, March 2006 (PDP/06/3) explained that:

“ the existing solvency margin guidelines fail to reflect fully differences in size among insurers operating in the same class, in risk and investment portfolios of individual insurers, in reinsurance arrangements, and in other insurance business-related risks. This weakness can result in inadequate capital buffers for those insurers that expand rapidly, operate in volatile lines of insurance business, or take excess risks in investment and other activities. Also lacking are well-articulated methods enabling insurers to estimate their unearned premium reserves and loss liabilities, IBNR claims in particular.”

Branching licences

Market observers comment that although there are no remaining statutory or published regulatory restrictions on the establishment or operations of branches by foreign insurers relative to domestic insurers for ongoing business, there should therefore be no general disparity in the licensing process between foreign-invested insurers and domestic insurers. However there is still inequitable treatment of branching applications and approval is not automatic as could have been expected. This could be due to lack of regulatory capacity, but has resulted in a lack of transparency and procedural predictability.

Branch approvals are still being granted consecutively rather than concurrently, while established and start-up Chinese companies receive concurrent approvals to open multiple branches. However, senior officials at the China Insurance Regulatory Commission have recently confirmed their commitment to allow foreign companies to establish multiple concurrent branches.

Subsidiary conversion

Despite CIRC's requirement that foreign-owned insurers convert their Chinese operations from branches to subsidiaries, CIRC has delayed approval of companies' applications for such conversion. This delay contravenes CIRC's own regulation (Baojian Fa 45, page 3, section 6) that requires its response to applications within two months.

Political risk insurance

Foreign non-life insurance companies have been unable to gain CIRC approval to provide political risk insurance coverage for Chinese companies, and one company has been waiting

to receive approval for its product for about 18 months. China Export and Credit Insurance Corporation is wholly owned by the Chinese government, and is the only insurer allowed to offer political risk insurance in China for non-domestic exposures.

Non-Discriminatory Treatment with Regard to Regulation and Supervision

In recent years, foreign financial institutions operating in China have been subject to special, non-prudential – and at times discriminatory – regulation and supervision. Regulations continue to require three years of operation and two continuous years of profitability before foreign banks' branches are permitted to carry out local currency business. Recently announced rules require foreign banks to incorporate locally with minimum capitalisation of one billion Yuan (\$ 120 million) and an additional one hundred million Yuan for each branch. A portion of foreign banks' branch capital must be deposited in Chinese banks, and foreign banks remain subject to minimum interest rate rules when borrowing from Chinese banks. Most problematic, the 75 percent loan-to-deposit cap discriminates against foreign banks because their small number of branches – made worse by a slow approval process – limits foreign banks' deposit base.

Regulatory and Procedural Transparency

Observers who advocate increased transparency report that related to the issue of non-discriminatory regulatory and supervisory treatment, foreign firms hope to see that China continue to make progress regarding the critical issue of regulatory and supervisory transparency. Fair and transparent regulation plays an integral role in the development of deep and liquid capital markets that attract market participants, increase efficiency, and spur economic growth and job creation. Transparency generally means that the public and industry participants have the opportunity to participate in the rule-making process, to access information about proposed rules, to question and understand the rationale behind draft rules, to have sufficient opportunity to review and comment on proposed rules, and that final rules and regulations be clearly articulated and easily understood.

Unfortunately, they say, regulatory ambiguity continues in China and administrative procedures and the rule-making process continue to be inconsistent and unnecessarily opaque. New regulatory guidelines are too often promulgated without notice or consultation with the industry. Even when industry consultation has been sought, the response period has often been insufficient. While China has agreed to publish the laws and regulations governing financial services as its WTO accession protocol requires, it has not committed to all of the essential elements of modern regulatory transparency, including advance notice of new rules or rule changes, public comment, and the right to judicial review.

Pension Regulator: While the Ministry of Labour and Social Security (MOLSS) is the main regulator for enterprise annuity schemes, a lot of collaboration is needed between MOLSS and the other financial service managers such as CSRC, CBRC, and CIRC. Further, it requires a lot of work and manpower to set up and run a well-regulated private pension market in China and much more dedicated and focused resources are needed at the regulator level, without which policy making and approval process would naturally be slow. Some say that if there were to be a fully staffed centralised decision-making pension authority with dedicated resources it could well ensure that the annuity regulatory system remains sound and healthy.

After issuing the first post WTO amendment to China's Insurance Law in 2003, the China Insurance Regulatory Commission (CIRC) followed with important implementing rules regarding the administration of insurance companies, asset management, risk control and other aspects of insurance regulation. However, certain regulations still need clarification.

- Acquired Rights. It is not fully clear that foreign insurance companies operating in China at the time of WTO accession may continue to operate and expand their existing structure without modification of juridical form, under the conditions that existed, and pursuant to the approvals granted, prior to the recently issued regulations and implementing rules on administration of foreign insurance companies (including their operations, financial structure, capital and mode of establishment). By the same token, non-life companies already established in China (whether as a branch or otherwise) need clarification on whether they can open additional branches and sub-branches, whether or not they re-establish as a subsidiary.
- Capitalisation Requirements. It appears not to be clear whether the RMB 200 million capital requirement for initial establishment, whether as a subsidiary or a branch, includes the right to establish sub-branches without limitation on numbers, and without having to satisfy any additional capital requirements. The Chinese government has yet to provide its rationale for requiring additional capital of RMB 20 million for each additional branch, particularly given that any additional branches would still be backed by the full asset base of the admitted entity and have to comply with all CIRC solvency rules.
- Overseas Utilisation of Insurance Foreign Exchange Funds. CIRC's *Provisional Measures on the Administration of the Overseas Utilisation of Insurance Foreign Exchange Funds* establish a qualifying threshold (total assets of RMB 5 billion) for companies to be able to invest their foreign exchange capital in overseas funds or equities. The prudential justification for this requirement does not appear to be clear.

This limitation applies to both domestic and foreign providers, but it is likely that only the largest insurers, ie mostly domestic companies, will have the necessary assets to qualify. Many foreign-invested insurers invariably will not qualify unless CIRC recognises the assets of the parent foreign company when determining the asset level of a foreign-invested company.

- Insurance Asset Management Restrictions. Under Article 8 of CIRC's *Interim Regulations for Insurance Assets Management Companies*, only providers that have held licences for more than eight years are permitted to apply to establish an insurance asset management company. Although China previously stated that this limitation applies to both domestic and foreign providers, it effectively excludes all foreign companies entering the market since China's WTO accession in 2001.
- Reinsurance. Senior officials at the China Insurance Regulatory Commission have recently informally described their commitment to allow foreign reinsurance and insurance companies to conduct cross border reinsurance with Chinese direct insurers or reinsurers on the same basis as reinsurance companies admitted in China.

An administrative clarification would appear to be needed indicating that China will suspend implementation of the 2005 Regulations on Administration of Reinsurance Business, as the regulation discriminates against foreign reinsurance companies by requiring right of first refusal for 50% of each primary company's reinsurance program with domestically admitted reinsurers. The position under these measures for a 100% owned insurance operation as to whether it can cede to a parent or affiliate insurance company is not clear.

Investment Channels

One of the major issues and challenges for insurers is investment channels. Chinese insurance companies held a combined 1.85 trillion Yuan (US\$ 236.5 billion) of assets on 31 October 2006, up 25 per cent on last year. However, because of strict constraints on which fields insurers can invest under the original insurance law, their investment return has hovered at around only 3 per cent over the past few years.

Although the CIRC has taken measures to open investment channels, such as allowing some insurers to pour money into infrastructure projects and buy stakes in banks, these moves haven't yet been included in the law. Some insurance companies have already embarked on pilot programs in the property sector.

Expansion of QFII and QDII Programs

Enacted in December of 2002, the Qualified Foreign Institutional Investor (QFII) Act permits qualified foreign institutional investors to invest in the securities of Chinese companies. Qualified investors must meet various size (ie assets under management) and experience requirements, must invest a minimum of \$ 50 million, and must submit to restrictions on repatriation. Liberalisation of these and other restrictions⁹⁴ would encourage greater foreign portfolio investment in China – which would contribute significantly to the further development, broadening, and deepening of China's capital markets, with all of the associated benefits discussed above.

China's Qualified Domestic Institutional Investor (QDII) program, initiated in May 2006, allows approved financial institutions in China to make overseas portfolio investments in foreign currencies, both for themselves and on behalf of clients. The program has been slow to gather momentum, however, due to limited knowledge of the program, a lack of understanding on the part of potential investors regarding overseas investing, and comparatively low returns associated with regulatory restrictions on investments. Permitted investments are generally limited to bonds and money-market instruments. The programs success has also been hampered by restrictions on qualified investors. Broadening of the QDII program to include more investors such as insurance companies and mutual and pension funds, and expanding permitted investment alternatives to include higher-yielding instruments, would help educate Chinese institutions about overseas investing and expose them to quality research and international best practices with regard to brokerage services. It would also provide opportunities for foreign asset managers through sub-advisory or pension mandates, as well as the creation of local investment funds with an international focus.

Foreign insurance suppliers are not permitted to engage in the statutory insurance business, and approval is needed to participate in pensions and fund management.

As for other sectors such as banking, asset management and securities, the required capitalisation at high levels is used to protect domestic insurers from foreign competition.

Some observers point out that from an investment perspective, excessive and often discriminatory capitalisation requirements continue to act as constraints on the foreign insurers' ability to compete with local established insurers on a fair and equitable basis.

CIRC's Draft Insurance Fund Management Regulation (December 2005) would enforce outsourcing of the asset management (on-balance and off-balance sheet funds) of small and medium insurance companies to an Insurance Asset Management Company (IAMC). The draft regulation stated that an insurance company that does not own an IAMC, must outsource all its investments in equities, corporate bonds and mutual funds to an IAMC or any professional investment institution (though no specific definition was given).

⁹⁴ Liberalisation should include crediting the Chinese operations of global companies to account for the international experience and asset base of the parent for purposes of authorising access to newly permitted asset classes.

An IAMC is a subsidiary company to be set up by insurance companies that have total assets of at least RMB 10 billion. Currently there are nine approved IAMCs that are all formed by large domestic companies. CIRC's official rationale for the policy is that an IAMC has better internal controls and investment capabilities for improving insurers' risk management and returns. However, it is not likely that domestic and foreign insurers would want to outsource their investment function, which is a core business element, to their competitors.

There are concerns regarding potential disclosure of investment asset portfolio information to competitors and also, most important of all, potential conflicts exist for the IAMC to allocate assets to its parent insurance company's portfolio or those of competing insurance companies. If the proposal is implemented, all small and medium-sized companies, that are not able to set up their own IAMC will lose the right to manage their own assets to their competitors' IAMC. Many small and medium-sized insurers view this initiative as a policy favouring large domestic insurers.

In June 2006, CIRC started to implement this initiative by indicating to insurers that in order to invest in direct equities, they would have to outsource equity investments to an IAMC, and CIRC would not consider any direct equity investment applications filed by them. Meanwhile, many insurers are already preparing to apply to manage their equity investments directly.

CIRC also stated it considered that most small and medium-sized companies are incapable of direct equity investment because of their lack of research capabilities, the fact that there was no separation between investment departments and finance departments and an absence of a third-party custodian to protect asset misappropriation risk.

In fact, it would appear that the foreign insurers' parent companies have long histories of direct equity investment overseas. Such firms could support and invest in research and systems capabilities, and install international-standard risk management systems for direct equity investment in their China operations. Enforcing outsourcing could add uncertainty and undermine insurers' commitment on spending resources to prepare for direct equity investment, which is important to insurers' portfolio diversification and future business opportunities in pension or asset management.

Enforced outsourcing of direct equity investment is seen as the first step in CIRC's initiative to have all assets outsourced. It is possible that the Chinese regulator will impose different kinds of restrictions (such as asset-based requirements) to push small and medium-sized insurance companies to outsource their fixed income investments and other future new investments (eg overseas investment, infrastructure investments, securitised assets investments) to large local insurers' IAMCs.

To any insurance company, investment capability and control are core strategic business areas to be controlled by the insurer itself. CIRC has long cited that, overseas, many small insurers outsource their investments for the sake of economies of scale. However, this would obviously not be the case for joint venture insurers in China which have strong support from their foreign parent companies. A self-controlled investment function is critical to operating an insurance business. The less than robust internal control and investment capabilities in local insurers, along with the repeated scandals in their investment functions, are of obvious concern to foreign joint venture insurers.

To operate and compete in the China insurance market on a level playing field, investment capabilities are of significant importance to foreign insurers. The asset and capital requirements used by China do not target foreign insurers only. However, since foreign insurers' main competitors in China are large and long-established local insurers, the capital and asset requirements put foreign insurers at a disadvantage in investment yield, asset diversification, direct control on investment management and, subsequently, product pricing.

Competition law

At present there is no anti-trust law and this can pose a risk to foreign insurance companies. The debate has started among officialdom on how to rectify this situation.

4.3.5 PENSIONS

Chinese households historically save as much as a third of their income as compared to single-digit savings rates in the United States and Europe. This pronounced propensity to save is related to the declining role of the state and the fact that most Chinese depend on their families and private savings to pay for retirement, healthcare, and the economic consequences of accidents or disasters. The Five-Year Plan calls for the establishment of a social safety net – from universal social security and medical care, to insurance schemes for unemployment and labour accidents – but such programs remain at the planning stage.⁹⁵ Thus pensions are largely unfunded, under-funded or non-existent for many citizens.

In the spring of 2005, Chinese regulators started establishing an “enterprise annuity” system as a second pillar individual account defined contribution retirement product. It is estimated that within ten years the assets under management should be close to US\$ 100 billion.

However, the rules and standards for these licences remain unclear, but appear to prohibit one company from providing a comprehensive package of services (provision, administration and trustee).

Additionally, China has no national tax policy to promote enterprise annuities which is a stated policy goal of the current five year plan.

The Pension System: it is reported that the following problems are being encountered:

Licence Approval: the Ministry of Labour and Social Security (MOLSS) approved the first batch of licences for enterprise annuity service providers (“EASPs”) in August, 2005, but no further applications have been accepted since then. Further, the EASP licences were classified into four kinds, namely trustee, record-keeper, investment manager and custodian. In addition, only one provider has been allowed to offer one-stop-shop of all four services above to clients, due to the fact that all other providers were granted only one or two licences.

Some observers say that given the potential size of the market and the pension needs of enterprises, MOLSS should consider providing the marketplace with a clearer, more transparent and fairer licence approval process, with clearly stated criteria so as to create a level playfield for all interested and qualified financial service companies to compete in this market. Further, if EASPs could be granted two or more licences, they could be able to provide bundled services to clients at a competitive cost. This would be in the best interest of the millions of Chinese customers.

Tax Incentives: A number of provinces in China have issued policies that provide various levels of tax incentive for corporate annuity contributions, while many others do not have such policies in place. There is no individual income tax incentive for employee contributions.

⁹⁵ The US Treasury has previously advocated that activation of the Chinese consumer can be accelerated by China's leadership permitting, indeed encouraging, the marketing of new risk protection products that would obviate the need for precautionary savings. Specifically, the leadership should encourage the development of the fledgling defined contribution pension (“enterprise annuity”) system by streamlining the regulatory approval process, allowing for provision on a consolidated basis, and by implementing tax incentives to encourage individual retirement savings.

Tax incentives could be necessary for promoting private pensions and be crucial to the healthy development of the pension market.

Foreign Participation Limit: Foreign participation in the enterprise annuity market is promoted by western insurers as a means to bring tested professional pension management experiences from mature pension markets in the world to the fledgling annuity market in China.

Master Trust Plan: The annuity rules as they stand now do not allow master trust plans, hence all enterprises annuity plans will have to be set up as individual trusts. This makes small plans unattractive to service providers, while there is a strong need on the part of the medium and small sized companies for such plans in order to enjoy good quality service at a lower cost. This effectively shuts the small companies out of the enterprise annuity market.

Pension Asset Investment: Currently the annuity rules stipulate that no more than 20% of EASP's assets can be direct equity investment and no more than 30% can be investment in equity-related investment. This significantly limits the potential for higher long-term returns for pension assets. In addition, the kinds of investment options allowed for EASPs assets are rather limited too. Thus foreign insurers are pressing for a higher percentage to be allowed to invest in equities, and that EASPs be allowed a broader range of investment options. This will help ensure a higher long term return for pension assets while at the same time allowing pension assets to be prudently diversified to control risks.

The report by UNCTAD on its workshop on insurance found that:⁹⁶

39. *China provides an interesting and positive example of the liberalization and regulation of insurance services.* In fact, a closer look at China reveals the linkages between its domestic reform process and its accession to the WTO. In 1998 the Chinese Insurance Regulatory Commission (CIRC) took over from the People's Bank of China as the main regulator of the insurance sector. The CIRC works according to the "1 plus 3 principle", whereby the Central bank collaborates with three government agencies, which focus respectively on banking, securities and insurance. The establishment of the CIRC has greatly strengthened the supervision of the insurance industry.

It was reported that the focus of the Chinese Insurance Regulatory Commission is risk prevention, which is approached according to five lines of defence:

- (1) enforcing internal controls of insurance companies;
- (2) enforcing the regulation of the solvency;
- (3) reinforcing on the spot inspections;
- (4) enforcing the regulation of insurance investments; and
- (5) establishing and completing the system of insurance protection.

However, some private sector observers feel that CIRC is the weakest of the three financial regulatory bodies.

Although China's WTO accession agreement committed it to opening its pension market to foreign entities by January 2005, it has failed to implement necessary pension reforms to make this commitment a reality. It has launched its *Enterprise Annuity* pension scheme but it has such a cumbersome approval and structural format that, as yet, no foreign companies have gained access to this market – which has a potential of an estimated 200-300 million

⁹⁶ The meeting on "Trade and Development Aspects of Insurance Services and Regulatory Frameworks" was held on 24 November 2005 and the report is given in the document UNCTAD/DITC/TNCD/2006/1, 19 April 2006.

consumers. The US has voiced its concerns over this situation, most recently in the *Strategic Economic Dialogue* bilateral talks between the US and China in Washington in late May 2007. This situation is exacerbated by (1) a lack of transparency in the application process and (2) the apparent unwillingness of the appropriate regulatory bodies – CIRC, CSRC, and CBRC – to communicate with each other and/or with the MOLSS.

In its “China Quarterly Update – May 2007” the IMF reported that the government now aims to meet the 80 percent country coverage target for rural health insurance during 2007, some three years ahead of the original date. This policy subsidises rural health insurance with RMB 40 per person (20 from central government and 20 from local government). Such cover is voluntary, with personal contributions of RMB 10 per year. Even so, total spending on rural health will still lag behind urban levels considerably.

4.3.6 GATS SPECIFIC COMMITMENTS FOR INSURANCE SERVICES

A WTO Trade Policy Review for China describes the specific commitments of China resulting from its accession to the WTO in 2001, which were to enter fully into effect by 1 January 2006.⁹⁷

§149 In the GATS, China made specific commitments in nine out of the 12 large sectors contained in the classification list generally used by Members for GATS scheduling purposes: business services; communication services; construction and related engineering services; distribution services; educational services; environmental services; financial services; tourism and travel related services; and transport services. No commitments were made in health related and social services; recreational, cultural and sporting services; or other services not included elsewhere.

§150 In its horizontal commitments schedule, market access limitations with regard to commercial presence (mode 3) include minimum equity requirements on market access for foreign equity held in a joint venture (at least 25% of the registered capital of the joint venture). The establishment of branches by foreign enterprises is unbound unless otherwise indicated in the specific commitments; representative offices of foreign enterprises are permitted to establish in China, but may not engage in any profit-making activities, except as indicated in China's specific commitments. There are also limitations with regard to ownership of land by enterprises and individuals: 70 years for residential purposes; 50 years for industrial, education, science, culture, public health, physical education and "comprehensive utilisation" (multi-utilisation of land, according to the authorities) and other purposes; and 40 years for commercial, tourism, and recreational purposes. Market access for natural persons is unbound, except for the temporary stay of managers, executives, and specialists of a corporation from a WTO Member as intra-corporate transferees of a representative office, branch or subsidiary (initial stay of three years); employees of a FIE (the shorter of three years or length of contract); and service salespersons negotiating the sale of services (90 days).

§151 [] The presence of natural persons (mode 4) is unbound, except for the persons permitted entry into China as listed above.

§194 In the GATS, China made commitments with regard to life, health and pension/annuities insurance, non-life insurance, reinsurance, and services auxiliary to insurance. Market access through cross-border supply (mode 1) is unbound except for: reinsurance; international marine, aviation, and transport insurance; and brokerage for large-scale commercial risks, international marine, aviation, and transport insurance and

⁹⁷ WTO document GATS/SC/135, 14 February 2002.

reinsurance. Market access through consumption abroad is unlimited, except for brokerage, which is unbound. There are no mode 1 and 2 limitations on national treatment. With regard to market access through commercial presence (mode 3), foreign non-life insurers were initially to be permitted to establish branches and joint ventures with maximum of 51% foreign ownership; within two years from China's accession to the WTO (December 2003), foreign non-life insurance providers were to be permitted to establish as wholly owned subsidiaries; the authorities confirm that this took place on schedule. Foreign life insurers are permitted to establish through joint ventures, but their ownership is restricted to 50% of total equity. In addition, the "Rules on Administration of Insurance Companies" restrict a single foreign shareholding to 20% and all foreign shareholding in such joint ventures to 25%.

§195 For brokerage services, foreign equity of up to 50% is permitted in joint ventures in large-scale commercial risk insurance and reinsurance, and international marine, air transport, and transport insurance and reinsurance; this was to be raised to 51% within three years of accession (December 2004), which the authorities confirmed took place on schedule, and removed altogether within five years. Other brokerage services are unbound.

§196 Foreign life and non-life insurers and brokers were to be permitted to provide services in five cities upon China's accession⁹⁸, to be extended to an additional ten cities⁹⁹; all geographic restrictions were to have been removed within three years of accession; the authorities confirmed that this took place, as scheduled, at the end of 2004.

§197 There are also restrictions on the business scope of foreign insurance providers. Upon accession, foreign non-life insurers were to be permitted to provide "master policy" insurance, insurance of large-scale commercial risks without geographic restrictions, as well as insurance for enterprises based outside China, and property insurance, related liability insurance, and credit insurance of foreign-invested enterprises in China. They were to be permitted to provide the full range of non-life insurance services to foreign and domestic clients within two years of accession (December 2003); according to the authorities, this liberalisation took place as scheduled. Insurance companies may provide individual but not group insurance to foreigners and Chinese nationals. By December 2004, foreign insurers were, as scheduled, able to provide health insurance, group insurance, and pension/annuities insurance to foreigners and Chinese nationals. Reinsurance services for life and non-life insurance were open to foreign providers upon accession through branches, joint ventures or wholly foreign-owned subsidiaries without any geographic or quantitative limits on the number of licences issued. Licences for insurance services were to be issued without an economic needs test or quantitative limits, upon accession, subject to certain conditions.¹⁰⁰ Market access through mode 4 is unbound except as in China's horizontal commitments.

§198 With regard to national treatment, there are no limitations for mode 3 except that foreign insurance institutions may not engage in statutory insurance business; and as of the date of China's accession, 20% of all primary risk insurance for non-life, personal accident, and health insurance business must be ceded to an appointed Chinese reinsurance company. The percentage to be deposited with the appointed Chinese company is to decline gradually (to 15%, 10%, and 5% annually within three years after accession); there will no longer be such a requirement four years after China's accession to the WTO (December

⁹⁸ Shanghai, Guanzhou, Dalian, Shenzhen, and Foshan.

⁹⁹ Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan, and Tianjin.

¹⁰⁰ The conditions are: the investor must be a foreign insurance company with more than 30 years of establishment experience in a WTO Member; it should have had a representative office for two consecutive years in China; and it should have total assets of more than US\$ 5 billion at the end of the year prior to application (the asset requirements for insurance brokers were set at US\$ 500 million at accession, falling to over US\$ 400 million within one year; more than US\$ 300 million within two years; and over US\$ 200 million within four years after accession).

2005); according to the authorities, the requirement was expected to be removed on schedule. National treatment with regard to mode 4 is unbound except as indicated in China's horizontal commitments.

The paper "Chinese implementation of WTO commitments on insurance", by the American Insurance Association (AIA) and the American Council of Life Insurers (ACLI) (16 March 2006), recorded that their objectives for the GATS negotiations are simple and universal:

- Freedom to choose our juridical form of establishment (branch, subsidiary or joint-venture);
- The ability of a foreign financial firm to own 100% of its operations;
- Non-discriminatory treatment of foreign companies;
- The ability to supply services cross-border to sophisticated consumers;
- Full transparency in regulation, supervision and establishment of a centralised administrative procedures process.

This paper went on to describe the scene as follows:

Under the terms of its December 2001 WTO accession, China committed to implement a set of sweeping reforms that require the lowering of barriers to trade in virtually every sector of its economy, progressively increased market access, national treatment, and regulatory transparency. The phase-in period for many of these commitments had already been completed by 11 December 2006, which marked the five-year point since China's accession. Fulfilling these commitments has required nothing short of a wholesale institutional transformation of China's economy and the relationship between government and major industries – a transformation that has been complex, challenging, expensive, even painful. In the five years since its accession, China has made tremendous progress, in some cases exceeding the requirements of its WTO commitments.

Reported current problems include:

Non-Discriminatory Treatment for Licences, Corporate Form, and Products

Many foreign insurance companies, under pressure from Chinese authorities to do so, have sought to convert branches to subsidiaries – but the approval period, which is supposed to be no more than 60 days, often stretches beyond a year.

Regulatory restrictions on the approval of new products, services, or other activities also obstruct foreign financial institutions' ability to serve the needs of Chinese customers. For example, China's authorities have yet to approve the marketing of political risk insurance products or to provide adequate tax treatment for defined contribution pension products or producer commissions to encourage the sale of sophisticated commercial insurance products. Given the importance of integrating Chinese businesses into the global trading system, western non-life insurance companies and insurance intermediaries seek to be permitted to market their international expertise and global coverage to Chinese exporters by offering political risk and other similar products. Regarding China's recently created defined contribution pension system ("enterprise annuities"), licensing procedures have not been clearly defined after two years and no foreign company has been authorised to be a provider.

In March 2006 the American Insurance Association (AIA) and the American Council of Life Insurers (ACLI) wrote to the USTR setting out their aims for the removal of certain administrative barriers, which they considered were also in direct violation of China's WTO commitments.

A “[] existing and newly authorised insurance providers should be permitted to apply for concurrent multiple branches with the same administrative procedures for domestic and foreign invested insurers.” The CIRC should have “a commitment to act on applications within 20 business days of receipt.”

B The “CIRC should develop a centralised administrative procedure for development of new or revised regulations that will ensure consistent transparency for all market participants in a manner which allows for substantive interaction with regulatory formulation and with sufficient time for notice and comments, implementation and compliance.”

C “CIRC should publicly issue an annual written report on licence applications including disclosure of the number of applications by domestic and foreign-invested companies, and, the time taken in handling applications and approvals, deferrals and denials.”

The Financial Leaders Working Group¹⁰¹ had given this general appraisal in 2005 and had listed the detailed issues as follows:

Although China has made significant concessions to open its insurance market further, a number of major obstacles remain. The removal of geographical restrictions on commercial presence could be accelerated. Chinese licensing and regulatory processes are not yet fully transparent, and there is lack of clarity in the division of regulatory authority between national and provincial officials and agencies. China should be urged, within the framework of discussions under GATS Articles VI and VIII, to specify plans for applying regulation in a transparent and non-discriminatory manner.

The national treatment barriers are significant, especially in statutory insurance. The prohibition on foreign-owned insurers from writing “statutory” insurance business have effects going wider than the strict ambit of such business. For instance, in the field of motor insurance, the “statutory” insurance - which foreign insurers may not write - is third party motor liability insurance. This is itself a serious impediment, as motor third party liability accounts more than 50% of the total Chinese non-life market. But the restrictions tends to go wider: it means in practice that foreign insurers have no access to the market for related motor risks (e.g. covering risks such as fire, theft, loss or damage affecting the insured’s own vehicle) as policyholders generally insure such risks with the domestic insurer offering the “statutory” cover. As a separate statutory insurance matter, the recent nationalisation of workers compensation may affect foreign insurers’ newly developed position in the employers’ liability market.

There are various regulatory restrictions which (while arguably falling under the GATS Financial Services Prudential Carve-Out) have significant restrictive effects on market entry. Capitalisation requirements in China remain high at a minimum of RMB 200 million (equivalent to US\$ 26m in January 2007) for initial establishment and RMB 20 million for each additional branch: these requirements could be eased without sacrificing prudential rigour. There are also excessive requirements for insurance companies engaged in overseas use of foreign exchange funds (usually foreign insurers) which only the largest companies can meet:

- (1) The company has a permit for conducting foreign exchange business;
- (2) Its total assets at the end of the previous year are not less than RMB 5 billion;
- (3) Its foreign exchange funds at the end of the previous year are not less than USD 15 million or equivalent value in a freely convertible currency;

¹⁰¹ “Trade Barriers to Insurance”, FLWG, 1 December 2005.

- (4) Its solvency margin complies with relevant stipulations of the CIRC;
- (5) It has a specialised fund-use department or a relevant insurance asset management company;
- (6) Its internal management system and risk control system comply with the stipulations of the Risk Control Guidelines for Use of Insurance Funds;
- (7) The number of its professional managerial personnel with over 2 years' overseas investment experience complies with relevant stipulations;
- (8) Other qualifications specified by the CIRC and the SAFE.

Similarly, insurers' permitted investments in the securities sector are heavily restricted by Provisional Regulations jointly issued and put into effect by the State Council, China Insurance Regulatory Commission and China Securities Regulatory Commission in October 2004. These specify that an insurer's annual permitted investments cannot exceed 5 percent of its total reported assets at the end of the previous year, according to the regulations. This means that most insurance company funds may only be invested in low-return bank deposits, and certain types of bonds - a serious impediment for foreign insurers, whose attractiveness and profitability suffer from their inability to invest in a wider range of investment products. Greater flexibility on investment options and equality of treatment on foreign investments for both domestic and JV insurers is desirable.

The FLWG recorded the following points on the specific commitments of China:

Market Access in Modes 1 and 2

China places restrictions on:

- Cross-border supply (except on international MAT insurance and reinsurance and brokerage related to international MAT and large-scale commercial risk insurance and reinsurance).
- Consumption abroad is unbound for brokerage services.
- Requirement for reinsurance cessions (reducing under WTO accession terms).
- The list of legal entities permitted to write insurance and reinsurance does not include "an association of underwriters".

Market Access in Mode 3

China places restrictions on:

- Accident & Health insurance – only possible for life companies.
- Foreign equity holdings in life insurance joint ventures and joint broking ventures (ie limited to 50%).
- Granting of licences
- Branching, including requirements for consecutive branch-by-branch approval, with lengthy application processes
- Business scope of commercial presence.
- Reinsurance cessions.

Market Access in Mode 4

- Natural persons designated as agents must be permanent residents.

National Treatment

China imposes:

- A \$ 50,000 floor on large-scale commercial risk.
 - Limits investment options available to foreign funded insurers.
- Restrictions on investment of assets.
- Restrictions on cross-border transfer of capital (which is subject to authorisation).
- Higher capitalisation requirements for foreign insurers.
- Foreign insurers restricted from “statutory” insurance business and certain other classes (e.g. surety bonds).
- Discriminatory restrictions on sub-branches (foreign-owned insurers may only establish one sub-branch at each application, while domestic insurers are permitted to establish multiple sub-branches).
- A greater tax burden for foreign insurers.

Comparison with FLWG Best Practices in Insurance

Insurance Monopolies

- Accession commitments are still being implemented. It is not yet clear how far problems will arise.

Independent Regulatory Authority

- There is an Independent Regulatory Authority, which accords with best practice.

Revised offer of services specific commitments

In July 2005 China tabled a revised offer (WTO document: TN/S/O/CHN/Rev.1).

The changes shown in this document amount merely to a ‘cleaning up’ of the wording to reflect the fact that the phased-in commitments shown in their accession schedule had now been implemented. It does not offer any further liberalisation commitments.

Note: The “Annex on Specific Commitments”, to the present report, lists for each BCIMR country the GATS specific commitments and current offer under the WTO DDA negotiations (whether initial or revised).

The European Services Forum issued comments on China’s revised offer for services sector specific commitments in March 2006. It characterised the offer for insurance and insurance-related services as “Weak”. It stated that the offer “maintains Mode 2 market access limitations for foreign brokerages.” The statutory insurance business remains “closed to foreign insurance companies” and “foreign life insurers are only allowed through 50% ownership joint ventures. In addition, foreign insurers are only permitted to operate in a limited amount of the business.”

4.3.7 DISTRIBUTION

It looks likely that the brokerage sector will remain closed to foreigners until 2008 at the earliest.

4.3.8 SUPPORT PROFESSIONS

There is a shortage of actuaries, and the standards of accountancy are not high, although “in preparing financial statements, insurers may use generally accepted accounting principles.”¹⁰²

¹⁰² IMF Policy Discussion Paper (IIF No 6), by Prasad and Rajan, March 2006 (PDP/06/3).

4.3.9 CONSUMER AWARENESS

There is a low awareness of financial planning on the part of consumers, and so their funds are left in the banks.

STOP PRESS

Financial Times reports during August 2007

- Foreign currency reserves reached \$ 1,336 billion in June 2007. (23rd)
- China's State Administration of Foreign Exchange will allow the purchase of securities offshore through the Tianjin branch of the Bank of China. (21st)
- Prudential has raised its stake in the joint venture with CITIC from 33% to 49% (14th)
- In the first half of 2007 foreign-owned P&C insurers' market share was 1.15% (compared with 1.24% in H1/06 and 1.17% for 2005). Foreign life insurers' share was 5.79% (compared with 4.82% in H1/06). (15th)
- Some foreign stakes in Chinese insurers:
 - HSBC has a 17 per cent stake in Ping An
 - Carlyle Group 19.9 Pacific Insurance
 - Zurich Insurance 19.9 New China Life Assurance
 - Axa / Winthertur 15.6 Taikang Life Assurance
- China Life had 47 per cent of total life insurance premiums in the first half of 2007. (15th)
- Restrictions on Qualified Domestic Institutional Investor entities to invest overseas were loosened which will be beneficial to foreign insurers. (8th)

4.4: INDIA

4.4.1 GENERAL BACKGROUND

The IMF country report (No 06/56) on India in February 2006, in its overview, described how:

“the current rapid growth is presenting new challenges to macroeconomic policy, while ensuring the sustainability of this growth requires broad-based fiscal and structural reforms.” (§ 1) “Various surveys suggest poor infrastructure and a high regulatory burden hinder in making greater inroads into world markets. Poor roads and inadequate investment in ports and airports result in long delays and higher transport costs for Indian exporters. [] In addition to facing some of the highest industrial electricity prices in the world, electricity outages cost Indian firms 8 percent of annual sales, four times higher than in China” (§ 7).

Whereas in an article “Economic and Market Analysis: India Macroscope on Insurance”, R Malkani and A Shah, Citibank, 21 August 2006, there was a more hopeful take:

“The main growth-drivers are seen to be intact in that the economy is forecast to continue growing rapidly particularly the service sector (unless there unforeseen catastrophes such as flooding) and Fitch has raised its rating for India to investment grade (BBB-) which should help reduce financing costs. The Rupee is holding its value on the foreign exchanges at 45-47 to the USD, and government forex reserves and nearing USD 150 billion and a current account deficit under 2% of GDP.”

They also pointed out that:

“With a 20 mn-strong Diaspora, India continues to top the list as the largest recipient of private transfers in the world with remittances during FY06 coming in at US\$ 24 bn. [] Invisibles have soared from US\$ 0.2 bn in FY91 to US\$ 40.9 bn in FY06, and are now a vital part of India’s BoP.”

India’s GDP of US\$ 785 billion ranks it as the fourth-largest economy in Asia and 12th-largest in the world.

Demographically, India is a young country and it is getting younger. It is home to 20% of the world’s population under age 24. The UN Population Division expects that in India there will be a growing proportion of the population between the ages of 25 and 59, which may produce a large surplus working population.

The government estimates that the country needs \$ 320 billion of investments in roads, ports and bridges by 2012. The Asian Development Bank estimates that the number of people living in cities will rise to 461 million by 2025 from 286 million. India’s economy has grown at an average annual rate of more than 8% over the past four years. Revenue from sales of commercial and residential property throughout India has grown 30% a year in the three years to 2006, and land prices in 2007 in some areas have tripled in value since 2004. The Reserve Bank of India has raised interest rates six times in the past 18 months to try to rein in inflation which peaked at almost 7% in March 2007.¹⁰³

“There has been a sluggish response to the urgency of remedying the astonishingly under-emphasised social infrastructure – for example, the need to build many more schools, hospitals and rural medical centres – and developing a functioning system of accountability,

¹⁰³ Digest from “India Charges Ahead”, Time, Special Report, 13 August 2007.

supervision and collaboration for public services. To this can be added the neglect of physical infrastructure (power, water, roads, rail), which required both governmental and private initiatives. Large areas of what economist call 'public goods' have continued to be under-emphasised."¹⁰⁴

The last WTO Trade Policy Review report found that:¹⁰⁵

§69 [] In 2000/01 India's services sector accounted for around 49% of GDP and employed around 19% of the total workforce (in 1999/00), which suggest that the sector's labour productivity may be considerably higher than the national average.

§70 [] Reform in infrastructure and other services has been undertaken since the early 1990s with varying degrees of success.¹⁰⁶ In several services, including banking and electricity, liberalization began in the early 1990s. The authorities have noted that although the decision to invite private investment was frequently accompanied by regulatory reforms, teething problems became impediments to attracting private investment.

The European Commission, on its website, describes India's trade and economic policy as follows:

"After independence in 1947 and until the beginning of the 1990s, India's trade policy was heavily influenced by the 'Swadeshi' (self-sufficiency) mentality and the 'licence raj' system of restrictions on production and imports. A first generation of reforms (1991-1996) – aimed at, inter alia, liberalising trade – led to a reduction in import tariffs, elimination of quantitative restrictions, exchange rate reforms and deregulation of industry resulting in yearly growth rates of around 7% (compared with 3% before the reforms).

"A second generation of reforms was initiated in 1999 to address issues related to lack of competitiveness, poor infrastructure and over-regulation. India has set the ambitious target of an annual 8% sustainable growth besides doubling the per capital income over 10 years."

India is a member of the South Asia Association of Regional Cooperation (SAARC) and its South Asian FTA (SAFTA) which entered into effect on 1 January 2006. It focuses primarily on merchandise tariff reductions and for this at first between India and Pakistan. The services dimension remains to be addressed in the future.

Since late 2005 the EU has been exploring with India how to develop bilateral trade through a broad-based trade and investment agreement. The EU accounted for 21% of India's trade in 2005.

4.4.2 FINANCIAL SERVICES

The WTO 2002 Trade Policy Review report reported that India signed the Fifth Protocol of the GATS in 1998 which "raised the limitation on licences for new and existing banks from 5 to 12 per year; in addition, banks would be allowed to install automatic teller machines (ATMs) at branches and at other places identified by them (ATMs installed in premises other than branches are treated as new premises and would therefore require new licences). New

¹⁰⁴ "Can life begin at 60 for the sprightly Indian economy?", Amartya Sen, FT, 14 August 2007.

¹⁰⁵ WTO document reference: WT/TPR/S/100, 22 May 2002, Chapter 4

¹⁰⁶ The Mohan Committee report on infrastructure services, which was published in 1996, suggested the need for a mix of private and public support to develop infrastructure services (Mohan Committee, 1996).

commitments were also scheduled in stockbroking and financial consultancy services.”¹⁰⁷ This TPRM report also advised that:

§82 An efficient financial services sector, capable of mobilizing savings and channelling them into the most productive uses is essential for India's successful economic restructuring and long-term development. Although efforts have been made to introduce competition in the sector, with banking reforms commencing in the early 1990s, banking and insurance are dominated by state-owned enterprises, some of which continue to face financial problems. The sector is thus in need of further restructuring. In addition, there is a need to bring regulation and supervision closer to international best practices.

The IMF country report (No. 05/87) on India in March 2005 reported that: “Commercial banks held 61 percent of the outstanding stock of government securities at end-March 2002. The next most important investor was the state-owned Life Insurance Corporation of India (LIC). Other investors included provident funds, mutual funds, other financial institutions, and retail investors” (§ 28).

4.4.3 INSURANCE SERVICES

The Indian market is considered one of the largest untapped life insurance markets in the world. Out of a population of 1.1 billion, only 15% are insured, though the insurable population is estimated to be 400 million and, with a savings rate of 26% of gross domestic product, the potential to grow is significant.

The Life Insurance Density (premium per capita) has more than doubled from \$ 6.2 in 1999 to \$ 18.3 in 2005. The life insurance penetration (premium as % of GDP) increased significantly from 1.39% in 1999 to 2.53% in 2005. The life insurance industry has had compounded annual growth rate of 22% from 1999 to 2005.

An official brief history of the insurance sector in India can be found on the website of the General Insurance Corporation of India:

“The entire general insurance business in India was nationalised by General Insurance Business (Nationalisation) Act, 1972 (GIBNA). The Government of India (GOI), through Nationalisation took over the shares of 55 Indian insurance companies and the undertakings of 52 insurers carrying on general insurance business.

“General Insurance Corporation of India (GIC) was formed in pursuance of Section 9(1) of GIBNA. It was incorporated on 22 November 1972 under the Companies Act, 1956 as a private company limited by shares. GIC was formed for the purpose of superintending, controlling and carrying on business of general insurance.

“As soon as GIC was formed, GOI transferred all the shares it held of the general insurance companies to GIC. Simultaneously, the nationalised undertakings were transferred to Indian insurance companies. After a process of mergers among Indian insurance companies, four companies were left as fully owned subsidiary companies of GIC (1) National Insurance Company Limited, (2) The New India Assurance Company Limited, (3) The Oriental Insurance Company Limited, and (4) United India Insurance Company Limited.

“The next landmark happened on 19th April 2000, when the Insurance Regulatory and Development Authority Act, 1999 (IRDDA) came into force. This act also introduced

¹⁰⁷ WTO Trade Policy Review: document WT/TPR/S/100, 22 May 2002: Chapter 4.

amendments to GIBNA and the Insurance Act, 1938. An amendment to GIBNA removed the exclusive privilege of GIC and its subsidiaries carrying on general insurance in India.

“In November 2000, GIC was re-notified as the Indian Reinsurer and through administrative instruction, its supervisory role over subsidiaries was ended.

“With the General Insurance Business (Nationalisation) Amendment Act 2002 (40 of 2002) coming into force from March 21, 2002 GIC ceased to be a holding company of its subsidiaries. Their ownership was vested with Government of India.

“The functioning of GIC has to be within the regulations of the following major Acts:

Companies Act, 1956
Insurance Act, 1938
General Insurance Business (Nationalisation) Act, 1972
General Insurance Business (Nationalisation) Amendment Act 2002
Insurance Regulatory and Development Authority Act, 1999

On the web screen, this section ends with the following certificate:

“A M Best certifies the General Insurance Corporation of India
has a Best’s Financial Strength Rating of
A Excellent
14 November 2005”

The WTO Trade Policy Review report of 2002 gave the following history:

§92 The insurance sector is dominated by the Life Insurance Corporation (LIC) for life insurance and the General Insurance Company (GIC) for general insurance and reinsurance, both of which are state owned.¹⁰⁸ However, with the enactment of the Insurance Regulatory and Development authority (IRDA) Act in 1999, and amendments to the Life Insurance Corporation Act, 1956, and General Insurance Business (Nationalization) Act, 1972, the sector was opened to competition from private Indian insurance companies. The IRDA Act established a statutory body, the Insurance Regulatory and Development Authority (IRDA), on 19 April 2000. The IRDA, which has a Chairman and four full time members appointed by the Government, has the authority to: regulate and develop the insurance sector in an orderly manner, particularly in regard to socially weaker and rural sections of society; grant licences to new companies; and to oversee the functioning of the Insurance Ombudsman, established in 1998 under the Settlement of Public Grievances Scheme. In addition, a 24 member Insurance Advisory Committee was established in May 2000 to examine and approve regulations drawn up by the IRDA.¹⁰⁹ The Authority has thus far, in consultation with the IRDA, notified regulations relating to *inter alia*: the obligations of insurers to the rural or social sector; licensing of insurance agents; assets-liabilities and solvency margins of insurers; registration of companies; and company statements and auditors reports.

¹⁰⁸ The LIC was formed as a result of nationalization in 1956, while the GIC and its four subsidiaries (National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd., and the United India Insurance Company Ltd.) was formed in 1973 as a result of the nationalization of the general insurance business, previously comprised of 107 companies. The LIC also has subsidiaries in Bahrain and Nepal and branch operations in the United Kingdom and proposes to expand its offshore operations to Mauritius, Sri Lanka, and the United States. In addition, it has two subsidiary companies: LIC Housing Finance Limited and LIC Mutual Fund.

¹⁰⁹ Ministry of Finance

§93 Amendments were also made to the Life Insurance Corporation Act, 1956, the General Insurance Business (Nationalization) Act, 1972, and related sections of the Insurance Act, 1938, to remove the exclusive monopoly operated by the LIC and the GIC in life and general insurance services, respectively. As a result of the change in legislation, by February 2001, the IRDA had issued Certificates of Registration to 17 private Indian insurance companies, of which ten are in life insurance, six provide general insurance services, and one is a reinsurer.¹¹⁰

§94 Under amendments to the Insurance Act 1938, an Indian insurance company is described as: a company registered under the Companies Act, 1956; with an aggregate foreign equity participation, either by a company or through its subsidiaries or nominees, of no more than 26% of the paid-up equity capital of the Indian insurance company; and whose sole purpose is to carry on life, general or reinsurance business. In addition, no insurer is allowed, under the Act, to provide insurance services unless the company has a paid-up equity capital of Rs 1 billion; for reinsurance the minimum paid-up equity capital required is Rs 2 billion.¹¹¹ Financial sector companies, such as banks and non-banking financial companies (NBFCs), are also permitted under the new legislation to invest in the insurance sector through joint-venture companies, subject to their meeting net worth and other prudential criteria.¹¹² The maximum equity that may be held by banks and NBFCs in these joint-venture companies is currently restricted to 50% of the paid-up capital of the insurance company.¹¹³ Banks and registered NBFCs not eligible as joint-venture participants may invest in up to 10% of the net worth of the insurance company, or Rs 500,000, whichever is lower, to provide infrastructure and services support.

§95 Since their formation, the LIC and GIC have expanded their geographical coverage of the country, providing services through over 6,000 divisional branch offices. They have also made a significant contribution to savings and the financing of the public-sector deficit, partly due to mandatory requirements for investment in government and approved securities.¹¹⁴ These requirements also apply to new private-sector entrants to the market under the

¹¹⁰ The companies are: HDFC Standard Life Insurance Co. Ltd.; ICICI Prudential Life Insurance Co. Ltd.; Max New York Life Insurance Co. Ltd.; Om Kotak Mahendra Life Insurance Co. Ltd.; Birla Sun Life Insurance Ltd.; SBI Life Insurance Co. Ltd.; Vysya Life Insurance Company; Bajay Allianz Life Insurance Co. Ltd and Tata-AIG Life Insurance Co. Ltd. in life insurance services and Royal Sundaram Alliance Insurance Ltd.; Reliance General Insurance Co. Ltd.; IFFCO-TOKYO General Insurance Co. Ltd.; Bajay Allianz General Insurance Company; ICICI Lombard General Insurance Company Ltd; Metlife India Insurance Co. Pvt. Ltd and Tata-AIG General Insurance Co. Ltd. in general insurance services; and General Insurance Corporation (reinsurance).

¹¹¹ Ministry of Finance online information, *Insurance Division*. Available at: <http://finmin.nic.in/demo/ecoinsur.htm> [24 August 2001].

¹¹² For banks these criteria are: (i) net worth of not less than Rs 5 billion; (ii) CAR not less than 10%; (iii) a "reasonable" level of non-performing assets; (iv) net profit for the last three continuous years; and (v) a "satisfactory" performance track record of subsidiaries, if any. For NBFCs, the criteria are: (i) owned funds of not less than Rs 5 million; (ii) CAR of not less than 12% (15% for NBFCs engaged in loan and investment activities holding public deposits); (iii) net NPAs of not more than 5% of the total outstanding leased/hire purchase assets and advances taken together; (iv) net profit for the last three continuous years; (v) a satisfactory performance track record of any subsidiaries; and (vi) compliance with regulations and requirements concerning servicing of public deposits held (Reserve Bank of India, 2000b).

¹¹³ The Reserve Bank of India may, nevertheless, in some cases, allow banks to hold equity greater than 50% initially, subject to disinvestment of equity in excess of 26% or any other percentage prescribed under the Insurance Act, of the paid up equity capital after a period of 10 years from the date of commencement of business (Reserve Bank of India, 2000b).

¹¹⁴ Under the Insurance Regulatory and Development Authority (IRDA) Investment Regulations 2000, life insurance companies must invest not less than 25% in government securities, not less than 50% in government or other approved securities, not less than 15% in infrastructure and other social sector, and not less than 15% in approved investments; pension and general annuity business must invest not less than 20% in government securities and 40% in government or other approved securities; general insurance companies must invest not less than 20% in government securities, not less than 30% in central, state and other guaranteed securities, not less than 5% in housing and loans to the State Government, and not less than 10% in infrastructure and social sector; the remainder may be invested by each group of insurance companies in investments to be determined by exposure/prudential norms specified by the IRDA.

provisions of the Insurance Act 1938 and the IRDA (Investment) Regulations, 2000. In addition, every insurer is required to cede 20% of its insurance business written in India to the GIC for reinsurance.

§96 Despite the expansion of insurance services in India, insurance spending remains low, estimated at some US\$ 6 per capita (US\$ 5 at the time of the last Trade Policy Review of India).¹¹⁵ Moreover, with a penetration rate of around 22% of the insurable population¹¹⁶, it is expected that the entry of new players in the insurance sector will help increase competition and product development to the benefit of the Indian consumer. In addition, in order to ensure that remote areas continue to receive access to insurance services, the IRDA has issued a regulation requiring all new insurers to expand their services to the rural and social sectors over a period of five years.¹¹⁷

The latest note by Willis in January 2007 described recent progress in the insurance market:

“The Indian insurance industry (Non-Life) was brought under state control in 1973. For the next three decades, four government-owned insurers dominated the scene, all selling the same products at the same prices and competing only on service. The liberalisation process began in 2001, when licences were issued to private insurers. The entry of private players such as AID, Allianz, Tokio Marine and Chubb in joint venture agreements with Indian companies eroded the market share of the government insurers, as private insurers’ share rose to about 26 percent in a span of just five years. Insurance brokers were allowed into the country in 2003: their number now exceeds 230. The liberalisation process, albeit slow and frustrating to many market participants, proceeds.”

The Citibank report, cited above (in 4.4.1 and 4.4.3), saw that:

“The growth of the insurance market in India is expected to remain buoyant due to the low penetration rate (3.1% of GDP), the low insurance density (per capita premium of USD 23 pa) and favourable demographics – half the population is aged below 25. Incomes are rising and about 90% of the workforce is not covered by any pension scheme, and the average household savings rate is rising partly due to insurance and is nearly 20% of GDP.”

Another section of the same report, “Theme: Insurance – Benefits Beyond Growth” stated:

“we discuss how deregulation, favourable demographics and robust economic growth have made India one of the most promising insurance markets. This has far-reaching benefits for the economy since it channels savings into long-term investments, creates jobs and has a variable return structure.”

“Since the entry of private players in 2000, insurance premiums have increased from Rs 275 bn in FY00 to over Rs 1 tr – a CAGR of 25%. We expect growth in the segment to remain buoyant due to (1) India’s low penetration rate – with premiums at 3.1% of GDP compared to world average of 7.5%, (2) low insurance density and (3) favourable demographics. The insurance sector has far-reaching benefits for the

¹¹⁵ Comparative figures for other countries in the region are US\$ 770 in Singapore and US\$ 63 in Malaysia (*Business India*, 25 June-8 July 2001, p. 47).

¹¹⁶ *Business India*, 25 June-8 July 2001, p. 47.

¹¹⁷ The requirements are: 5%, 7%, 10%, 12%, and 15% of total policies in each of the five years for life insurance and 2% and 3% in the first and second years and 5% thereafter for general insurance in the rural sector; and for 5,000 to 20,000 lives over the five-year period in the social sector for all insurers (Insurance Regulatory and Development Authority, 2000).

economy, as it channels savings into long-term investments. In addition to benefits to the consumer, it also helps fund the government borrowing program – for instance, life insurers invested over 57% of their funds in government securities in FY05 as compared to 51% in FY01. This has deepened the securities market and prevented the crowding-out effect.”

“*Challenges* to the sector include: (1) FDI limit capped at 26% - a bill to increase this to 49% is pending; (2) Tariff ceilings – proposed to be phased out in 2007; (3) Impact of equity market performance on unit linked plans and (4) Managing the agent distribution network. *Opportunities* include the (1) Growth in non-life segment especially in new growth areas such as liability, health and micro-insurance; (2) Capturing the embedded value of the insurance business – most of the private sector companies have a strong parentage and with listing mandatory in future, this will be important in the coming years; and (3) Bancassurance, which has resulted in insurance accounting for a meaningful part of banks’ fee-based income now.”

“The IRDA Bill [of 1999] prompted liberalisation and private sector participation. Today, 14 private life insurers and 8 general insurance players have entered the market. Since the entry of the private players, premiums have increased from Rs 275 bn in FY00 to over Rs 1 trillion – a CAGR of 25%. We expect growth to remain buoyant due to:

- Low penetration levels: Penetration, ie, volume of premiums as a percent to GDP, is 3.1% in India compared with the world average of 7.5%.
- Low insurance density: Insurance density, ie, the per capita premium, is US\$ 22.7 in India compared with the world average of US\$ 519.
- Favourable income and age Demographics: With half the population below 25, rising incomes coupled with the fact that 90% of the workforce is not covered by any pension scheme, India is a promising insurance market.
- High Savings Rate: This has resulted in greater risk awareness and a focus on protection-oriented products. With the insured population around 70 m, initiatives toward bancassurance and product-innovation are likely to enhance penetration.”

“Private sector participation has enabled the growth in household savings in insurance from a little of 13% of gross financial assets in FY00 to nearly 20% in FY05. [] Latest data indicate that over 12% of life insurance funds were invested in infrastructure and social sector projects.”

“The government proposes to completely phase out tariffs in 2007. This will result in a correction of cross-subsidies and lower rates, which could expand the market.”

“Corporate Entry: The private sector insurance companies have seen a CAGR of over 100% as compared to 25% for the industry as a whole. All new life insurers would have to list their companies within 10 years of commencement. Most have a strong parentage, and thus capturing the embedded value of the insurance business would be important.”

The IRDA official statistics on non-life insurance give the following picture under the heading: “December 2006 growth rate is 19.7 percent” by G V Rao, Chairman (January 2007):

“Considering that 65 percent of the market is controlled by the established players, it is their monthly performance that determines how the market as a whole would perform. [] the new players have recorded their usual 65 percent growth rate ..[]

the new players have maintained a consistency of a market share of 35 percent in premium completion in almost every month with a growth rate hovering around a figure of 60 percent plus.”

“Motor business forms about 43 percent of the total market premium [].”

Although India is prone to natural catastrophes, only a small proportion of the value at risk is insured, the government estimating at about 15%.

The article “Economic and Market Analysis: India Macroscopic on Insurance”, R Malkani and A Shah, Citibank, 21 August 2006 includes this passage:

“Until 1999 insurance was a government monopoly with the Life Insurance Corporation (LIC) and the General Insurance Corporation (GIC) handling life and non-life business respectively. When the Insurance Regulatory and Development Authority Bill (IRDA) Bill was passed it led to liberalisation and private sector participation. By 2006 there are 14 private life insurers and 8 general insurance firms, and premiums have increased at an annual cumulative rate of 25% since 2000.”

One UK participant in the non-life market, pointing out constraints to doing business, mentioned the compulsory cession of 20% of all business to the GIC, and their right of first refusal for all domestic reinsurance. The 26% cap on equity in any general insurance joint venture was also highlighted. They did not point to any constraints on the temporary entrance of foreigners, but did say that foreign insurance suppliers are treated less favourably than domestic companies, without describing how.

On the subject of outsourcing, which is receiving so much political attention, the “Market Intelligence Service, September 2005” by NASSCOM, Issue No 62, stated that:

“Reducing operating costs is the primary driver of business process outsourcing within insurance. The commoditisation of insurance products, higher payouts with the P&C industry, and a poor investment market has increased this pressure. While there are many ways of reducing costs, but most require significant cost and time. For instance, streamlining distribution channels, customer service, and key processes like claims processing and policy administration requires high upfront investments and years for implementation. In addition, consolidation of systems is technically challenging, requires tight collaboration across independent lines of business, and has little near-term payback. In contrast, the outsourcing of some business processes can be implemented relatively quickly, results in near-term cost savings, and is well understood by managers in financial services.

Back office processes. These include billing, production and mailing of documents, and payment processing. Back-office processes are commodity functions with little value added for clients. They are location-independent, relatively easy for carriers to implement, and are high-volume.

Management of closed books of the business. Life policies are particularly well suited to this option. [] Several Indian offshore outsourcers are particularly well placed for this as they have significant experience with legacy systems, data migration, and application maintenance.

Customer service. There are many options for customer service. Outsourcing can be done by line of business, time of day, or peak volume periods.

Core business processes. Outsourcing of core business processes is expensive and high-risk and is generally avoided by carriers.

Niche services. Example services include state licensing and appointment, consolidated statements to agencies, and new businesses submission.

Though BPO adoption has been lagging, there is now a fairly strong interest in the sourcing of classic insurance back office tasks such as case management, administration, claims processing, new business, and problem tracking/resolution, from outsourced service providers.

[A chart] depicts the progression of insurance BPO beyond support functions such as of HR and F&A, and basic maintenance and processing activities to include more complex and core insurance processes such as underwriting and actuarial analysis, statutory and regulatory reporting, commission account and risk assessment.

The article "An Indian Perspective" by J B Boda Insurance, November 2005, referred to above, noted also that:

The policy wordings are controlled and almost 70% of the volume of business being property damage, breakdown, motor and workmen's compensation.

The Indian partner controls funds and treasury operations, while the foreign partner manages the operations.

Initial focus has been on volume of sales and large premiums due to limitations in the infrastructure, the high cost of expertise and overheads.

There are social obligations imposed to write rural insurances.

Market participants have mentioned to the present author that corruption is still rife.

Key features of the Indian insurance sector

Contributed by

**S J Gidwani, Secretary General,
Insurance Institute of India,**

Background information on India

- Household savings rate for 2006 was over 29% of GDP
- Market share of state owned enterprises: non-life – 65%, life – 75 to 80%
- Leading I.T. Services provider
- English speaking population larger than that of England and U.S.A.
- Quality manpower with quality educational background.

The Indian Insurance Sector

The insurance business in India in the year 2018 will be two centuries old, the first company having started in 1818. The Postal Life Insurance of India was established in 1884, and it has an unbroken record of insuring and servicing customers for 123 years.

NUMBER OF REGISTERED INSURERS IN INDIA

Type of business	Public Sector	Private Sector	Total
Life Insurance	1	15	16
General Insurance	6	9	15
Re-insurance	1	0	01
Total	8	24	32

The Life Insurance Corporation of India (LIC) ranks 30 among the top life insurance companies in the world. It has 220 million policies in force, and its other highlights as the largest life insurance company in India, are:

1. Outstanding claim ratio of 0.1%

2. Has launched seven new products during the years 2006 and 2007. The total product range is more than 40.
3. Was adjudged number one service brand in India by the Economic Times and AC Nielsen for the year 2006, for the fourth consecutive year.

Except for the wholly State-owned LIC, all other life companies are privately owned. Out of 15 private life insurance companies, 14 are joint ventures in foreign collaboration with equity restricted to 26% for the foreign partner. The Reliance Life Insurance Company Ltd is totally Indian, there being no foreign partner.

The life insurance premiums in the year 2006-07 (April to March) increased by more than 100%.

Non-life Insurance

There are six state-owned general insurance companies and one national reinsurer. In the private sector there are 9 insurers and 8 are joint ventures with foreign collaboration. The share of public sector insurer is approximately 65 to 70% and private sector about 30 to 35%

Investment linked products (or Unit Linked Products) are gaining precedence over traditional life insurance products.

Micro Insurance is also gaining popularity through self-help groups and NGO's for meeting the insurance needs of vulnerable sections of the society.

Insurance market background

The regulations do not put restrictions on geographical areas for operations of joint ventures. One licence is required for the whole country. There is no restriction on the number of insurers which can operate in India. A company can choose either life or non-life business and if it is interested in both lines of business, then two separate companies need to be established and registered with the regulator.

Insurance Sector Elements

There are also corporate agents which are granted licences. They appoint salespersons who have to qualify as agents by training and examination to sell life insurance business.

Bancassurance is gaining popularity as an important branch of insurance distribution. In a year or so mergers are expected among a number of banks.

Insurance requires a workforce possessing sound technical-domain knowledge of insurance, and well-qualified human resources are a must for successful operations.

Risk Management Education is needed together with a general increase in awareness about the important role insurance can play in the life of individuals, society and the economy.

Ethical standards, beyond corporate governance, should reflect that insurance is a trusteeship business for serving its customers and not merely a business benefiting only its shareholders.

The Insurance Institute of India

The Institute, which was established in 1955, provides insurance qualifications and has produced nearly 60,000 graduates in insurance since then. If you are a Fellow of Insurance Institute of India you get credits in the examinations in U.K., U.S.A. and Canada in the Insurance Institute's established there.

Over 100,000 candidates every year take its professional exams. In 2006 there were one million candidates for the agents examination, and in 2007 this may reach two million.

Institute of Global Insurance Education (IGIE)

The IGIE is a global body, comprising leading insurance institutes of the world which meet annually to exchange experience. The founding institutes were from Canada, Britain and America, and the Insurance Institute of India is a member, along with those from Brazil, South Africa, Australia, New Zealand and Bahrain.

4.4.4 THE REGULATION OF INSURANCE SERVICES

The IRDA current website describes the regulatory position as follows:

“Insurance business is divided into four classes:

1. Life Insurance
2. Fire Insurance
3. Marine Insurance
4. Miscellaneous Insurance

Life Insurers transact life insurance business; General Insurers transact the rest.

No composites are permitted as per law.

Legislation (as on 1. 4. 2000)

Insurance is a federal subject in India. The primary legislation that deals with insurance business in India is:

Insurance Act, 1938, and Insurance Regulatory & Development Act, 1999.

Insurance products (as on 1. 4. 2000) (for latest information get in touch with the current insurers – website information of insurers is provided at the web page for insurers):

Life Insurance:

Popular products: Endowment Assurance (Participating), and Money Back (Participating). More than 80% of the life insurance business is from these products.

New products have been launched by life insurers. These include linked-products. For details, please visit the websites of life insurers.

General Insurance:

Fire and Miscellaneous insurance business are predominant. Motor Vehicle insurance is compulsory.

Tariff Advisory Committee (TAC) lays down tariff rates for some of the general insurance products (please visit website of GIC for details)

Two recent IRDA official circulars included the following passages:

Circular: 034/IRDA/De-Tariff/Dec-06, 4 December 2006

“terms, conditions, clauses, warranties, policy and endorsement wordings applicable to the above mentioned classes of business as well as Marine Hull insurance business shall continue to be followed until further orders. [] In respect of all classes of business where the rates applicable are now controlled by tariff, insurers are not permitted to cancel the current insurance policies and issue fresh policies covering substantially the same properties or interests, in order to alter the rates of premium offered to the client. The insured is free to cancel its insurance at any time as per the relevant policy conditions [].”

Circular No 042/For Office/06-07, 8 January 2007

This dealt with the conditions set for permitting India insurance companies to open offices abroad. They can only be representative offices:

“and no underwriting will be done outside India or other than in Indian rupees” and “the completion of the underwriting contracts should be done only in India.” “This entire activity would invariably [be] done by accredited Indian staff of the insurers placed in the liaison office or at Head Quarters in India.” “The Indian insurance company shall be required to comply with the Foreign Exchange Management Act, 1999 and any other law in force.”

Also on the IRDA website there is an article “An Indian Perspective” by J B Boda Insurance, November 2005, which says on its page 5 that:

“The law requires property registered in India to be insured in India, and the Reserve Bank of India regulations do not permit remittances of foreign exchange for the purpose of purchasing insurance abroad, unless approved:

“Persons, firms, companies etc. resident in India are not permitted to take insurance cover of any kind with insurance companies in foreign countries without the prior permission of the Reserve Bank. Besides, permission of the Government of India under the General Insurance Business (Nationalisation) Act 1972, is also required to be taken in such cases.” [revised] 12 September 2002.

There is no compulsion in Indian law to purchase insurance, apart from a few mandated covers. If insurance is considered for purchase, then it is to be effected from any of the licensed insurers in India. If the intention is to purchase insurance abroad then permission is required from both the government of India and the RBI. The basis of permission for reasons stated in GIM, other RBI regulations and, generally, non-availability of the required type of insurance in India.

The only exceptions that allow purchase abroad by residents are as follows:

- 1 CIF imports to India and FOB exports from India
- 2 Units located in Special Economic Zones.

The official website of the GIC gives information about reinsurance.

General Insurance Corporation of India

“As sole reinsurer in the domestic reinsurance market, GIC provides reinsurance to the direct general insurance companies in the Indian market. GIC receives statutory cession of 20% on each and every policy subject to certain limits. It leads many of domestic companies’ treaty programmes and facultative placements. GIC’s capacity for each class of business on the Treaty and Facultative basis for domestic business is given in the following table: []”

“GIC is spreading its wings to emerge as an effective reinsurance solutions partner for the Afro-Asian region, and has started leading the reinsurance programmes of several insurance companies in SAARC countries, South East Asia, Middle East and Africa. To offer its international clientele an easy accessibility, efficient service and tailor made reinsurance solutions; GIC has opened liaison/representative offices in London and Moscow. GIC provides

following capacities for Treaty and Facultative business on risk emanating from the international market based on merits of the business. []”

“Investments were made within the regulatory framework of the Insurance Act, and IRDA Regulations and within corporate policy. The funds of the Corporation are managed in-house. []”

“IRDA regulations stipulate that without prejudice to Section 27 or 27(b) of the Act, every insurer carrying on General Insurance Business shall invest and at all times keep invested his total assets in the following manner []”

However, it is notable that the GIC cannot accept the risk arising from all the reinsurance cessions it is offered, which provides an opening for reinsurers. Although primary insurers are legally bound to offer the GIC all their cessions, this is rarely enforced for any amounts over the 20% of their premium business.

The official IRDA Journal, in its Issue Focus describes the position on the “Insurance Ombudsman”

“The government of India promulgated Redressal of Public Grievances Rules 1998 (under the Insurance Act 1938) to establish the Institution of Insurance Ombudsman in the country with a view to provide the insuring public a speedy and inexpensive grievance redressal mechanism.”

“The institution of Insurance Ombudsman started functioning since 1999. Ombudsmen are appointed from persons with experience in Industry, Civil, Administration and Judicial Services. [] At present there are twelve Ombudsmen covering all parts of the country with specific territorial jurisdiction []. [] the objective is to provide “a forum for resolving disputes and complaints from the aggrieved insured public or their legal heirs against insurance companies operating in general insurance business and life insurance business, in the public and private sector.”

Only natural persons may bring their cases forward, and not complaints “in respect of policies issued on firms/organisations/companies. Even single proprietary firms are excluded from the ambit of RPG Rules 1998.” Neither can complaints be admitted about lapsed policies, routine administrative service matters, or against the staff of insurance companies and their “agents/development officers/marketing officials.”

The Willis, International Alert, January 2007 – issue 20, was entitled: “Indian insurance tariff rates withdrawn”

“Insurance regulators in India are ending nearly three decades of price controls. The Insurance Regulatory and Development Authority recently announced that effective January 1, 2007 insurance tariff rates are withdrawn across all lines of business except Auto Liability. Nearly 70 percent of the USD 5 billion Non-Life industry in India has been subject to controlled rates and terms since 1973. This eagerly anticipated announcement is considered a significant move in gradually opening up the insurance industry of the subcontinent to broader marketplace competition.”

However: “Controls remain in place for other aspects of insurance: policy wordings, liability limits, clauses, extensions, warranties, etc. In all lines of insurance subject to controls, ie Property, Engineering, Motor, Workmen’s Compensation, Public Liability (Act), insurers are now free to price their products but may not change the products

themselves. [] observers anticipate these restrictions will be withdrawn by April 2008.”

“A key exception in the retention of product controls has been allowed for large properties with a total insured value in excess of USD 550 million in one location. These properties are no longer subject to tariff rates, wordings or conditions, although they must still go through a qualifying process before placement can be made outside India.”

“Unchanged is the government’s requirement for cession of large risks to the state-run national reinsurer, the General Insurance Corporation of India. The national reinsurer can decide how much it wants to retain, subject to a maximum of 20 percent.”

“Price controls will remain in force for Auto Liability insurance. Auto Liability premiums have been revised upwards to provide some relief to insurers, because the industry has been losing money due to rising Auto Liability compensation awards. An Auto Liability pool to be administered by the GIC will be set up January 2007 with participation required for all Non-Life insurers.”

In view of the expected price war, given the standard terms and conditions, the regulator has “put into effect a rule that any insurer reducing prices by more than 20 percent must substantiate the rationale for such a reduction with voluminous paper work. Some observers believe this will effectively cap reductions at 20 percent” although it may cause some market confusion initially.

Before the removal of the price controls insurers commonly cross-subsidised some lines from the profits, say, of property and engineering policies.

Non-admitted policies will remain illegal. Direct insurance brokers are not allowed to collect premiums on behalf of insurers, and premiums must be paid directly to insurers prior to attachment of cover.

4.4.5 PENSIONS

The present author understands that the current situation on state and other pensions is as follows:

Beginning in late 2003, the federal government began the process of implementing pension reforms by replacing various Defined Benefit schemes with the New Pension System (NPS) Rules. These Rules came into effect on 01 January 2004 and apply on a mandatory basis to all employees joining service from this date in central (civil) ministries, non-civil departments, and various other bodies. However, employees of the Indian Armed Forces and central (civil and non-civil) employees recruited prior to 1st January 2004 are specifically excluded from the NPS.

Each new (eligible) employee of the federal government is mandated to contribute 10% of the basic salary plus allowances on a monthly basis towards a pension. The relevant parent ministry or department or organization matches this contribution and transfers the full 20% to the individual pension account of each eligible employee on a monthly basis. These pension contributions are presently placed in the public account under a separate accounting head and earn the General Provident Fund (GPF) (ie Treasury bills) interest of 8% per annum. The Ministry of Finance estimates that since 2003-04 over 100,000 central government employees have joined the scheme.

The NPS is based on personal retirement accounts created by individual members. Members in this system will enjoy a variety of important benefits, including portability across jobs and locations, rights and choices regarding fund managers and schemes, freedom to switch between service providers, low transactions costs, nationwide access, and protection against fraud and malpractice through the Pension Fund Regulatory and Development Authority as the dedicated regulator.

Any success of the NPS in providing broad-based access to retirement savings will depend on a nationwide service delivery infrastructure. To lower the costs of access and service delivery under NPS for the public, the existing network of non-proprietary, third-party distributors including banks and postal branches may be harnessed into the NPS to serve as points of presence (POPs).

Since March 2003, sixteen state governments have notified a revision in their respective pension and GPF rules and announced a similar pension scheme for their own new employees.

The Pensions Fund Regulatory Development Authority bill, which would provide the authority to regulate the National Pension System and similar voluntary systems, has been stalled for some time, despite being a stated priority of the government. The Bill would enable suitable legislation for establishing the PFRDA as a statutory body and enable the government to offer the National Pension System.

An experienced observer considers that the Congress-dominated government not only failed in its attempts to achieve meaningful pension reforms but sidestepped the issue entirely by deciding to place the PFRDA (pension regulatory body) in the Finance Ministry rather than creating an independent entity (similar to IRDA) as originally envisaged. Although supported by PM Singh and Finance Minister Chidambaram, Parliament failed to enact the necessary legislations after the proposal was originally tabled some three years ago.

The Sigma issue by Swiss Re No 5/2004 “Exploiting the growth potential of emerging insurance markets – China and India in the spotlight” points out that:

“it is obvious that private sector suppliers will also have a key role to play. Many insurers have been vying to offer pension products, particularly to higher income households to supplement state-run schemes. However, the bigger chunk of the working population could also offer huge opportunities, even if the challenge is somewhat daunting. For example, hundreds of millions of informal sector workers in India are in need of pension protection. Private sector insurers will have to consider means to reach this population, design and manage numerous portable accounts and allow for flexible contributions due to the volatility of these workers’ incomes. Another challenge will be to integrate private sector schemes with the numerous public sector schemes.”

Writing in the February 2007 issue of a broadsheet available on www.globalpensions.com, Jagadish Salunkhe says, in his article “India wakes up to pensions inadequacy” that:¹¹⁸

“Providing income security for the elderly is a subject that has not received adequate attention either from the Indian government or from the public. India has a very limited social security system, and individuals are often unaware of the impending risks of not planning for their old age.”

¹¹⁸ Only selected extracts are quoted here.

“The government [] has set up an interim Pensions Fund Regulatory Development Authority (PFRDA) which released its first draft of pension fund regulation in September 2005. The draft will eventually be sent to parliament for approval.

“One key impact of the government’s initiative was the introduction of a defined contribution type of plan, the New Pensions System (NPS), for new central government employees. The draft regulations also gave direction for providing pensions in the ‘unorganised sector’ (small family-run businesses and the self-employed).

“The draft envisages the creation of a Permanent Retirement Account Number for plan members maintained by a Central Recordkeeping Agency (CRA), which can be accessed using any points of presence such as banks, brokerage houses, post offices and similar institutions.

“The CRA will transfer monies to fund managers at plan members’ discretion. The subscribed money will be invested in funds with different levels of risk and return, such as secured funds, balanced funds and growth funds.

“Investments in microfinance institutions guaranteed by the Reserve Bank of India will also be permitted, although the PFRDA has not yet contemplated giving permission to pension funds to invest abroad.

“In a country like India, where social security measures are insignificant and individuals are either ill-organised or inattentive to planning and providing for their old age, the employer has a significant financial and social role to play.”

Due to the foregoing, access to the sizeable Indian insurance and pension markets by foreign companies is significantly hampered or limited. Regulation and supervision are reasonably transparent but non-Indian firms are effectively, albeit subtly, denied full and equitable access to many insurance and, especially, pension/retirement savings markets.

4.4.6 GATS SPECIFIC COMMITMENTS FOR INSURANCE SERVICES

The following material is an extract from the last WTO TPRM review:

WTO document reference: WT/TPR/S/100, 22 May 2002: Chapter 4

§72 [] India scheduled commitments across a range of services under the General Agreement on Trade in Services. These are: business services, communication services, construction and related engineering services, financial services, health and social services, and tourism and travel related services.

The Financial Leaders Working Group has observed that India’s commitments in 1997 were very limited. With the passage of the Insurance Regulation and Development Authority Act 1999, the Indian insurance industry is now being liberalised, and privatisation of the Indian insurance market has begun. The nationalised General Insurance Corporation and Life Insurance Corporation no longer enjoy monopolies. These liberalisation measures should now be bound through fresh GATS commitments.

Various regulatory issues affect market entry and competitiveness. Capitalisation requirements (US\$ 25 million for initial establishment) may restrict entry of single-line insurers (e.g: health). The effect of the tariff is gradually being reduced, as various lines are de-tariffed; but motor insurance (highly significant in the non-life field) has yet to be included in de-tariffing. Restrictions on claims-payments in foreign currency often entail a lengthy permission process from the Reserve Bank of India (RBI); and removal of these restrictions would reduce administrative costs and reduce currency risk. Solvency requirements are also

comparatively high; and restrictions on insurers' permitted investments mean that most funds may only be invested in low-return state and central government bonds - a particular impediment for foreign insurers, whose investment returns and profits may suffer from denial of access to a wider range of investments. Accounting standards do not yet allow for the inclusion of deferred acquisition costs.

There are ongoing issues relating to the position of joint ventures with foreign participation, on the one hand, and domestic-owned insurers, on the other. The current foreign equity cap of 26% hampers private companies' growth prospects, as growth requires more capital allocation which the local partners may be unable to match: and for this reason the government has made clear its intention to raise the foreign equity ownership cap to 49%, although this has yet to result in action. However, current Indian law (the Insurance (Amendment) Act 2002 (i.e. the Insurance Act 1938, as amended by the IRDA Act 1999)) has disinvestment provisions that currently bite mainly on Indian promoters holding 74% of joint-ventures with foreign participation or up to 100% of Indian insurance companies. These provisions (Section 6AA) provide that where an Indian insurance company includes promoters holding more than 26% of the equity, the promoters must divest the excess over 26% after the company completes 10 years of operation or "within such period as may be prescribed by the Central Government". In the case of an FDI joint-venture this would result in promoters holding 52 % (26 % by the Indian and 26 % by the foreign promoter), with the balance of 48 % being widely held (presumably following a public flotation). Section 6AA would therefore sit oddly with allowing foreign participation to increase to 49%. It would imply that if foreign investors raise their holdings beyond 26% (no doubt paying an acquisition premium), they will have to reduce them again to 26% a few years later (risking a loss in a forced divestment sale). All this could create market uncertainty for the Indian private insurance sector, quite apart from threatening the basis on which insurers could meet additional capitalisation requirements for solvency margin purposes.

This situation is harmful to India's DDA negotiating position as well as to the country's ability to attract further FDI in the insurance market; several Western companies have a strong interest in the Indian market but refuse to make any financial commitments in the current circumstances.

As the market becomes more liberalised, restrictions on reinsurance represent an increasing constraint. There is a requirement for 20% mandatory cessions (across all non-life classes of business, and without regard to any underwriting requirement for cessions) to the General Insurance Corporation (GIC, the public sector general insurer which acts as national reinsurer). The GIC thus benefits as of right from an automatic share of 20% of all business written by all insurers in India. In addition, the GIC has the right (but no obligation) to accept any risks that require reinsurance over and above the 20% mandatory cessions, and so can operate its own economic needs test to determine whether, and to what extent, such risks can be ceded to foreign reinsurers. This unfair advantage works to the detriment of foreign reinsurers, and has allowed the GIC to remain, in effect, a monopoly reinsurance provider for most purposes, substantially preventing cessions abroad. Taken as a whole, this system of preferential cessions to the GIC has several related effects. Most importantly, it inhibits competition in reinsurance, by preventing direct insurers in India from seeking better rates and terms available from foreign reinsurers competing in the global reinsurance market (which in turn would make for downward pressure on reinsurance costs, not least by allowing scope for increased commission payments to ceding insurers). In the same way, it also prevents Indian insurance joint ventures with foreign partners from benefiting from economies of scale potentially available through efficient use of the foreign partner's global reinsurance links. Finally, it distorts underwriting practice by preventing direct insurers from retaining profitable classes of business in their own books, which would eliminate unnecessary reinsurance costs and increase their profits.

Certain other marketplace practices currently inhibit competition and favour public sector insurers. Some Government Banks are unwilling to accept insurance covers written by private insurance companies (e.g. Marine), so deflecting their clients from placing risks with private insurers. Some public sector entities insist on cover by public sector insurers. Such practices make it difficult for private insurers to target certain segments of the market. Without these practices, the revenues available to private insurers would increase.

Cross-border insurance and intermediation is a significant field in which India has not yet made any commitments.

The Financial Leaders Working Group summary of India's specific commitments is as follows:

Market Access in Modes 1 and 2

- Whether a country protects acquired rights will be evident as offers are made and should be addressed according to the Model Schedule.

India prohibits:

- Foreign reinsurers being granted the right of first refusal privileges while domestic reinsurers have this right (see Market Background Information).
- Cession abroad, substantially. Reinsurance can be taken out with foreign reinsurers to the extent of the residential uncovered risk after obligatory or statutory placements has been made domestically with Indian insurance companies (Article 3 (1) IRDA (General Insurance-Reinsurance) Regulations, 2000).
- Cross border trade and consumption abroad for MAT, except for freight insurance, where goods in transit to and from India may be insured with foreign insurers.

India further:

- Maintains a reinsurance monopoly in the non-life sector.
- Imposes 20% mandatory cessions across the board for non-life classes to state reinsurer (S.101A, Insurance Act 1938).
- Requires different percentages for domestic and foreign reinsurers with respect to mandatory cessions. Domestic cessions have to be maximized before foreign cessions (Article 3 (1) IRDA (General Insurance-Reinsurance) Regulations, 2000).
- Imposes restrictions on intermediation for reinsurance.
- Legal form discrimination for insurance and reinsurance: and there is no provision allowing licensing of "an association of underwriters".
- Requires that when Indian citizens or enterprises purchase insurance services from an insurer abroad, they are required to have overseas remittance permission from the Reserve Bank of India in accordance with "The Foreign Exchange Management (Insurance) Regulations, 2000 Sec 3." However, the permission is not granted.

Market Access in Mode 3

India imposes:

- Restrictions on foreign equity ownership of insurance and insurance brokerage companies. Foreign insurers and brokers cannot establish unless via a joint venture with an approved partner with a minimum 74% local shareholding (Ss.2, 7A(b), Insurance Act 1938, as amended).
- A limit on earnings permitted to be paid to shareholders.
- Legal form discrimination for insurance and reinsurance.

India does not permit:

- Private sector participation in the pension system (both private and public), but some private sector participation is expected eventually.
- Commercial presence for insurance intermediaries (apart for reinsurance, with restrictive conditions).
- Licensing of “an association of underwriters”.

National Treatment

- There may be discriminatory tax requirements on foreign insurers.
- Foreign reinsurers are not granted the right of first refusal privileges, while domestic reinsurers do have this right.

Comparison with FLWG Best Practices in Insurance

A. Transparency

- Insurance companies which provide comment and recommendations on proposed or revised regulations do not usually receive a written reply from the supervisory authority in response to those comments.
- There are no procedures in place to provide notification to the World Trade Organization before measures are adopted with respect to taxation that affect all insurance products.

B. Solvency and Prudential Focus

- 74 % of the market gross written premium is regulated by tariff, with the Tariff Advisory Committee deciding on price, terms and conditions. This results in poor development of underwriting skills, leads to cross-subsidisation, and prevents insurance companies from competing for market share by offering product or price differentiation.

D. Independent Regulatory Authority

- There is an Independent Regulatory Authority, which accords with best practice.

Revised offer on services specific commitments

In August 2005 India tabled a revised offer of specific commitments (WTO document: TN/S/O/IND/Rev.1).

This stated that: “India has offered to undertake extensive commitments in a number of new sectors/sub-sectors including [] life insurance services; services auxiliary to insurance; []” Also: “India had already made a substantial mode 4 initial offer by including all the categories of natural persons like intra-corporate transferees, business visitors, contractual service suppliers and independent professionals. Further improvements have been made in the sectoral coverage of both the contractual service suppliers and independent professionals and the definition and parameters of all these categories have been brought in line with the common categories paper submitted by a number of members including India.”

Under the Horizontal commitments Business visitors would be allowed to stay for up to 180 days [previously 90 days] and the new commitments inscribed for “Contractual Service Suppliers – Employees of juridical persons” and “Independent professionals” applies to those who work in certain listed sectors.

Note: The “Annex on Specific Commitments”, to the present report, lists for each BCIMR country the GATS specific commitments and current offer under the WTO DDA negotiations (whether initial or revised).

4.4.7 DISTRIBUTION

The Citibank report (referred to above in 4.4.1) pointed out that:

“Unlike LIC, which has over one million agents, the private sector insurers have also adopted the bancassurance route – which refers to the distribution of insurance products through a bank’s distribution channels. Today, insurance accounts for a major part of banks’ fee-based income and has facilitated job creation.”

However, competition is severe as one bank has 28 million customers and 2,000 branches.

Commenting on this scene in the article “An Indian Perspective” by J B Boda Insurance, November 2005, said:

“The government insurers have a good network of offices throughout the country which is difficult for the private players to match for a few years.

Corporate agents were allowed in 2000, and brokers as intermediaries were allowed licences to operate from 2002. By late 2005 there were about 220 brokers licensed for insurance, reinsurance and as composite brokers.”

The Swiss Re Sigma report No 5/2004 had the following to say:

Most Indian insurers have distribution arrangements with banks. The requirement of joint ventures has tied numerous foreign insurers with large domestic banks. In addition, the legal requirement that insurers have to achieve minimum sales to the rural and social sectors also encourages the use of bancassurance which provides insurers with efficient access to these sectors. Given an estimated 66 000 bank branches (of scheduled commercial banks) in India, insurers are keen to join forces with banks to sell their products. Many private sector life insurers expect sales through banks to have generated some 20–50% of their new business in 2003.

A briefing note for the Lord Mayor of London’s visit to India in September 2003 prepared by the Association of British Insurers said, in reference to insurance broking:

“A restriction on foreign equity, whatever its level, is not entirely logical, for a number of reasons. First, broking is not a capital-intensive business so a restriction on capital is not necessarily an effective protectionist measure. Secondly, insurance and risk management advice is available from consultants other than brokers (eg the large consultancies linked to accountancy firms) who are unaffected by any foreign equity restriction. Thirdly, insurance broking and consultancy needs to be recognised as a source of human and capital and capacity for innovation and flexibility that the larger Indian insurance companies will increasingly need if they are to expand and, ultimately, move outside India to newly-invested operations overseas.”

On the IRDA website (www.irdaindia.org) there are 202 insurance brokers listed as licensed.

About three-quarters of non-life premiums are collected via managing agents (direct sales agents) employed by the state-owned insurers. Furthermore, customers get a 5% discount when dealing directly with an insurer. Telephone and internet low-cost channels have not yet

made much impact. The situation may change now that the government no longer sets premium levels, and advice or help in shopping around may become valued.

However, with their eye firmly set on the short-term job situation the unions resist most changes designed to improve efficiency and the quality of service.

There is a one-bank one-insurer limit (ie exclusive bancassurance) requirement, such that a bank can only sell the products of one life insurer and one non-life insurer.

The logic of this requirement is not clear as no one insurer can meet all the needs of a single bank's customers because each insurer specialises in different products. Observers feel it would be commercially preferable to allow a bank to choose from multiple insurers in order to have a full suite of products fully to satisfy its customer base.

Currently there is a cap on agents' compensation: they receive a 40% commission from the first-year premium, 7.5% from the second- and third-year premiums and 5% from the fourth. Observers point out that this is significantly lower than rates in most countries, and feel it should be raised so that agents could make a meaningful income through the delivery of quality products and services to their insured clients.

One European insurer already in the market is hoping to sell insurance products through approaches on mobile phones.

4.4.8 SUPPORT PROFESSIONS

"In preparing financial statements, insurers may use generally accepted accounting principles."¹¹⁹

There are no standardised reporting, actuarial or training practices or requirements.

4.4.9 CONSUMER AWARENESS

A revealing article in IRDA Issue Focus: "The Indian Liability Insurance Kaleidoscope", Uttara Vaid, January 2007, gave the background to the low consumer awareness about insurance in India:

"In India, in the pre-liberalisation days, Liability Insurance remained in the realm of the unknown, un-demanded and unsold. The advent of private companies eager to bring different products into the market changed that – but only a bit. Why 'only a bit'? [] in the US, 50% of the Non-Life General Insurance premium comes from Liability Line of Business. In Europe, the share of liability insurance in the entire non-life premium could be between 25% and 50%. In India, however, pure liability insurance accounts for approximately only 3% of the Non-Life insurance premium."

"The fatalistic Indian attitude 'whatever has to happen will happen anyway!' and the Karmic theory of past sins being responsible for any misfortunes visiting us; prevent us from being a redressal/compensation seeking society. The low legal awareness coupled with low insurance awareness affected the growth and development of this line of business."

¹¹⁹ IMF Policy Discussion Paper, by Prasad and Rajan, March 2006 (PDP/06/3).

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“Change is perhaps the slowest in the financial sector, where the opportunity for India is probably the largest. Insurance, pensions and banking remain heavily state-owned, state-controlled and, therefore, tiny – compared with what an economy the size of India’s really needs. A committee established by the government has come up with a bold road map for turning Mumbai into an international financial centre.” Andy Mukherjee, *International Herald Tribune*, 17 August 2007.

“[] long-term measures to develop infrastructure, deregulate public-sector operations and cut red tape must continue, or a huge proportion of potential productivity and consumer demand will stay woefully untapped. [] Another stumbling block is India’s powerful unions and huge bureaucracy [] businesses face restrictive labour regulations that reduce their scope to hire and fire, limiting efficient allocation of resources and driving up costs. [] Some 35 per cent of Indians are living on less than \$ 1 a day compared to just over 16 per cent of Chinese. Or put another way, behind India’s boom lies mass poverty. [] The Singh administration must tackle the budget deficit, control inflation and keep the rupee’s appreciation in check. [] Today India is the 12th largest economy in the world and is experiencing its fastest rate of growth for 18 years. For the year to March 2007, India’s GDP grew by 9.4 per cent. By the middle of the century, India is likely to have grown to be one of the biggest economies of the world.”, Hugh Young, *Financial Times*, 15 August 2007.

4.5 MEXICO

4.5.1 GENERAL BACKGROUND

In 2010 Mexico will celebrate its 200th anniversary as an independent state. It was only six years ago, however that “the election of Vicente Fox completed a long transition to democracy, ending 72 years of authoritarian rule under the Institutional Revolutionary Part (PRI). It also seemed to set the seal on the economic modernisation of the world’s largest Spanish-speaking country, with a population of 106m.”¹²⁰

“In recent years the country has enjoyed greater political freedom than perhaps at any other time in its history. The government has maintained economic and financial stability, with inflation for this year estimated at 3.7%. Easier bank credit, together with a vast house building programme promoted by government, is slowly bringing tangible benefits to a expanding middle class. Social policies have helped cut poverty.

The economy has limped along at an average of just 2.5% since 2000. The government’s finances look better than they are, helped by extra oil revenues equal to 2% of GDP.

Labour productivity is low and growing only slowly. Oil apart, Mexico’s exports to the United States are losing market share to China’s. Some of the social policies have reduced the incentive for millions of small businesses to put themselves on a proper legal footing. That is only one symptom of a wide absence of the rule of law. Another is mounting violence from drug gangs.

Thanks in large part to NAFTA, much of the north is making visible progress. By contrast, the populous south remains locked in poverty, backwardness and neglect. Meanwhile, each year some 500,000 or so young Mexicans cross the country’s northern border into the United States in search of a better life.

Apart from better schools and alternatives to subsistence farming, the south needs better transport links. NAFTA has made this more urgent.

Most railways and roads were built in a radial pattern, with Mexico City as the spider in the centre of the web. At the peak in 1970, half of the country’s industrial production took place in Mexico City alone. Goods from the south bound for the United States must pass through the bottleneck of Mexico City, climbing to 2,500 metres (8,000 feet) above sea level. [Referring to federal plans to build new motorways and ports with associated railway links] these projects would require federal investment of \$2 billion - \$3 billion a year over the next five years. Once completed, they would cut transport costs by up to 25%, as well as boosting tourism.

Mexico is much better placed to weather an American recession than it was in 2000. That is because inflation is low, the public-sector deficit is close to zero and the current-account deficit is much smaller than it was six years ago. Nor is growth coming only from exports. Mexican banks are lending again.

Because of its relatively conservative fiscal policy, the government now absorbs only 16% of national savings, down from 80% in 2000. This has helped everyone else to borrow more cheaply.

¹²⁰ This quotation, and much that follows as a digest on this and the next page, are from “A survey of Mexico”, Economist, 18 November 2006.

Since 1999 the public-sector borrowing requirement has fallen from 6.3% of GDP to around 2%, despite a modest increase in public spending.

Telecoms costs in Mexico, though falling, remain above the international average. Mexico also has fewer phones per person than any other OECD country or Brazil, which privatised eight years later but encouraged competition.

This is because Telmex still exercises significant monopoly power. Its competitors tell a Kafkaesque tale of regulatory capture. Pedro Cerisola, the minister of transport and communications, was a Telmex manager of long standing, and one of his deputies is a former manager of Televisa. In breach of his legal duties, the ministry has dragged its feet in approving licences for would-be competitors and shown Telmex their business plans.

But Mexico is Mexico. Telmex is merely one of the more egregious examples of the widespread rule of oligopoly.

The size of the informal sector goes a long way to explaining why Mexican productivity is so low: small businesses in this sector find it hard to expand or to innovate. It is also one of the reasons why the tax take is so meagre. But there is no simple recipe for change. Many people consciously choose to work in the informal sector, not least because it is hard for those who never completed their basic education to get a well-paying job in the formal sector.

Tangles of red tape have made it unnecessarily hard for informal businesses to go legal. That is starting to change. A reform last year cut the average time it takes to set up a new business in Mexico City from 58 to 27 days. Together with cuts in federal corporate income tax and a new capital-markets law that improved corporate-governance standards, this lifted Mexico 19 places to 43rd (out of 175 countries) in the World Bank's latest annual survey on the ease of doing business around the world.

Writing in the *Financial Times* on 5 February 2007, Jorge Castaneda, a former foreign minister of Mexico, said:

“12 straight years of macro-economic stability, democratic elections, respect for human rights and a more outward-looking foreign policy have transformed Mexico, its people and its view of the world. The middle class has expanded, institutions work (albeit imperfectly), the media are free, sometimes outrageously so, and more Mexicans than ever acknowledge their welfare is largely linked to the US.

“But the old corporatist system, founded in the 1930s, has survived all these changes intact. The monopolist control of practically every walk of Mexican life is in place; indeed, it may be stronger than ever. Therein lies Mr Calderon's – and Mexico's – challenge. Huge monopolies, both public and private, dominate the country.

“Lastly, but just as importantly, Mexico's three main political parties have a lock on electoral participation. Independent, or write-in candidacies are not allowed. Creating a new party is only possible for those willing to enter into the shady, complicit and corrupt practices of the existing ones.”

A publication by Reactions “New developments in the Latin American Insurance Markets”, 2005 edition included the following:

Strong fundamentals entail country rating upgrade

After a three-year period of weak or even negative growth through late 2003, the Mexican economy recovered in 2004, growing 4.4% mainly due to an export-led resurgence underpinned by high world oil prices, an increase in manufactured exports to the US, rising domestic private consumption and increased investment. Reflecting the positive economic developments, sound fiscal and monetary policies, and effective liability management, Standard & Poor's and Moody's upgraded Mexico's sovereign rating from BBB- to BBB and from Baa2 to Baa1 in January 2005. [] After slightly increasing to 4.7% in 2004, inflation has declined again this year. This trend is expected to continue in 2006.

4.5.2 FINANCIAL SERVICES

The WTO Trade Policy Review report of 2002 gave the following description:¹²¹

§101 The Mexican financial system is composed of the following institutions: banks; auxiliary credit organizations (financial factoring companies, financial leasing companies, currency exchange houses, general deposit warehouses, credit unions, and savings and loans); securities houses; insurance; bonding; and retirement savings. Primary responsibility for the regulation and supervision of the financial sector lies with the Department of the Treasury and Public Credit (SHCP) and its regulatory agencies: the National Banking and Securities Commission (CNBV) supervises the banking, securities, and credit ancillary organizations and activities sector; the National Insurance and Bonding Commission (CNSF) supervises the insurance and bonding sector; and the National Savings and Retirement System Commission (CONSAR) supervises retirement savings. In addition to its normal operations (including regulating the payment system and operating as a reserve bank and lender of last resort for credit institutions), the Central Bank regulates financial operations, the foreign exchange, and derivatives markets.

§102 Two regulatory entities have been established since Mexico's previous Review: the Institute for the Protection of Bank Savings; and the National Commission for the Protection and Defense of Financial Services Users (CONDUSEF), which provides advice and defends customers of financial institutions. Other important regulatory reforms have resulted in the easing of foreign ownership restrictions, with significant changes to the prudential regulatory regime also introduced (see an extract from Table IV.11 at the end).

4.5.3 INSURANCE SERVICES

"Mexico is quickly emerging as a key market for US insurance companies largely due to the opportunities for foreign investors and improving regulatory oversight.¹²² Generating more than 25 percent of the total premiums in the region, Mexico has the second-largest insurance market in Latin America. Currently, 3 foreign and 2 Mexican insurance companies that comprise almost 59 percent of the market dominate the insurance market in Mexico. Yet insurance has experienced low penetration in Mexico, representing only 2 percent of the total GDP of Mexico, much smaller than the insurance market in the United States as well as other Latin American countries such as Brazil, Chile and even Colombia. Nevertheless, small niches of insurance products, such as educational, transportation and natural hazard products exist in this growing market and offer substantive opportunities for US firms."

"Conditions in the Mexican insurance remain mixed.¹²³ Premiums are growing, but the expansion of the industry will likely be constrained by competitive pressures. The aftermath of the 2005 hurricanes is not yet entirely clear: however, higher reinsurance costs will be

¹²¹ WTO document: WT/TPR/S/97, 15 March 2002: Chapter 5.

¹²² US Commercial Service Mexico at http://www.buyusa.gov/mexico/en/financial_insurance.html.

¹²³ This quotation and the following paragraph are taken from "The Mexico Insurance Report" of Business Monitor International – at <http://www.businessmonitor.com/insurance/mexico.html>.

shared by both the non-life insurers and their clients. Several of the leading local groups may lose out (or be bought out) in a competitive landscape that is probably unstable.”

“In Mexico, [] we are less convinced of the cross-border firms’ commitment – both to the non-life and the life market. The reason for this is many Mexicans who could conceivably buy insurance are in the USA: a part of the competition comes from the US insurance industry. We think it is significant that MetLife appears to have such a dominant (indeed, unassailable) position in the Mexican life segment. In the non-life segment, one consequence of the massive hurricanes of 2005 is that Mexican groups will likely face greater competition from insurers (and, indeed, captive reinsurers) who are based outside Mexico.”

The Berkshire Hathaway Topics No 14 issue “Three decades of market presence in Mexico”, indicates that:

“The market liberalisation and elimination of barriers to market entry in the 1990s greatly accelerated the maturing process. The markets suddenly experienced the switch to completely new or unfamiliar processes that were brought in by the new providers. Of course, this had to affect – and did affect- the market structures and the local insurance regulators. The stronger competition due to the foreign insurers led to the creation of new products, new insurance techniques and new sales channels (credit cards, banks and the internet). Mexico serves as a good example of the market dynamics in Latin America following the implementation of the trade agreements. As late as 1993 the insurance market was firmly controlled by Mexicans; 26 of the 38 companies were funded by Mexican investors. The situation has since changed dramatically, as only 23 of the 67 companies operating in Mexico are controlled by Mexicans today, and those 23 players only generate slightly less than 50% of the country’s total premium income. The total premium volume more than doubled during the same period, however, growing from USD 5.6 billion to USD 12.2 billion. The development of life insurance premiums is undoubtedly typical of the insurance industry’s maturing process, as the more highly developed a market is, the larger the share of life insurance premium is in that market. The share of total insurance premiums attributable to life insurance has sharply increased in Mexico, Chile and Brazil since 1996.”

“On the whole, around 25% of the total Latin American premium of approximately USD 50 billion is ceded to reinsurers, with around 12% of life insurance premium and 35% of non-life premium being ceded on average. In September 2005 17.3% of the total premium in Mexico was ceded to reinsurers. A total of 73% of Mexican non-life premium (excluding motor insurance) was ceded. Around 94% of the catastrophe premium included in the non-life premiums was ceded, which means that losses for the reinsurance market were substantial in the wake of the catastrophes that occurred in 2005.”

“All market players are undoubtedly rethinking their strategy for dealing with such risks in the future. Based on the experience gained, the Mexican insurance association AMIS is currently preparing a new policy or tariff for windstorm risks in consultation with primary insurers and reinsurers.”

“Mexico generated liability premiums of nearly USD 373 million in 2005, which is almost 50% of the total liability premiums produced in Latin America. At present this amounts to nearly 7% of the total non-life premium income. This has tripled over the last eight years, and we believe that it will continue to show substantial growth in Mexico (and many other countries in the region) in the years to come as a result of economic and social developments. The increasing flow of trade with the US is fuelling the demand for liability covers, since such covers are often required for exports.”

The WTO Trade Policy Review report of 2002 had found that:

§118 Mexico's insurance and bonding sector comprises insurance companies, mutual insurance companies, and bonding institutions. As at September 2001, there were 70 insurance firms of which two were state-owned (including AGROASEMEX, which provides specialized insurance services for the agricultural sector), two were mutual companies, and 66 were private companies. Among private companies, 34 firms – accounting for close to 40% of direct insurance premiums – were subsidiaries of foreign financial institutions, while 16 were part of Mexican financial groups. Additional market information is provided in Table IV.14. With respect to bonding activities, there were 15 companies in 2001 of which seven were part of Mexican financial groups and four were subsidiaries of foreign financial institutions. The total bonds issued by the bonding sector amounted to some Mex\$2 billion as at September 2001.

Table IV.14
Mexico's insurance market, January-September 2001
 (% unless otherwise specified)

Direct premiums (Mex\$ million)	75,964
Life	34.0
Pensions	13.4
Injuries and illness	11.1
Damages	41.5
Vehicles damages	17.3
Vehicles	24.2
Reinsurance (Mex\$ million)	2,731
Total (Mex\$ million)	78,695

+Source: National Insurance and Bonding Commission (CNSF).

A report on Latin America by Lloyd's of London, for its members, included the following factual description:

“The NAFTA agreement set out a schedule for increased foreign ownership, with a faster rate of opening for investors from the US and Canada. Several companies, the most notable being ING, used American subsidiaries to access the market. In 2000, ING purchased a 39.7% share and later gained a controlling interest in Comercial America, Mexico's largest insurer. Today, foreign-owned companies have the second-highest level of market share in Latin America (after Chile) at 58%.”

The IMF Country Report No. 04/419 of December 2004 showed how the asset distribution in the financial system was apportioned as at March 2004: mutual funds held 10.7%, pension funds 11.5% and insurance companies 5.2% a combined total of 28%, whereas commercial banks held 51.3%.

The publication by Reactions “New developments in the Latin American Insurance Markets”, 2005 edition included the following:

The Mexican non-life insurance market grew by 2.4% in real terms in 2004 to US\$ 4.4bn. The most important lines of business were motor followed by property, which

together accounted for 75% of the total premium volume. The driver of growth in 2004 was engineering business, following strong growth in the construction (mainly housing) sector. Liability premiums grew, albeit at a slower rate. Credit also grew significantly in 2004, however its contribution to the total growth was very small. Property premiums, on the contrary, decreased and motor premiums stagnated. Overall, life-insurers' results worsened in 2004 due to a lower investment result, however the underwriting result improved to 4% of net premiums earned – almost triple 2003's figure.

In 2005, direct market is expected to grow, although at a slower pace, influenced by a decline in property business. The first half of 2005 showed a fall-off in non-life premiums, however these results may well have been caused by a shift in the renewal date and a subsequent distortion of quarterly comparison.

In auto insurance, the price war that started in the fourth quarter of 2003 and remained until the first quarter of 2005 had a negative effect on premium growth. In spite of a 28% increase in new auto sales during 2004, auto premiums had zero growth, which reflects a more than proportional downturn in prices.

Life insurance market

Premium growth rates are continuing at a good pace, and the sector generated 9% growth during 2004 to reach a total of MxP 134,547.1 mn (USD 112.1 bn at an exchange rate of MxP 11.15). As expected, life insurance is showing the strongest growth, with an increase of 18%. (Although direct premiums from individual life products with investment components commercialized by Seguros Banamex somewhat distort growth ratios due to accounting rules, individual life remains strong at a 15% annual rate. Mexican GAAP rules account for the investment component as direct premiums, and not as a separate account as other accounting systems such as US GAAP does.)

A more stable economic environment with lower inflation rates has contributed to the development of sophisticated individual life products, which are increasingly accepted as long term savings products. As such, individual life premiums already represent 22% of the total business mix, compared to five years ago when the figure was 13%.

Bottom line results

Bottom line results reported by Mexican insurers during 2004 show mixed performances. Issues of asset reallocations in investment portfolios and changes in reserve requirements impacted companies' net earnings with different magnitudes and resulted in deteriorating profitability measures for the sector as a whole. Overall, the net income of MxP 6,914 mn generated during 2004 had a nil growth []. This is a reflection of higher reserve requirements and a substantial fall in net financial income.

The need to decrease mismatches in investments and reserves forced some companies, especially those with long-term life products, to change the composition of their portfolios in an increasing interest rate environment, which resulted in realized investment losses. [] The implementation of sufficiency criteria for loss reserving resulted in larger requirements for an important number of companies, which put more pressure on net results.

The Financial Leaders Working Group report of 1 December 2005 recorded that:

“Less than 10% of the population owns life insurance, fewer than 5% of Mexican homes are insured, and it is estimated that 75% of vehicles on the road in Mexico are uninsured. Mexico’s insurance sector remains under-developed, with about \$9 billion in premium volume at the end of 2000. However, the market shows promise for future growth reaping the benefits of over ten years of past liberalization.”

“Foreign investment in the insurance sector has increased, which should lead to increased competition, and in turn, to greater consolidation of the market as more marginal insurers are gradually acquired or seek merger opportunities. Life, annuities, and accident and health products generated 51% of premium income in 2000 (compared to about 30% in 1996), with property and casualty products comprising the remainder. Personal lines are expected to continue to provide considerable growth in the market, with annuities an especially important component. With options for raising capital limited for the insurance sector, reinsurance plays an important role in the market. Earthquake insurance carries a fixed national tariff; other types of insurance may set their own tariffs, subject to approval.”

4.5.4 THE REGULATION OF INSURANCE SERVICES

The WTO Trade Policy Review of 2002 gave the following description of the legal position:

§119 The insurance industry is governed by the General Law of Insurance Companies and Mutual Institutions of 1935, as amended. Main responsibility for the application of these statutes rests with the SHCP and CNSF.

§120 In addition to the foreign participation limitations described above, individual foreign investors may hold no more than 20% of the capital of an insurance company. Mexican nationals must have both majority ownership and administrative control of domestically established insurance companies. There are no nationality requirements for board members of domestic insurance companies. For subsidiaries of foreign financial institutions, the majority of board members and the director must reside in the Mexican territory, regardless of their nationality.

§121 The law establishes several prohibitions for contracting services with companies established abroad, including: damage insurance for maritime and air transport vehicles registered in Mexico; civil responsibility insurance and any other kind of insurance covering events that might occur in Mexico; and credit insurance by firms subject to Mexican laws.¹²⁴

§122 Foreign reinsurance companies may have representatives in Mexico, but these may only accept or assign reinsurance liabilities in the name of their main offices. To participate in reinsurance operations, foreign reinsurance companies must be registered with the SHCP. Companies engaged in reinsurance operations may use the services of intermediaries residing in Mexico or abroad. Reinsurance intermediaries residing in Mexico must be authorized by the CNSF, while reinsurance intermediaries residing abroad and wishing to offer services in Mexico must be registered with both the CNSF and the SHCP.

¹²⁴ Article 3 of General Law on Insurance Companies and Mutual Institutions.

Extract from:

Table IV.11 Main financial sector laws

Law to Regulate Financial Groups (<i>Ley para regular las Agrupaciones Financieras</i>)	18 July 1990 (4 June 2001)
Regulations for the Establishment of Affiliates of Foreign Financial Institutions (<i>Reglas para el Establecimiento de Filiales de Instituciones Financieras del Exterior</i>)	21 April 1994
Law on Saving Systems for Retirement (<i>Ley de los Sistemas de Ahorro para el Retiro</i>)	23 May 1996 (16 January 2002)
General Law of Insurance Companies and Mutual Institutions (<i>Ley General de Instituciones y Sociedades Mutualistas de Seguros</i>)	31 August 1935 (19 January 2001)
National Insurance and Bonding Commission Regulations, on Inspection, Vigilance and Accountancy (<i>Reglamento de la Comisión Nacional de Seguros, y Fianzas en Materia de Inspección, Vigilancia y Contabilidad</i>)	14 January 1991
People's Savings and Credit Law (<i>Ley de Ahorro y Crédito Popular</i>)	4 June 2001
Law for the Protection of Financial Services Users (<i>Ley de Protección y Defensa al Usuario de Servicios financieros</i>)	18 January 1999 (5 January 2000)

Source: The Mexican authorities.

The IMF's Financial System Stability Assessment Update of 4 August 2006 (No. 06/350) included the following report on the insurance sector (here CNSF is the acronym for the National Insurance and Sureties Commission).

II. FINANCIAL SYSTEM INSTITUTIONS AND MARKETS

8. **The financial system is diverse, but dominated by large foreign-owned financial conglomerates.** The system includes commercial banks, *insurance* companies, pension funds, broker dealers, investment banks, development banks, non bank financial institutions (Sofoles), securities firms, and leasing and factoring companies (Figure 3). Sofoles do not take deposits and are licensed by the Secretariat of Finance and Public Credit (SHCP) to grant credit to specific segments of the economy. The financing of mortgage Sofoles comes from different sources, including the SHF. The Sofoles have also started to tap the private market and, recently, a few of the large mortgage Sofoles have been acquired by private banks. Large, multinational financial groups are involved in almost all the salient lines of financial business – with the exception of insurance – and dominate the financial landscape.

Insurance sector

41. **Regulations for the insurance industry have been strengthened in line with the 2001 FSAP recommendations.** Legal amendments in 2002 led to several improvements including harmonizing licensing rules for life and nonlife insurance companies and making them applicable to changes in control; and strengthening standards for corporate governance and internal controls (e.g., on the role of the Board,

conflict of interest, establishing the compliance officer, and requiring independent directors). However, **CNSF** has not yet achieved full political, budgetary, and operational autonomy.

42. **Solvency regulation has evolved to include projections of liabilities to better assess the adequacy of reserves.** Specifically, the CNSF has completed and implemented a dynamic solvency model, an important step toward the adoption of statutory solvency rules envisioned within the Solvency II's framework. The model uses historical data to construct claim distributions for different lines of business. It allows the CNSF to calculate the probability of capital shortages of each insurance company by stressing variables that affect its underwriting and overall profit. The output of this exercise guides insurance supervisors in their work with the industry to monitor the solvency of the institutions and the adequacy of capital requirements and technical reserves. According to stress tests conducted in the context of the FSAP update, the insurance sector appears resilient to severe shocks (Appendix III).

Annuities

43. **The annuities industry has stalled and measures are needed to ensure that it remains solvent.** The 1997 pension reform introduced the option of purchasing private annuities with IMSS's disability, death, and workers' compensation benefits. Indeed, during 1997-2001 the annuity market grew rapidly (Figure 8). However, because disability payments under the pre-1997 regime come from the government budget (and not IMSS reserves), IMSS took advantage of legislation introduced in 2001 that allows it to issue disability benefits under the old regime, and this led to a collapse of the annuities market. The authorities should consider introducing legislation to close the unintended loophole. In addition, the National Council of Populations' mortality table that annuity companies are required to use, consists of preliminary data that should be made more accurate.

48. **Although considerable progress has been made in levelling the playing field and reducing regulatory arbitrage, there are still certain regulatory inconsistencies which require attention.** In some cases, different norms apply to similar financial products. For instance, in the case of derivatives, banks can offer, negotiate, and invest in these instruments on and off exchange, but mutual funds are excluded from this market. There are insurance products with a savings component which are regulated differently than savings products issued by banks; and there are mutual fund-like products offered by insurance companies that do not seem to follow the segregation rules applicable to mutual funds.

49. **The system of cross opinions on regulations issued by the different regulators reflects an intention to establish adequate checks and balances.** Nonetheless opinions are not binding on the requesting agency and, in some cases, there are no time limits to issue opinions. To foster transparency and accountability, the requesting authority should explain its rationale when acting against the opinion received. Deadlines to issue opinions should also be established.

50. **The high degree of globalization of the Mexican financial system puts a premium on cross-border cooperation among financial regulators and supervisors.** Implementing effective group-wide cross-border consolidated supervision enhancing cross-border supervisory cooperation, and readying for an efficient resolution process in the case of failure of a foreign-owned financial group are all critical to the success of the Mexican regulatory and supervisory agencies in discharging their duties. The effectiveness of formal Memoranda of Understanding (MOUs) with foreign

regulators must be cemented in practice by continuously enhancing the strong working relationships that already exists between Mexican supervisors and their foreign counterparts.

The following amendment to the law affecting insurance companies was noted in the list of such key actions:

- **Amendments to the Law of Mutual Insurance Institutions and Associations and the Federal Sureties Institutions Law.** Aimed at strengthening the institutional and regulatory framework for the activities of insurance institutions; increasing the efficiency of insurance institutions' operations; consolidating the insurance sector's legal framework with that in place for the financial sector; and developing best corporate practices among intermediaries. Recently, a new amendment introduced the Mortgage Credit Insurance (*Seguros de Crédito a la Vivienda*) and Financial Warranty Insurance (*Seguros de Garantía Financiera*).

Stress testing

125. **The insurance sector (life and non-life) appears resilient to severe shocks.** The CNSF conducted a series of sensitivity tests and scenario analysis based on forward-looking, dynamic solvency testing models developed internally. Individual shocks and scenarios included: no premium growth in nominal terms (premium shock); an interest rate drop by 190 basis points in peso rates, reductions of 114 basis points in UDI (inflation-indexed) rates and 114 basis points in the reference foreign interest rate; premiums shock plus loss rate increases; and premium shock plus interest rate shock plus loss rate shock. Under the combined scenario, the number of insurance institutions with a solvency ratio below 1 percent increases from four as of December 2005 to 11, but these represent only about 7 percent of the market solvency requirement (Table 10).

An OECD paper in its 'Policy Issues in Insurance' series on 'Insurance regulation and supervision in OECD countries' (No 3) lists the following points about the regulation of insurance in Mexico. As Mexico is a member of NAFTA, at some of the points comparison is made with the USA.

- Cross-border purchase of cover is permitted, provided it is not possible to obtain cover in Mexico.
- Foreign pension funds are not regulated.
- The creation of a banking subsidiary by an insurance company is prohibited.
- The shareholding in a bank by an insurance company is prohibited, and vice versa.
- Life insurers can write insurance supplementary to life cover.
- The simultaneous pursuit of life and non-life insurance is permitted, unlike in most OECD countries.
- Professional reinsurers are licensed, depending on the ratings they have.
- Publicly owned insurance companies are licensed, but not co-operatives.
- Both the business plan and general policy conditions have to be submitted to the authorities by domestic and foreign-controlled insurance firms (as in the USA).
- Policy forms must be submitted for approval (as in the USA)
- Reinsurance arrangements have to be submitted for approval (as in the USA)
- A deposit of a fixed amount is required for non-life insurers in addition to the minimum capital requirement, the amount depending on the type of class written.
- These deposits must be held in the country of the head office (as in the USA)
- For life insurance the bases for the calculation of premiums and technical provisions have to be submitted for approval (some tariff controls persist in certain USA States)
- Supervisor requires submission of annual reports and accounts, and cooperates with the companies' actuaries and auditors. Ratings are also used as another source of information.
- Reinsurance companies have minimum capital solvency requirements imposed.
- An equalisation reserve as a valuation adjustment for non-life insurers (common in EU Member States) is not prescribed (nor is it in the USA) because of the volatile nature of certain risks.
- Special deposits are required to cover technical provisions, and must be located in the country of the head office (as in the USA)
- A distinction is made between the treatment of the 'assets representing the technical provisions' which are the basis for satisfying the claims of the insured and the 'assets covering the other liabilities' which serve to satisfy the other creditors is required.
- Investment in derivatives are permitted exclusively for hedging purposes
- Investments abroad to cover technical provisions are not allowed.
- Insureds have a right to object to portfolio transfers
- Insurers do not finance a policyholder protection fund
- Specific capital requirements are set for conglomerates
- Reinsurance intermediaries are regulated
- Insurance agents must hold professional qualifications
- Liability insurance is required for agents acting for more than one insurer
- The insurance supervisor also supervises insurance intermediaries
- Agents, as well as brokers, must be registered
- Actuaries are supervised by the state
- Actuaries must be legally independent of insurance firms
- The insurance supervisor does not supervise pension funds
- Insurance companies are taxed in the same way as other companies

Finally, this OECD report notes that: “Mexico continues to evolve, with the NAFTA having a profound effect on its financial services market.”

The Willis International Alert No 15 of May 2006: “Mexico’s Premium Payment” explained how in Mexico premium payments have to be paid promptly, as in many cases policies have been cancelled because of failure to follow the rules, leaving would-be insurance buyers unprotected. They recommended a number of “simple steps that any organisation buying insurance in Mexico should consider in order to avoid such unpleasant circumstances.” These included:

- Utilise a secure and fast method of payment – either electronic bank transfer or a recognised courier service for checks. Don’t rely on the postal system.
- Always make provision in any transfers for the cost of the transfer or bank charges which may be added to the premium amount – any shortage in the payment may result in it being rejected.
- Wherever possible, make payment in the same currency as the currency invoiced; this will avoid any shortage due to foreign exchange fluctuations.

They described the ‘key facts to know for Mexican premium payers’, which include:

- Failure to pay insurers within 30 days of inception may result in policies being voided without notice
- Late receipt of an invoice/premium payment notice, partial payment or errors in the settlement of any premium do not grant buyers a grace period
- Only insurers – not brokers – may invoice and collect premiums
- Brokers may (and often do) facilitate payment and reconciliation.
- The regular postal service in Mexico is considered inefficient and unreliable.

Competition policy

“‘Mexico lacks a competition culture,’ says the OECD. The Federal Competition Commission is fairly toothless, though a new law is supposed to give it more bite.”¹²⁵

4.5.5 PENSIONS

Recent innovations in social policy may be making it more attractive to remain in the informal economy.¹²⁶ Formal private-sector workers are obliged to contribute to the Mexican Institute of Social Security (IMSS), which provides pensions and health care, as well as to a housing fund. Between them, workers’ and employers’ contributions add up to a hefty 35% of wages.

The institute is yet another of Mexico’s union-driven Stalinist monopolies. It administers the state pension scheme and is perhaps the largest single provider of health care in North America. Its trade union is the second-biggest after the teachers’, with 380,000 members. Mr Zedillo reformed pensions, switching from a pay-as-you-go system to Chilean-style individual capitalised accounts for new workers, but with one embellishment. The government makes a contribution to each account (at a total cost of \$1.5 billion a year) because otherwise many pensions would be too low to live on.

Mr Fox’s government [] launched or expanded a range of non-contributory social-protection schemes for workers outside the IMSS. The IMSS covers only 13m workers, or 30% of the workforce. The schemes include Oportunidades, the anti-poverty programme that replaced a series of less effective transfers and subsidies. [] a former official at the social-development

¹²⁵ “A survey of Mexico”, Economist, 18 November 2006.

¹²⁶ “A survey of Mexico”, Economist, 18 November 2006.

ministry, says that more than 95% of those who get Oportunidades have never worked in the formal sector. [He] fears that if more benefits are added to the scheme, they never will.

Mr Fox's government also launched a health-care programme called Seguro Popular for those outside the social-security system. In practice, this is non-contributory. All told this year public spending on health for workers in the informal sector will total 131 billion pesos (\$ 12.1 billion), against 107 billion pesos for those in the IMSS. Since 1998 public spending on social protection for informal workers has expanded by 110%; the figure for the social-security system is only 21%. Meanwhile, general public investment in infrastructure and the like has risen by just 0.8%.

4.5.6 GATS SPECIFIC COMMITMENTS FOR INSURANCE SERVICES

The WTO Trade Policy Review report of 2002 recorded that:

§103 [] Mexico took part in the extended GATS negotiations on financial services and accepted the Fifth Protocol on 29 January 1999.¹²⁷ [] With respect to insurance services, commitments on market access and national treatment were made only for commercial presence except in the case of re-insurance services, for which national treatment was bound for cross-border supply. Market access through commercial presence for insurance services included in Mexico's schedule was bound at 40% of the paid-up capital (under the Uruguay Round market access was generally bound at 30%); the limit on individual holdings by foreign investors was bound at 10% or 20% with SHCP authorization.¹²⁸

§104 Foreign financial institutions may establish representative offices in the Mexico with prior SHCP authorization; representative offices may not act as financial intermediaries, nor promote acceptance of funds by the firm they represent. Foreign financial institutions without commercial presence may not solicit and transact business with customers in Mexico.

§105 Access to the financial services market provided for in Mexican laws is in practice more favourable than Mexico's GATS commitments. In January 1999, the Credit Institutions Law, the Securities Market Law and the Law to Regulate Financial Groups were amended in order to allow foreign investment to participate up to 100% in the capital of commercial banks, financial groups, securities brokerage firms, and securities market specialists. The total percentage of foreign investment in other financial institutions (including general deposit warehouses, financial leasing companies, financial factoring companies, currency exchange houses, and insurance and bonding institutions) remains limited to 49% of the paid-up capital. Foreign investment is still prohibited in credit unions and development banks.

[Here, Chart IV.1 shows that the Department of the Treasury and Public Credit has reporting to it the National Insurance and Bonding Commission, which is responsible for the Insurance and Bonding Sector, which comprises 61 insurance companies and 15 bonding institutions.]

§106 Notwithstanding the above provisions, unrestricted foreign ownership is possible only through the legal figure of subsidiaries of foreign financial institutions. The limits on foreign ownership of financial institutions do not apply to subsidiaries of foreign financial institutions based in countries with which Mexico has concluded agreements covering financial services providing for such establishment. Besides the NAFTA, Mexico has signed such agreements with Colombia and Venezuela, the European Free Trade Association, and the European Union. In the case of the FTAs with Bolivia and Nicaragua, which also include provisions on financial services, the establishment of subsidiaries is not allowed.

¹²⁷ WTO document WT/LET/288, 18 February 1999.

¹²⁸ WTO document GATS/SC/56/Suppl.3, 26 February 1998.

§107 Foreign financial institutions from other countries may hold only non-controlling interests in domestic institutions. However, pursuant to its accession to the OECD, Mexico allows the establishment of subsidiaries of foreign financial institutions from all OECD countries.

§108 [] the Mexican legislation allows the establishment of financial groups (holding companies) controlling different types of institutions. Such groups must include in general at least three of the following institutions: (i) a bank; (ii) a brokerage house; (iii) an insurance company; (iv) a bonding company; (v) a mutual fund management company; (vi) a currency exchange broker; (vii) a general deposit warehouse; (viii) a financial leasing company; (ix) a financial factoring company; (x) a limited scope financial institution company; (xi) a retirement savings company; (xii) managing companies of investment companies. Financial groups may also be established with only two types of entities provided they are selected among the following: (i) a bank; (ii) a brokerage house; or (iii) an insurance company. The establishment of holding companies must be authorized by the SHCP, which grants such authorization on a discretionary basis.¹²⁹ The majority of board members of a financial group must be Mexican nationals or foreigners residing in Mexico.

The FLWG compendium "Trade Barriers in Insurance" (1 December 2005) gave the following description of the situation.

Although Mexico is an OECD member, Mexico's commitments are not scheduled according to the Understanding. There are few commitments in cross-border trade (with the exception of reinsurance) and only minority foreign equity holdings are offered, with Mexican control in all cases (plus additional requirements such as the rule that a Board of Directors will consist of at least 25% of "independent board members" in all cases). The measures Mexico has bound in the WTO are, in fact, less favourable than actual practice. Mexican trade policy officials have indicated that these restricted commitments were made as part of a future bargaining strategy and that Mexico recognises the need to liberalise fully in the insurance sector.

American and Canadian firms, as well as foreign firms already established in the United States and Canada, have enjoyed the benefit of the easier access allowed under NAFTA rules, which permit majority holdings of up to 100% for subsidiaries, while still denying access for branches. The EU/Mexico Trade Agreement (operational from March 2001) contains provisions effectively extending NAFTA treatment to all EU Member States: European insurers would wish to see this enhanced access reflected in Mexico's WTO commitments.

Significant sub-sectors in which Mexico has not yet made any commitments include:

- reinsurance consumption abroad;
- cross border and consumption abroad of services auxiliary to insurance, including broking and agency services.

The FLWG listed the market access and national treatment commitments of Mexico:

Market Access in Modes 1 and 2

- Whether a country protects acquired rights will be evident as offers are made and should be addressed according to the Model Schedule.

¹²⁹ Financial Groups Law published in the *Official Journal* on 18 July 1990.

Mexico prohibits:

- Mexican residents from purchasing personal insurance or any kind of insurance from foreign companies for risks within Mexico.
- Any person acting on behalf of a foreign company in Mexico for risks that could occur in the country.

The economic needs test for cross border sales of insurance requires an insured to prove to the Mexican authorities that no Mexican insurer is willing or able to take the risk, and even then the specific approval of the Ministry of Finance is required.

Mexico further:

- Requires different percentages for domestic and foreign reinsurers with respect to mandatory cessions.
- Places restrictions on cross-border trade in reinsurance (registration requirements). All amounts exceeding permitted retention limits must be reinsured with authorised Mexican institutions or registered foreign reinsurers.
- Imposes discriminatory withholding taxes on premiums to reinsurers abroad, in certain circumstances. The premiums for overseas reinsurance cessions are tax free as long as the reinsurer is located in a country having a double-taxation agreement with Mexico. For cessions to countries where no agreement exists, tax equivalent to 2% of the ceded premium will normally be charged; but cessions to a tax haven can attract a tax charge as high as 40% (Mexican Income Tax Law operative January 1999).

Market Access in Mode 3

Mexico prohibits:

- Commercial presence by branch.
- Most insurance intermediation and services auxiliary to insurance on which there are only limited commitments.

Mexico imposes:

- Aggregate restrictions on non-NAFTA/non-EU foreign shareholdings in Mexican firms (usually 40% in aggregate). Foreign investment in Mexican insurance companies is subject to the regulations of the Ministry of Finance and Inland Revenue regarding the organisation and operation of foreign subsidiaries in Mexico.
- A 49% ceiling on non-NAFTA/non-EU foreign equity participation in local insurers and reinsurers.
- Nominated joint venture partner.
- Restrictions regarding the ability to provide services using the home company name in the host country market. Products have to be registered under the name of the local subsidiary.
- Capital/holding restrictions for brokers.
- Mandatory deposit by foreign undertakings proportional to the percentage of premiums received.

Exclusive service supplier arrangements or monopolies for insurance and reinsurance prevent full and open competition, however this is changing. For a time, Aseguradora Hidalgo had a monopoly on government insurance. This has been fought by all Mexican insurers and it is likely to disappear, both because legal provisions have been changed, and because Aseguradora Hidalgo is to be sold to private investors.

National Treatment:

- Foreign insurers are prohibited from competing with domestic insurance service suppliers for providing insurance for state-owned or state-affiliated enterprises.
- Only local companies can use banks for distribution.
- There are restrictions on foreign activity in the pensions sector (though this does not apply to NAFTA countries).
- Operations involving annuities, in accordance with Social Security laws and health insurance, can only be carried out by specifically authorised companies.
- Mandatory deposits are imposed on foreign undertakings proportional to the percentage of premiums received.
- A discriminatory 2% withholding tax is imposed on the premium to reinsurers abroad, under the Mexican Income Tax Law enforced in January 1999. (However, the countries which have concluded a tax treaty with Mexico are excluded.)
- There are discriminatory domestic regulations against foreign companies: when insurance companies hold working assets in foreign currencies, and 8% is added to the gross solvency margin requirement.
- Foreign insurers are not permitted to insure residential risks.

Comparison with FLWG Best Practices in Insurance**A. Transparency:**

- New and existing regulations are not submitted for public comment with a reasonable amount of time prior to their enactment. Laws are proposed to and enacted by Congress. In a few cases there have been requests for comments, but as an exception, not a rule. It is more common to send proposed legal provisions to the Mexican Bar and associations of companies in the industry (for insurance, the Association of Insurance Companies (AMIS).) These comments generally do not carry much weight though.
- Market participants are usually afforded an adequate time period to become familiar with and be prepared to implement new and revised regulations before they become effective. However, there are occasions where the lead time is considered insufficient.
- Insurance providers which provide comment and recommendations on proposed or revised regulations do not receive a written reply from the supervisory authority in response.
- No procedures are in place to ensure that consumers can assess the creditworthiness of insurance companies and for insurers to provide information on their creditworthiness to the public. However a few insurance companies are rated by companies such as Duff & Phelps, AM Best, etc., and they use it as publicity.

B. Solvency and Prudential Focus:

- The policies by which the insurance authorities approve new products, forms, rates and services are supposed only to ensure compliance with the laws, but in practice the insurance authorities have full discretionary powers to approve or reject a policy text.
- There are restrictions on the payment of dividends by foreign insurance providers. These tax regulations discourage the payment of dividends to foreigners.
- There are no internationally recognized accounting and auditing standards in use by the regulatory authority. Accounting principles are used, but are not recognized internationally.
- There are complex capital and investment requirements. Rules on minimum capital are index-linked, increasing with inflation as expressed in Investment Units

(UDIs) (Value in October 2004 = \$ 3.458391 MXP). Current requirements are: Life 6,816,974; Annuities 28,000,000; Accident & Health 1,704,243; Property 8,521,217. Investment of technical reserves can only be in financial instruments that are authorised by the National Banking and Investment Committee and issued by Mexican companies. Restrictions include those on mutual funds and pension funds holding non-Mexican securities.

- Insurance companies cannot obtain loans or credit, except by issuing bonds convertible into stock.

C. Insurance Monopolies:

- The designated insurance monopoly in the country (Aseguradora Hidalgo) is allowed to offer insurance products outside its monopoly designation.

D. Independent Regulatory Authority:

- There is an Independent Regulatory Authority, which accords with best practice.

Revised GATS conditional offer on insurance services

In July 2005 Mexico tabled its revised conditional offer for services (WTO document No. TN/S/O/MEX/Rev.1).

Under Mode 4, two new categories of natural persons are to be permitted temporary entry: c) investors, and d) business visitors. Thus now "authorisation for entry and temporary stay will also be authorised for board members and auditors."

The categories of investor and business visitor are spelt out in some detail. Those in the investor category would be allowed entry for one year, with up to four one year extensions, and business visitors would be allowed 30 days, which could be extended. The latter would need to show proof of nationality, evidence of relevant experience, and to prove no intention of entering the labour market, such as source of remuneration and principal place of business, as evidenced by an employer's letter.

The coverage of 'specialists' is explicitly to cover persons "who possess technological knowledge in the physical sciences, engineering or other natural sciences; and those with advanced knowledge in jurisprudence, economics, sales administration, accounting and other human sciences." The activities that require such skills relate to those "where nationals do not have the capacity to undertake them" and where a "university education (at graduate level) or higher education" is necessary.

All categories permitted entry under Mode 4 may be required to obtain a visa or entry permit before arrival in Mexico.

Under the Sector commitments, there are no changes in the sub-sectors offered for the insurance sector, and there are no changes to Modes 1 and 2 in the market access and national treatment columns.

In the Mode 3 market access column the restrictions would be eased a little, with the new standard wording for each of the sub-sectors. Up to 49% of paid up capital could be acquired by foreign companies and up to 100% of additional capital, with a limit of 30% of the voting rights of the ordinary capital. Mexican investors must maintain both management and effective control. Entities which exercise the functions of governmental authority would not be permitted to acquire shares.

In the Mode 3 national treatment column there is no change.

In Mode 4 in the market access and national treatment columns, in every case, the wording has been changed from “Unbound” to “Unbound, except as indicated in the horizontal commitments”.

4.5.7 DISTRIBUTION

All forms of distribution are in existence, and they have to be licensed and are regulated and supervised by the insurance supervisor.

4.5.8 SUPPORT PROFESSIONS

The insurance supervisor makes regular contact with the accountants and actuaries employed by insurance companies, and both are regulated.

4.5.9 CONSUMER AWARENESS

“The public attitude towards legal action has changed and the citizens’ faith in the legal system is becoming stronger. Mexican insurers are also increasingly confronted with bodily injury claims due to growing tourism, especially if US citizens are involved, who sue Mexican insurers for compensation on the level that is common in the US. It should be borne in mind that these claims can also be brought before American courts.”¹³⁰

¹³⁰ “Three decades of market presence in Mexico”, The Berkshire Hathaway Topics, No. 14 issue.

4.6 RUSSIA

4.6.1 GENERAL BACKGROUND

The following overview was given in the “WIIW Research Reports 325”, February 2006

“The pace of structural reforms has slowed down substantially. State interventions in the economy are increasing, the resulting bureaucratic obstacles and corruption being blamed as the main culprits for the poor investment climate. [] the government restricts access of foreign investors to ‘strategic’ sectors.” [] “revenues from oil and natural gas exports account for more than 60% of the total – and the huge foreign exchange inflows exert appreciation pressures on the Rouble. [] the Rouble has strengthened by some 50% in real terms against the US dollar since 2000 (real appreciation against the Euro was much less pronounced).”

“Russia’s GDP increased by slightly more than 6% [in 2005], roughly maintaining the average growth rate of the past five years. In 2005, the main driver of growth was rising domestic demand (both private consumption and investments grew by more than 10%) while the contribution of real net exports to GDP growth was again negative. However, export revenues boomed for the second consecutive year in nominal terms, largely thanks to surging energy prices. [] the trade surplus reached EUR 100 billion (more than 16% of GDP) and the current account surplus nearly EUR 70 billion (11% of GDP). [] The government budget also recorded a record surplus in 2005 (more than 8% of GDP) []. The Ministry of Finance announced in September [2005] its intention to repay all remaining debt to the Paris Club – USD 28 billion - in the course of 2006.”

	1995	2000	2005	2010
GDP per capita in Russia compared with the EU 25 average = 100	37	30	39	44
Other indicators:				
Consumer price index 2000 =100		100	200	
Exchange rate Rub/Eur		26	35	
GDP in nominal Rub bn		7,306	21,665	
Unit labour costs: Austria = 100	14	31		

The following is a composite picture assembled from a variety of sources and interviews.

The Russian population is 144 million and life expectancy is declining to 60 for men and 74 women.

There had been a seven year straight growth in GDP by the end of 2005, at an annual average of 6.4%. Demand is driven by investment and consumers who do not save (unlike in China and India) due to mistrust of the financial sector. There has been an average 12% per annum increase in real incomes over the last five years, which has fuelled the growth of a middle class. On the other hand the inflation rate is still high.

There are large foreign currency reserves, \$ 180 billion at end 2005, built up from the 80 % of exports that are natural resources.

The business climate is rather poor due to red tape and corruption, which also discourages inward FDI. A high proportion of foreign investors have been directly affected by corruption, most often involving the tax authorities. Indeed, there is a

general lack of trust in financial and other institutions. Corruption, coupled with the lack of active measures against corruption, together with organised crime are key general concerns for investors. There continue to be political and other killings of high profile people.

Little progress has been made in building the rule of law, though the separation of the appellate division from the lower courts division has resulted in a more effective check and balance.

These extracts from an article in the Financial Times by N Buckley on 31 October 2006 record the flavour of some aspects of the Russian market.

“Just off Revolution Avenue in the Russian city of Voronezh [] is a franchise of Mango, the Spanish fashion chain [] the once dowdy Rossiya department store is a mini-mall with franchises of Benetton and Diesel [] a cash-and-carry run by Germany’s Metro [] McDonald’s outlets and Irish pubs are transforming the 1m-strong regional capital – even though the roads and other government services are worse than ever.

After the hardships of the 1990s, Russia is finally witnessing the rise of a prosperous post Soviet middle class. Some international observers feel, moreover, that if democracy, press freedom and the rule of law are to flourish in Russia, that may depend on an assertive middle class pushing for such rights.

Companies from carmakers to cosmetic giants now list Russia alongside China and India among their most dynamic consumer markets.

The consumer boom is the fruit of nearly eight years of economic growth averaging 6.6 per cent [] real wages and consumer spending are growing twice as fast. The average monthly wage was up 13.6 per cent year-on-year in September to \$ 415 – still low, but four times what it was when Mr Putin became president in 2000.

Low housing and utility costs mean a relatively high proportion of Russian’s wages goes straight into disposable income. A lingering suspicion of banks, born of the 1998 crisis, also means spare cash is more likely to go into flat-screen television sets or washing machines than into savings accounts.

A study in 2000-01 of Russia’s social structure [] classed fewer than 1 per cent of Russians as a super-rich elite. At the other extreme, 10 per cent of the 144 m population lived in real poverty. In between, 20 per cent formed a more-or-less comfortable middle class; just under 70 per cent were lower-middle class – struggling, but able to afford a few consumer luxuries. [] But few of the 70 per cent lower middle class have made the jump to the next rung, its members are working largely in the public sector or less successful parts of the economy.

As Russians get richer, entertainment and travel should also flourish [] Turkey and Egypt are becoming to Russians what Spain was for Britons in the 1970s. Mohamed Rachid, Egypt’s trade minister says 1 m Russians visited last year, and the total could reach 1.5 m in two years. Russian tourists coming to Egypt are the highest spenders.

Dependence on energy and raw material exports makes the economy vulnerable to any correction in commodity prices.

4.6.2 FINANCIAL SERVICES

The banking system is still rather weak, and the central bank is not a strong regulator. Many of the 1,200 banks are low-capitalised institutions and some could be little more than fronts for organised crime.

Consumer credit has mushroomed from zero a few years ago to about \$ 40 bn.

An Axco publication "Russia: Life and Benefits" (November 2006) gave the following comment: "The confidence of ordinary Russians in the country's banking sector, which plummeted after the financial crisis of 1998, has been growing steadily and deposits have increased six fold since 2002. This has been encouraged by a deposit insurance scheme for private individuals set up in 2004." Indeed, many of those with some money preferred to keep their savings in cash, and estimates of the total were in the range US\$ 20-30 billion, although these cannot be verified.

Within the CIS region, the Russian Federation is the dominant market for insurance services. In 1999, it accounted for almost 90 per cent of the aggregated CIS insurance premiums, while the second largest market of Ukraine had less than 7 per cent. In the same year, Russia had insurance premiums in non-life insurance with a value equivalent to three-quarters of transition economies' average. In the other CIS countries for which data are available, this indicator did not exceed one half of the average.

The situation was even more diversified in the sub-sector of life insurance. In 1999 its weight in the Russian GDP exceeded 85 per cent of the transition economies' average and, according to the opinions of experts, the development of life insurance in the Russian Federation should be attributed to the recently enacted changes in tax regulations favouring contractual savings and private insurance savings schemes. At the same time, the volume of insurance premiums and their ratio to GDP recorded at the end of the previous decade attest to a virtual non-existence of life insurance.

In terms of premiums per capita, in 1999 the Russian insurance sector had indicators significantly inferior to the transition economies' average (respectively 25 per cent of the average for non-life and 30 per cent for life insurance sub-sectors). In the other CIS countries, for which data are available, these percentages were even lower.

4.6.3 INSURANCE SERVICES

An OECD study "Reforming the Insurance Market in Russia", by M Mariska and T Manson, Policy Issues in Insurance, No. 10, OECD, 2005, found that since the abolition of the insurance state monopoly in 1988 "a competitive market oriented insurance industry has been slowly developing." The market is characterised by low insurance penetration averaging "about USD 21 per person, for life and non-life insurance combined, a figure that is substantially below most other central and eastern European countries."

It is probable that about two thirds of the premiums shown in official data are derived from 'non-risk financial schemes' which allow companies to reduce tax. Companies have generally low capitalisation and some may face financial difficulties. This is partly due to the past legacy and partly due to the general financial instability experienced in Russia during the 1990s. There are over 1,000 insurance companies mostly very small. The larger ones are developing branch networks across the country, and some major foreign firms have entered the market, but their share of premiums is still small.

By 2003 the non-life market generated some US\$ 3.5 billion in premiums,¹³¹ of which the motor class was the largest due to the introduction of compulsory third party liability cover, though other liability classes are under-developed. Commercial property insurance is growing fast and MAT is an important segment of the non-life. One forecast for the non-life market is that over the next five years it will grow at between 20% and 30% each year. The market is growing fast and companies are improving their technical expertise. The market has huge potential.

Long-term life insurance is a very small part of the market. It is estimated that total long-term life premium is USD 120 million. The cause of the failure of the long-term insurance market to develop can be seen in the experience of financial instability of the 1990s and the general mistrust that the Russian population has in all Russian financial institutions.

The Russian insurance state monopoly was abolished in 1988. Since that time, a competitive market orientated insurance industry has been slowly developing. Today, the market is characterised by low insurance penetration.

An accurate assessment of market size is very difficult because a high proportion of 'premiums' generated by the Russian market are derived from non-risk financial schemes, the purpose of which is to allow companies to reduce tax. It is probably that two thirds of the premium income shown in official figures are derived from such schemes.

A further problem facing the market is the generally low capitalisation of insurance companies. There are concerns that some insurance companies may face financial difficulties because of lack of capital.

Nevertheless, the insurance market is now growing fast, insurance companies have greatly improved their technical expertise and the legislative framework has benefited from new legislation passed in 2004. The market has huge potential and there are clear signs that the potential is about to be realised. The Russian Federation is poised to achieve substantial expansion in its insurance sector which will be of ever-increasing benefit to its population and its growing industrial and mercantile base.

Commercial property and Marine, Aviation and Transport are an important segment of the non-life market. All classes of liability insurance, other than motor TPL are underdeveloped.

Motor is expected to continue to dominate the non-life market in the future, but other classes are also expected to contribute towards a continuing rapid growth. It is likely the non-life market will grow at between 20% and 30% per year for the next five years with the implication that it will triple in size during this period.

There are some signs of growth in the long-term life and pensions sector, but it is difficult to make firm predictions as to what rate of growth will occur. Nevertheless, there is a huge potential and there are some signs that many of the socio-economic barriers facing the market have reduced significantly.

There are over 1,000 insurance companies in Russia, the majority of which are very small. A number of large companies are developing branch networks throughout Russia. These companies are some of the best known brand names. There are also a number of successful regional companies which are able to compete with the larger companies. International penetration of the market is limited. A number of major international insurance companies have entered the Russian market, but their share of total premium is small.

¹³¹ For the 2006 figures, see the attachment to Chapter 1.

[End of extracts from the OECD paper.]

However, it should be noted that an earlier OECD report states:

“it is impossible to obtain an accurate assessment of the size of the insurance market in standard classes of insurance from official statistics. The main cause of this difficulty is that such a high proportion of ‘insurance’ business is derived from financial schemes.”

“It is our estimate that 72% of total insurance premiums (excluding compulsory medical) are derived from various types of scheme that are not standard insurance.”

“The compulsory medical insurance programme is not insurance: it is the method whereby the state administers its medical budget through special insurance companies.”

“the law of 2004 introduced a new methodology largely based on the European classification.”

In this OECD report the following proportions of the adjusted figure for 2003 were estimated, not including the non-insurance tax schemes:

	USD million
Life, accident and health	
Life	115
Medical	351
Accident and illness	170
Non-marine property	
Fire and allied perils	717
Financial risks	12
Other	171
Motor	
Private motor PD	547
Voluntary liability	84
Compulsory TPL	845
Commercial motor	237
Marine Aviation and Transport	
Property	110
Cargo	47
Liability excl. motor	139
TOTAL	3,545

[OECD quoted the calculations of United Financial Group, Moscow.]

Market structure

“Of the 1,000 insurance companies in Russia “there were 489 companies with a premium income of less than USD 500,000. In 2003, the largest company in Russia

had premium income of over USD 1 billion. [] In 2003, the top thirty companies had a combined premium income of USD 8.27 billion, over 55% of the total market premium income. The top hundred companies take 77% share of total market premiums. [] All of [the top three] companies must be seen as predominantly operating financial schemes. [] Only one company in the top seven can be seen as predominantly reliant on standard classes of insurance. [] Of the top thirty companies, five might be described as actual or former captives and thus are not major competitors to the market companies. Of the top 100 companies in 2003 “about 30 are mainly dependent on standard classes of insurance”.

“The total market share of majority-controlled foreign companies is therefore likely to be very small: we estimate it to be under 5% of the market in standard insurance. The market share of all companies with some foreign shareholding is larger, but is still likely to be under 20%.”

“The very size of Russia and the rapid growth that is expected means that substantial injections of capital will be required. We estimate that at least USD 2/3 billion in capital will be needed over the next few years for the non-life market alone.”

The 7 August 2006 version of “Russian Insurance” in their series “Industry Update” by Deutsche UFG, part of the Deutsche Bank Group had the following conclusion:

In non-life retail insurance, we believe that it will be impossible for foreign players to make a significant impact without acquiring a local player with a developed network of branches, given the strong brands already prevalent in Russia together with Russia’s size. In life insurance, there was never any domestic market to defend anyway in our view (the size of Russia’s life insurance market last year was probably somewhere around \$215 mn, as we argue elsewhere in this report), while in commercial non-life most of the big risks were reinsured abroad. Under the new agreement if implemented, these risks may be passed directly to foreign insurers without the need for a Russian insurer to act as the middle-man. It may mean a financial loss for these companies, but it is unlikely to have a major impact, especially as the real competitive battle in the sector is in retail, above all in motor insurance.

Their analysis of the Russia insurance market in 2005 gave the following figures:

Non-life free market grew	32% to \$ 7.2 bn
Life market grew	26% to \$ 215 mn
Non-life captive grew by	\$ 505 mn
Non-life grey schemes declined by	\$ 262 mn

There was strong growth in the obligatory motor third-party liability, in private entity motor damage, accident and illness, private property and voluntary medical.

“Recommendations for further improvement in the insurance industry” [by OECD]

“Our two main recommendations are first that the Government close the tax loopholes that permit excessive provision of financial schemes subscribed by corporations through insurance companies. We believe that heavy reliance on these schemes is detrimental to the insurance industry itself and insurance companies should themselves see the necessity for closing these loopholes.

Our second main recommendation is that there should be an increased emphasis on financial stability of insurance companies. [] More and better quality capital is needed and specific measures need to be taken to ensure that the insurance

consumer is protected against loss. Companies need to provide more and better information and should use international accounting standards.

Other recommendations include the continuing development of insurance education, especially continuing professional education for staff and agents; the development of a wide range of life insurance products and the introduction of a monitoring system to prevent financial fraud.”

In the Soviet era Gosstrakh had built up a huge life insurance portfolio: their agents sold small value short-term savings policies, collecting premiums monthly, which paid out on events such as marriage or a child's 18th birthday, so that by 1991 it held 52.5 million such policies valued at about US\$ 1 billion. The 1998 financial crisis destroyed the value of the policies through the Rouble revaluation, and the resulting mistrust in financial institutions has caused the general preference to keeping savings 'under the mattress'.

Subsequently the most popular 'real' life insurance policies have been for terms of one to five years used as savings vehicles, either as pure endowment, or payment of the sum insured should death occur before the policy term expire. Some carry riders such as personal accident, accidental death and critical illness benefits.

A significant feature of the Russian insurance market is the dominance of the Central Region, which includes Moscow. In 2005 it accounted for over 70% of the total, because its citizens have higher than average salaries due to the headquarters of most leading industrial and commercial groups being located there.

Life reinsurers only became established in Russia in 2006 when CJSC Munich Re became domiciled, and they were followed by Swiss Re and General Re, but no local reinsurers are active in this sector. However, this market for long-term life endowment products is relatively restricted.

The total number of insurance companies in Russia has fluctuated: since 2004 when there were 1,280 this has steadily decreased as the insurance supervisor cancelled the licences of those companies who could not meet increasing capital requirements which are to reach European levels. By mid 2006 the number had dropped to 920, and some predict that eventually there about 300 will survive.

The Russian Insurance Association (ARIA) has about 200 members but they account for up to 80% of market income, and the leading firms are represented on its council, and reflect the dominance of the Moscow region. There are in addition some regional associations.

The ARIA advocates, as one of its priorities, the amendment of the Tax Code to provide incentives for life and voluntary private medical insurance, and to eliminate tax avoidance through the salary scheme business (or 'unreal' insurance). They also seek regulatory permission to offer unit-linked contracts to stimulate business, in view of the declining interest rates which make it hard to offer attractive rates of return.

4.6.4 THE REGULATION OF INSURANCE SERVICES

This material is also taken from the OECD paper referred to above:

“The legal and regulatory framework for insurance

The legal framework for insurance is set out first in the Civil Code, in which most of the basic legal concepts are defined. In general, this basic legal framework is based

on similar legal concepts to those established in the West. Likewise, the Civil Code establishes a civil liability (tort) regime that follows established Western concepts.

The main specific legislation for insurance is the law 'On the organisation of insurance business in the Russian Federation'. This law sets out the rules under which foreign investors can take control of Russian insurance companies. It also sets out the functions of the Insurance Supervisor and establishes the solvency rules.

After 1993, the law prohibited foreign investors from owning more than 49% of the shares of an insurance company. This prohibition was easily circumvented and a number of international insurance companies began operating in Russia. In 1994, the Russian Government made an agreement with the European Union to allow free access to European insurance companies by 1999. As a result, the law was amended to allow foreign investors to control insurance companies, although a number of significant restrictions remained, the most important of which was the prohibition of foreign controlled insurance companies from transacting life insurance.

In 2004, further amendments to the law were passed. Investors from the European Union had most restrictions removed. Since it is possible for any insurance company to operate in Russia through a European subsidiary, this has led to situation where the Russian insurance market is now more open despite the fact that a number of restrictions still apply to non-European insurance companies.

Other major changes to the law were introduced in 2004 including the separation of life and non-life business, increasing minimum capital requirements for all insurance companies, requiring senior insurance staff to be qualified and improving the system of insurance regulation and supervision.

In 2004, the Ministry of Finance of the Russian Federation became responsible for implementing state policy towards insurance. The insurance supervisor became a 'Federal Service' in 2004, increasing its status as a supervisory authority. Licensing procedures were defined more precisely as was the supervisor's intervention powers. In general, the amendments to the law passed in 2004 are a substantial improvement to the legal framework of the insurance industry."

This OECD study recommended that the "Government close the tax loopholes that permit excessive provision of financial schemes subscribed by corporations through insurance companies" as these schemes are considered detrimental to the sector. In addition it was recommended that "more and better quality capital is needed and specific measures need to be taken to ensure that the insurance consumer is protected against loss." Companies also need to provide better information and "should use international accounting standards." Other recommendations focused on developing "continuing professional education for staff and agents", developing a wider range of life insurance products and "the introduction of a monitoring system to prevent insurance fraud."

The historical development of the Russian insurance market since 1921 is encapsulated in the following Axco summary:¹³²

- 1917 By the time of the revolution, the insurance industry in Russia had grown to a reasonable size and the larger companies, based in the cities, were developing along standard lines. Soon after the revolution however insurance was nationalised. The writing of property business largely ceased, but life business continued to be written until inflation wiped out the value of the policies in 1921.
- 1921 Gosstrakh ("state insurance") was founded, largely to take over compulsory rural insurance business. The company was a department of the Ministry of Finance, without any real reserves or investment policy. Insurance was seen as a means of gathering revenue both locally and nationally.
- Gosstrakh was also responsible for insuring Russia's exports, and hired former insurance executives with the relevant expertise to establish this part of its operations. Two overseas subsidiaries, the Black Sea and Baltic Insurance Company, London, (now in liquidation) and SOVAG in Hamburg were set up in the 1920s to write this business.
- 1947 The international business of Gosstrakh was transferred to a newly created entity, Ingosstrakh ("international state insurance").
- 1988 The state monopoly on insurance was ended when Ingosstrakh was permitted to insure risks within the Soviet Union. Other private insurers where also permitted.
- 1992 The *Law on Insurance* was passed.
- 1996 The new *Civil Code* was introduced.
- 1998 The Russian financial crisis affected the economy as a whole but insurers were in general able to continue paying claims; none of the leading companies became insolvent.
- 2001 Final privatisation of Gosstrakh began.
- 2003 Compulsory third party liability motor insurance was introduced from 1 July.
- 2004 Amendments to the 1992 insurance law were implemented which introduced higher capital requirements, split insurers into life and non-life operations and removed most of the restrictions on foreign insurers, effectively opening the market fully.
- 2005 Signs that finally the authorities were taking strong measures to reduce the amount of tax optimisation business, increase insurers' financial strength and reduce the number of insurers were widely welcomed by the insurance industry.
- 2006 With tax optimisation business fast disappearing and important growth in life insurance as loan protection, the market was finally seeing the market's potential starting to be realised.
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¹³² "Russia: Life & Benefits", Axco, Insurance Market Information series, November 2006.

Development of Regulation in Russia for Life insurance and Pensions¹³³

Insurance companies are regulated by the Civil Code Law on Insurance Business, and are licensed and supervised by the Ministry of Finance. From 2007 life and annuity insurance business must be conducted by specialised life insurance companies. Minimum shareholders capital is \$ 2 m or \$ 6 m if reinsurance is also conducted.

Non-State Pension Funds (NPFs) are regulated by the Civil Code Law on Non-State Pension Funds and are licensed and supervised by the Ministry of Labour. Minimum share capital is \$ 0.1 m, or \$ 1 m if the fund wants to participate in the State Pension Scheme. They must be non-profit organisations.

The insurance supervisor only licenses products that show a positive guaranteed return to the accrued insurance reserves. Unit-linked products are not available due to the rules on the insurers' fixed liabilities not linked to investment performance. There are no rules on the disclosure on commissions, investment procedures (though investment declarations must be published) or bonus accruals, and loadings, commissions, fees and charges can be hidden in the premiums. These can include the distribution channels such as direct sales force, tied agents, brokers and independent financial advisers, multi-level marketing networks, direct marketing and bancassurance.

The reserves of life insurance companies are supervised quarterly by the Insurance Supervision authority, and the companies must invest their reserves themselves, with no funds managed by an external Asset Management Company, and the use of reinsurance investment facilities (especially foreign ones) is not possible as survival risk cannot be reinsured. For NPFs their allocation of reserves is supervised daily by the Special Custodian. Investment can only be in Federal State Securities or in bank deposits. For investments other than financial instruments, the relevant reserves must be managed by external, specially licensed AMCs. The reinsurance of pension obligations is prohibited. NPFs must accrue at least 85% of earned interest to the pension accounts, and this must not be lower than the guaranteed rate.

The solvency margins for NPF 'insurance reserves' cannot include share capital and retained profits, which is stricter than for life companies.

There is no tax relief for individuals or corporations buying life and pension insurance, or contributing to individual accounts with NPFs ie premiums are not tax deductible and the employers' contributions are treated as additional employee income. However, life and pension benefits are tax deductible. If the employers' financed corporate pension plans are arranged under so-called 'solidarity accounts' with NPFs, where the amounts paid on behalf of individuals is not defined, then neither the contributions or the benefits are taxable.

4.6.5 PENSIONS

Although voluntary pension provision was permitted from 1992, the current legal basis is the Federal Law 75 of 7 May 1998. It had been obvious for some time that a major reform was necessary because the former state system could not sustain the levels of pension payments for much longer. Under the new law, the second pillar pension provision is funded by mandatory contributions from employers related to employee salaries. Part of this is paid into the State Pension Fund of Russia to fund social pensions, and the rest accumulates in individual personal accounts to provide a pension at retirement, and the management of the latter funds can be provided by independent asset managers.

¹³³ Taken from the paper: "Reforming the Insurance Market in Russia", by M Mariska and T Manson, Policy Issues in Insurance, OECD, 2005.

A third pillar consists of ordinary life endowment savings plans, but there is no tax benefit for these products, and little sign the authorities will introduce any. The multinational employers are the main buyers of voluntary group pension arrangements.

There are two types of voluntary private medical insurance, the first where contracts are arranged between insurers and healthcare clinics to provide specified treatment such as for maternity and dentistry. Each user pays an annual fee to the insurer, which passes most of it to the clinic. Although this is in effect a pre-payment, there are tax advantages in treating it as insurance. These schemes are popular in cities where the best clinics are located. The second type, and most common, is where cover is arranged by the employer in a worker's benefit package, which also has some tax relief.

4.6.6 GATS SPECIFIC COMMITMENTS FOR INSURANCE SERVICES

Russia is still in negotiations with WTO Members for its accession, which is expected to be completed later in 2007 or in 2008. The terms of its eventual services specific commitments are confidential during this process, and therefore cannot be assessed here. It has not received any 'requests' during the Doha Round liberalisation negotiations because it is not yet a WTO member.

The sticking points in the Russian accession negotiations, as far as services are concerned, appear to include the issue of whether insurance branches of foreign insurers have to obtain licences, and what the conditions are likely to be – if licensed at all.

It is not to be expected that Russia will make very open commitments for the movement of natural persons to supply services (under Mode 4).

A summary of the current restrictions on foreigners, provided in April 2007 to the present author by an official in Moscow, is as follows:

- FDI is capped at 25% of the insurance sector total investment
- Supply is limited in GATS Modes 1 and 2
- The Legal Form restriction prohibits branches
- JV participation is capped at 49% (for life, mandatory insurance, state procurement)

The current Russian insurance legislation contains more restrictive limitations for foreign investors as compared with that for other services sectors. The liberalisation of Russian insurance legislation will be realised within a transitional period, which will allow the Russian insurance community to be adapted to changing competition conditions. Such liberalisation will result in only partial opening of Russian insurance market.

It is expected that after Russia's accession to the WTO:

- The quota of foreign participation in the total charter capital of insurers/reinsurers will be increased from current 25% to 50%;
- JV participation will be increased from 49% to 51% for life and mandatory insurance for a period of 5 years starting from the Russia's accession to the WTO; after that, 100% of foreign participation in the charter capital of such companies will be allowed (JV participation capped at 49% in insurance of state procurements);
- Branching licences will be granted 9 years after Russia's accession to the WTO, subject to licensing, financial soundness, guarantee deposit requirements and requirements for the parent company (except for insurance/reinsurance of state procurement and mandatory insurance, other than mandatory insurance of civil liability of car owners).

The Financial Leaders Working Group gave the following description of the Russian scene in their paper "Trade Barriers to Insurance" (1 December 2005):

The insurance market in the Russian Federation is effectively closed to majority foreign-owned insurance companies. Where foreign insurers are present in the market they are discriminated against. The market was due to be liberalised under the terms of the 1994 EU Partnership and Cooperation Agreement, but the Russian Federation failed to comply with the terms of this Agreement. Had the Russian Federation complied, it would have been expected to extend the same treatment, on an MFN basis, to other WTO partners, on accession to the WTO. All existing insurance operations should be grandfathered as acquired rights if Russia accedes to the WTO.

A new Law on insurance was passed in 1999, shortly after the Russian Federation reneged on its earlier commitment to greater market liberalisation. This law enshrined protectionist policies for the Russian Federation insurance sector.

Foreign insurers are effectively unable to take a majority shareholding in Russian Federation companies and therefore unable to secure management control. This restriction is further exacerbated by a cap on the total level of foreign investment in the Russian Federation insurance sector as a whole.

The Russian Federation's new insurance law further undermined the stability of foreign insurance business in the Russian Federation, by permitting future discriminatory changes by the insurance regulator covering solvency and the investment of company reserves.

The Russian Federation's laws recognise insurers as juridical persons in the form of stockholding companies or state unitary enterprises (insurance organisations) that are licensed to conduct business in the Russian Federation. Life insurers may not offer non-life cover. Licensing is also required for reinsurance companies, as well as for insurance brokerage.

The sale of insurance in the Russian Federation on a cross-border basis is not allowed. A commercial presence in the market is required. Foreign suppliers of insurance are limited to a 49% equity ownership cap. Brokerage activity aimed at the conclusion of insurance contracts on behalf of foreign insurers is not allowed, unless otherwise stipulated in the international treaties of the Russian Federation or its federal laws.

The 'Common Strategy of the European Union on Russia', adopted on 4 June 1999, was applied until 2003, during which time the EC and its Member States supported a wide range of technical assistance to Russia in areas relevant to the WTO process.¹³⁴ It was decided to postpone the negotiation of an FTA until after Russia has acceded to the WTO. However, in the meantime, the EU already extends MFN to Russia, which means that Russia receives the same treatment as if it were already a WTO Member, and Russia extends MFN to the EU. EU and Russian companies are free to establish on this MFN basis, and in fact are then free to operate on a national treatment basis, ie as if they were locally owned companies. It also seems likely that Russia will 'grandfather' the conditions of firms which were already established by the date of the Russian accession to the WTO.

Russia has committed itself to approximate its legislation with that of the EU, including for banking law and for other financial services. However, the present agreement between the EU and Russia recognises that Russia is still in transition to a full market economy.

¹³⁴ This section is taken from "Implementation of the EU/Russian common strategy" found on the EC website.

On the USTR website the notes on the bilateral market access agreement on services between the US and Russia, signed in Hanoi on 19 November 2006, states that:

“Russia has undertaken market access and national treatment commitments in a wide array of commercially significant services sectors. US service suppliers will benefit, in particular from more open access in [] financial services [].

Another official document of the same date gives more detail on insurance services under the WTO accession negotiations:

“Russia will provide a significant level of market access and national treatment for US insurance companies, including 100 percent foreign ownership of non-life insurance firms upon accession. Limits on the number of life insurance licences granted to foreign insurance firms, as well as foreign participation in a small number of mandatory insurance lines will be phased out 5 years from the date of accession. Russia will allow foreign insurance companies to open direct branches for life and non-life insurance, reinsurance and services auxiliary to insurance nine years from the date of its accession.

“Russia retains the discretion to limit new foreign direct investment in banking and insurance and insurance branches, if foreign investment exceeds 50 percent of total investment in the sector. The calculation of the 50 percent ratio excludes foreign investment: 1) made by 1 January 2007; 2) in firms privatised after Russia’s accession; 3) in internal branches; and 4) over 51 percent after it has been in place in Russia for 12 years, unless Russia makes a formal decision annually to continue to include such investment.

“Russia has also agreed to conduct within 5 years from the date of accession an overall review of the discretionary foreign investment limit and whether it is necessary to keep it in place.

“USTR has taken the firm position that this discretion to limit new foreign investment in financial services in Russia’s accession agreement will not serve as an acceptable precedent in the context of the Doha Round, or any regional or bilateral trade agreement.”

This last paragraph sounds like a toughening of the US stance, at the WTO accession negotiations, on Russian controls on further foreign investment.

Some notes on the position for insurance services in the Russian Federation
Contributed by : Diana Keegan, AIG

Insurance Overall Sector Equity Cap

The foreign share of total charter capital in the insurance sector is limited to 25%. The US Bilateral WTO Accession Agreement would lift this limitation to 50% and the sectoral cap

- would be subject to review as to its necessity 5 years from accession
- would exclude foreign investment
 - in the sector as at 1/1/2007
 - in companies privatised post accession
 - in internal branches
 - over 51% if invested for 12 years (discretionary).

However, it should be noted that

- Total Capital as at 1/1/2005 USD 4.2 billion (150% increase from 2003)

Individual Company Equity Caps.

Non-EU foreign investment in life insurance companies is currently restricted to 49%. The US Bilateral WTO Accession Agreement would lift this limitation to 51% and eliminate it over 5 years.

Juridical Form

Direct branch operations of foreign insurers and reinsurers are currently not permitted. The US Bilateral WTO Accession Agreement would permit direct branch operations of foreign insurers, reinsurers and auxiliary services within 9 years, with certain seasoning requirements.

Regulatory Barriers

Transparency and problems associated with lack of transparency are of concern.

Prior permission to open internal branch offices of locally incorporated companies is required.

Licensing for Compulsory Insurance: Russia currently has many forms of insurance classified as compulsory. However of these, private industry is probably interested mainly in auto insurance.

- EU companies may not obtain licences to write compulsory auto without two years of experience in voluntary auto insurance
- Non-EU companies are not permitted to write compulsory lines, including compulsory auto and state/municipal property insurance.

The US-Russia Bilateral WTO Accession Agreement permits foreign-owned P&C companies to write compulsory auto on a timetable dependent on percentage ownership as follows:

- under 51% on accession
- 51% plus within 5 years of accession.

Company Officers: The President and Chief Accountant must be Russian citizens.

The Financial Leaders Working Group, in late 2005, pointed out the following situation related to market access and national treatment commitments:

Russia imposes:

- Restriction on cross-border and consumption abroad of all types of insurance and reinsurance.
- Legal form discrimination for insurance and reinsurance.
- Restriction on licensing of "an association of underwriters".

Market Access in Mode 3

Russia imposes:

- Restrictions on foreign equity, and participation in joint ventures to 49%.
- A quota on foreign aggregate equity share in the Russian Federation insurance sector to a 15% maximum in life, non-life and reinsurance.
- State monopoly on compulsory lines.
- Legal form discrimination for insurance and reinsurance.
- Restriction on licensing of "an association of underwriters".

Market Access in Mode 4

Russia imposes:

A requirement that for an insurance company managing directors and finance directors be Russian citizens.

National Treatment in Mode 3

- There are discriminatory (higher) capital requirements for foreign insurers.
- Foreign insurers are excluded from writing life business.

Comparison with FLWG Best Practices in Insurance

D. Independent Regulatory Authority:

- There is an Independent Regulatory Authority, which accords with best practice.

4.6.7 DISTRIBUTION

The Axco report quoted above also gave a description of insurance distribution in Russia.

During the Soviet era insurance could only be bought from one of the 100,000 Gosstrakh tied agents, and as a result today the most important sales channel is still a network of branches and agents who call on the insured to sell policies - and to collect premiums in some cases - though the numbers are now about 40,000 agents and 2,500 branches. Rosgosstrakh also retains its network of salesmen and continues to sell simple savings policies, indeed its coverage of the whole Federation is unrivalled and will be difficult to match. Although other companies have avoided such personal lines the major insurers have been setting up networks of branches in the regions or buying up small local insurers. Specialist life policy salesmen are now being trained.

From 1 July 2007 insurance brokers have to be formally licensed. There are about 1,500 brokers, of which 1,200 are companies, and 70% are located in the Moscow region. The majority are only active in compulsory MTPL insurance. Some 5% are linked to insurers, and 10% are tied to certain clients. It is probably that only 100 are true brokers, and an evaluation might find only a few who are sufficiently competent.

4.6.8 SUPPORT PROFESSIONS

Accountancy: The international accounting standards of the IFRS began to be introduced in 2006, though the larger insurers have been audited by western accounting firms for some years. Indeed since 2002 insurers and reinsurers have had to account for premiums on a gross written accrual basis, rather than amounts received.

4.6.9 CONSUMER AWARENESS

There appears to be a long way to go to raise consumer awareness of the value of taking out insurance policies that provide benefits when needed, either through unforeseen situations or when the time comes to retire.

Issues for developing countries to consider for the development of their insurance sector and its liberalisation

Contributed by

Rebeca Herrera Diaz

Director International Affairs, FASECOLDA, Columbia

- Laws banning cross-border solicitation for insurance policies should be introduced to enable the regulators to protect policy holders: however it is not possible to control national citizens who purchase products while they are abroad.
 - Taxation incentives can stimulate the growth of life insurance and pension savings schemes. This can be significant after negotiations when some taxation measures have to be implemented to avoid double taxation and/or discriminatory treatment of services depending on place of purchase.
 - Opening reinsurance to foreign competition could stimulate domestic primary insurance by increasing capacity.
 - Micro-insurance can increase general awareness of the benefits of insurance
 - Non-banking agents should be supported as they can specialise in insurance products.
 - Federal and provincial levels of authorisation should be coordinated and aim at a single licence. This also applies for cross-border trade in a regional trade agreement setting.
 - Bilateral FTAs can stimulate regulatory improvements for the insurance sector.
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5 CONCLUSIONS and FUTURE TRENDS

5.1 Categories of barriers and constraints

This study has attempted to identify barriers and constraints to commercial operations affecting foreign suppliers of insurance services.¹³⁵ Two categories are used in the analysis:

- Legal measures specific to insurance services. These can prevent full access to the market in a jurisdiction, or prevent national treatment [see GATS Articles XVI *Market Access* and XVII *National Treatment*.] These can include not only Economic Needs Tests (prohibited under Article XVI), but also non-discriminatory measures coming under Article VI *Domestic Regulation* (paragraph 4), and the Annex on Financial Services, such as capital adequacy and solvency requirements and the imposition of many other standards.¹³⁶

A summary of the most egregious measures in the BCIMR, in the GATS context, is given in the Attachment to this chapter.

- Other measures. Such regulatory ‘hurdles’ can affect the commercial operations of insurers, without specifically prohibiting anything for them as insurers, but which nevertheless restrict them in some way or increase operating costs, or both. The ‘usual suspects’ can form a long list, and include:
 - Exchange controls on current transfers
 - Controls on outward capital investments or capital repatriation
 - Restrictions on the investments of insurers’ assets
 - Stock market controls and supervision
 - Anti-money laundering and terrorist financing laws
 - Unduly high interest rate levels (due to government ‘crowding out’)
 - Universal service obligation requirements, eg for rural areas
 - Tax regimes with differential incentives
 - Land ownership restrictions and zoning laws
 - Preferential requirements for ethnic groups
 - Competition policies, including their absence or poor enforcement
 - Artificially high costs of telecoms-based communications (by policy)
 - Preferential free trade agreements and their interaction
 - Protection of infant industries
 - Social security safety nets
 - State pension and health policies
 - Absence of bankruptcy laws
 - Absence of privacy and data security laws
 - Poor performance of the legal system
 - Absence of patent and copyright laws, or their enforcement, for business processes and products

Such constraints can also arise from the bureaucratic systems at federal, provincial and local levels that can duplicate or complicate the issue of approvals and licences, increase their cost, or delay their outcomes and thereafter increase compliance costs

¹³⁵ The Oxford English Dictionary defines a ‘barrier’, when used figuratively, as “a circumstance or obstacle that keeps people or things apart or prevents communication or progress”, and ‘constraint’ as “a limitation or restriction”. The present author, in the mid-70s, joined the ‘Constraints Committee’ of the Committee on Invisible Exports (later British Invisibles) in the City of London, which identified problems encountered by exporters of services, both in the UK and in markets abroad, explained those to the UK Department of Trade and Industry and advocated government action to remove or reduce such constraints.

¹³⁶ The lack of independence of financial services regulators and supervisors should be included here, some might argue.

comparatively. These can come under the general heading of poor governance too. Overlapping administrative action can leave firms awash with differing official objectives, agendas, procedures and timetables.

Future negotiations under the GATS on disciplines for domestic regulations will have to find ways to reduce the adverse effects of these regulatory hurdles on international trade in insurance services.

Beyond these measures there are 'soft' barriers to which commercial operators have to adjust, and these arise from cultural, religious, historical, political, social, economic and other dimensions of life. The market overview sub-section at the start of each country section in Chapter 4 attempted to highlight barriers of this ilk that could be relevant for commercial insurance operations

This report attempts to be descriptive and analytical, and therefore does not include a lobbyist's route map on how to obtain the removal or reduction of such hurdles. Practitioners and their trade associations will have to assess what type of public advocacy they need to pursue, in which fora, at what levels and how best to influence the myriad stakeholders.

As a footnote on barriers to internationalisation, these extracts from a recent OECD paper "How are services being internationalised?"¹³⁷ are notable:

"This analysis does not look explicitly at these barriers, but rather takes them as given. It rather looks at how internationalisation and trade goes on regardless of the existence or not of particular barriers (§ 18).

The internationalisation process is going on in almost all sectors, but mainly in services to business, in digitally deliverable services, or where there are clear economies of scale and a permitting regulatory environment. Distance, culture and language as well as regulatory obstacles are important brakes on the internationalisation process (§ 56).

.. wholesale distribution, freight transport, insurance and the services related to financing of trade have all become increasingly internationalised in themselves (§ 19).

The expansion of FDI also has stimulated the internationalisation of certain infrastructural support services (wholesale) financial services and business services including a variety of consultancy services .. (§ 20).

Financial deregulation measures have opened up national financial services markets to increased competition including from foreign retail financial services suppliers (§ 23).

Financial services (which includes banking and insurance) are particularly strong in outward FDI flows from the G7 (§ 28).

In the period 1999-2004 .. the trade that has been growing fastest is in the broad area of 'Other commercial services' and from OECD export evidence within that 'Computer and information services' (§ 33). [In the accompanying Chart 3, insurance is shown as having grown by 15% average annual change, second only to Computer and information.]

In general wholesale banking and insurance services tend to be inherently more international in nature than retail services (§ 42).

¹³⁷ Bill Cave, OECD, Paris, 1 September 2006 Ref: STD/NAES/TASS/SERV(2006)14

5.2 Globalisation as the context for international trade in insurance services¹³⁸

Globalisation is the process of integration across frontiers among liberalising market economies, stimulated by rapidly falling costs of transport and communications. However, the policies and capacities of states remain central to any understanding of how economic globalisation works.

In trade terms, as David Henderson, the former OECD Chief Economist, has put it, globalisation involves the free movement of goods, services, labour and capital, thereby creating a single market in inputs and outputs; and full national treatment for foreign investors (and nationals working abroad) so that economically speaking, there are no foreigners.

If a sophisticated market economy is to work, it has to solve five problems:

1. Information must flow smoothly, giving people confidence in what they are buying
2. It must be reasonable to assume people will live up to their promises, even if these promises are to be executed decades into the future
3. Competition must be fostered
4. Property rights must be protected: this is the necessary condition for a sophisticated market economy, indeed, it is the most important single condition.
5. The worst side effects on third parties must be curtailed.

Amartya Sen, the Nobel-laureate economist, has stated that a fundamental requirement for the protection of property is the impartial rule of law: “legal and judicial reform is important not only for legal development, but also for development in other spheres, such as economic development, political development, and so on, and these in turn are also constitutive parts of development as a whole.” The independence of the judiciary contributes to both the economic and political freedom of a country

Financial intermediation is a central feature of a modern market economy where four essential functions are performed: the mobilisation of savings; the allocation of capital; the monitoring of managers; and the transformation of risk, by pooling risks and distributing them to those best able to bear it. These are vital functions, and it is absolutely impossible to imagine a successful market economy without a dynamic, competitive and flexible financial system.

However, careful regulation is necessary because financial markets are marked by inherent difficulties of uncertainty, asymmetric information, adverse selection and inability of principals to control their agents.

Difficulties exist within any financial system, because of asymmetric information, problems in foretelling the future, self-fulfilling panics and herd behaviour. When funds are transferred across borders, these vulnerabilities become greater still.

A major constraint on development is the absence of markets for transactions that take a long time to reach fruition, whether for borrowing, lending, investing and insuring. In such transactions trust and confidence matter a great deal.

In emerging market economies, difficulties over the design of the exchange rate and monetary regimes interact with the fragility of financial arrangements, to create a host of obstacles to stable and sizeable capital flows.

¹³⁸ This Section is a digest of material taken from “Why globalisation works”, Martin Wolf, Yale Nota Bene, 2005.

Factors to consider for international trade in services include:

1. Ignorance of financial and economic conditions in foreign countries is greater than at home. This applies particularly to emerging-market economies.
2. Low confidence in the probity of the governments and legal systems of countries abroad.
3. Important elements of the legal and regulatory systems malfunction or do not exist.
4. Banking institutions often have comprehensive guarantees, while being used by governments or owners for their own purposes, which makes them fundamentally unsound.
5. Financial and accounting information is often lacking altogether, or is totally unreliable.
6. Foreigners may expect to be discriminated against during a financial crisis, especially when the state or well-connected domestic interests are insolvent.
7. The government may have a long history of financial profligacy and default and so a poor reputation.

Where there is cross-border lending in a currency other than the borrower's, which is normal in lending to emerging markets, there is the additional foreign currency risk.

The characteristics of the advanced liberal democracies have been remarkably rare features of human societies, both in history and today, and it is to these that the governments of the emerging markets will have to aspire. These characteristics are:

- Constitutional democracies, subject to the rule of law
- Respect for private property and the ability to make contracts
- Protection of the freedom of speech and inquiry
- Recognition of fundamental human rights
- Elected governments
- Independent honest judiciaries, rational bureaucracies and armies subject to civilian control.

5.3 Rapid change affects supervisors and company operations

Around the world, both the regulators and insurers are being impacted by the increasing pace of change.

N Rangachary, then Chairman of the Indian Insurance Regulatory and Development Authority, speaking to the PROGRES International Seminar in 2002, said:

“I believe we can all agree that the opening up of the insurance markets in the emerging economies, including India, offers exciting opportunities for insurance, banking and other organisations providing financial services to expand their lines of business and their range of customer services. These opportunities potentially could lead to rewarding organisational synergies. While benefits may be substantial, from a supervisory perspective there is a paramount need to continuously reassess the supervisory regime to ensure it remains applicable and appropriate with the changing dynamics of the financial market place.”

A little later in his presentation, regarding the private sector, he said:

“As a result of an increasingly competitive global environment, emerging technologies and business models, changing customer values, new regulatory developments and increasing shareholder expectations, companies have been forced to change more

rapidly than ever. The pace of change in business has led to higher levels of increasingly diverse risk exposure. Recognising the need to address these risks in a more comprehensive manner, some companies have begun to adopt a comprehensive view of risk management which has transformed the profession from one that historically viewed corporate risk exposures in isolation, to one that now seeks to measure, manage, and exploit risk within a consistent framework. Therefore the need to develop and disseminate knowledge relevant to the identification, measurement, evaluation, controls, and monitoring, of risks on an enterprise-wide basis is increasingly becoming important.”

The balance between regulatory constraints and commercial freedom may have to be drawn differently to take account of the particularities of each jurisdiction and market. Regulators in developing countries may lack resources and have to apply simpler, if more restrictive, rules, and the insurers may not have developed sophisticated risk management techniques, and consumers may lack enforceable rights and information.

This balance is changing all the time, but at a different pace which has to be sustainable in each country. As Henry Paulson, the US Secretary of the Treasury, is reported to have recently emphasised, there is “the need to find ‘regulatory balance’ that ensures the confidence of investors without imposing excessive costs or constraining growth.”¹³⁹

5.4 Regulatory convergence

The trend toward regulatory convergence is apparent across the world, including in the BCIMR. The Swiss Re report (cited in the China and India sections of Chapter 4) describes this trend in a section on solvency regulatory changes around the world.¹⁴⁰ They see a clear trend to align standards of insurance supervision to best practices, with regulators in emerging markets increasingly gravitating towards the standards promulgated by the IAIS and other supra-national bodies. Gradually controls over products and prices are being lifted and solvency control reinforced. This has already been seen in Mexico and Singapore, and looks likely in Malaysia and South Africa. They foresee that the enforcement of more stringent solvency standards will underpin the need for sound technical underwriting, foster confidence in insurance and possibly accelerate market consolidation.

Despite this trend, there are fundamentals to be observed, which the Swiss Re report also points out. Certain prerequisites have to be in place in order to realise the full potential growth of the major emerging markets. These include the roles of government and the supervisory authorities. Insurance depends upon a predictable environment, including economic stability, legal certainty, sound institutions and the enforcement of property rights – a framework that insurers can trust and within which their clients can feel confident to make claims.

Insurance supervision needs to be effective, which supports the reputation of insurers, and open competition will only arise if the market environment is attractive, and with it the provision of product variety and good service levels. In addition to appropriate privatisation, liberalisation and deregulation, the relaxation of investment rules is necessary to help insurers respond to market developments and in doing so make their offers more attractive.

Efforts by the authorities to realise the potential of insurance could include the approval of private pensions, health or workers’ compensation insurance and the introduction of compulsory lines of business, the latter fuelled by society’s increased willingness to protect

¹³⁹ Press release: “Leaders of Global Financial Services Firms set dialogue with International Regulators to secure far-reaching reforms”, IIF, New York, 13 December 2006.

¹⁴⁰ “Exploiting the growth potential of emerging insurance markets – China and India in the spotlight”, Swiss Re, Sigma No 5/2004, page 14.

consumers and potential victims. For example, third-party liability cover can guarantee that funds are available to compensate victims, and compulsory earthquake insurance helps to avoid adverse selection. Governments can also provide information on insurance by means of standard forms explaining social security benefits and possible gaps in protection, as well as tax incentives to employers for promoting group risk coverage and individual private retirement plans.

The biggest effort, says Swiss Re, has to come from the insurance industry itself. New clients have to be reached and new products sold. Insurers will have to listen to client needs, design products accordingly and explain them better. Innovation in distribution channels will be necessary, such as through bancassurance, department stores or the sale of insurance covers when cars are sold, so as to reach a wider section of the population. Cost efficiency will be crucial, especially related to low-priced products. For life insurance, transparency is the main challenge, demanding simple products backed by good information. Insurers will need to act professionally to improve the sector's reputation, and so convince customers that a serious claim will be paid out in a reasonable period.

In his paper: "Some Reflections on Financial Services Liberalisation"¹⁴¹ under a section headed "the spread of a broader and deeper financial services regulatory agenda, focussing on international standard-setting", John Cooke drew attention to regulatory trends:

"The last decade or more has the advent of new bodies such as the Financial Stability Forum, as well as dramatic extensions in the activities of the Basel Committee (including Basel II), IOSCO, the International Accounting Standards Board and the International Association of Insurance Supervisors, quite apart from regional initiatives in financial services regulation such as the EU's Financial Services Action Plan and its focus (for insurance) on Solvency II. All these, quite apart from absorbing the attention of regulators and supervisors, have implications for harmonisation and/or mutual recognition of regulatory regimes, with unpredictable effects on future regulatory approaches to market access and national treatment."

5.5 Are there any common market trends in the BCIMR?

Identifiable common trends internationally in the big, yet very disparate, emerging markets were described in the Swiss Re report which forms a good starting point. These identified trends include strong economic growth where increasing affluence will provide demand for new products, with new distribution channels tapping this potential; the supervisory authorities will realign local regulations to international best practices, particularly for solvency, corporate governance and transparency; liberalisation will reduce entry barriers and increase competition, with the regulators backing away from micro-management of business practices; and the gradual privatisation of state companies and consolidation in some fragmented markets will be accompanied by higher penetration of foreign players.

The huge economies of China and India and their population size, coupled with fast industrialisation and globalisation, should spell ample opportunities for the development of insurance.

¹⁴¹ Presented at the PROGRES International Seminar in Geneva on 31 March 2006. John Cooke is Chairman, Liberalisation of Trade in Services (LOTIS) Committee, International Financial Services, London

The population forecasts for China and India in comparison with Brazil, Mexico and Russia in 2015 (in millions) are:¹⁴²

China	1,390
India	1,232
Brazil	201
Russia	135
Mexico	121

The reasons for a spotlight on China and India were described as being fuelled in part by the fast expansion of their insurance markets now becoming open to foreign firms. They are the two most populous countries in the world, their 2.6 billion people forming over one-third of the global total. Their economies are respectively the 7th and 12th largest, adding up to 5.5% of the world's total. Both markets have achieved rapid economic growth over the last decade with China averaging almost 9% and India over 6% each year.

However, the Swiss Re Report also listed four key challenges to be resolved for the realisation of the huge potential of these two emerging markets:

1. Natural catastrophes and capacity
2. Furthering market reforms
3. Detariffication in the non-life market
4. Pension reform and the role of private suppliers

It was pointed out that China and India are prone to natural catastrophes. In the decade to 2003 they accounted for about a quarter of global losses from such events, and for over 30% of the fatalities. However, insurance compensation from the claims arising was under 1% of the global insurance losses during the period, which underlines the heavy under-insurance of their CAT risks.

A comparison between China and India was also made by Jeffrey Sachs in his book "The end of poverty" (on page 183):

While India had not yet matched China in the depth and breadth of economic modernisation, "China gives the aura of a unified, well-oiled reform engine, but under the surface are the powerful tensions of clashing ethnicities, regional inequalities, large-scale migration, and extensive corruption. In India, nothing is under the surface. The politics are exuberantly in the open."

¹⁴² Section 2.1 of "World Development Indicators", World Bank, New York, 2004.

The market share of foreign owned insurers in the BCIMR can be seen in the following Swiss Re table:

Market share of (≥50%) foreign-owned insurers			Market share of (≥50%) foreign-owned insurers		
	Life	Non-life		Life	Non-life
Asia			Eastern Europe		
South Korea	10%	1%	Russia	na	na
China ⁺	2%	1%	Poland	52%	41%
Taiwan	33%	12%	Czech Republic	81%	89%
India	0%	0%	Hungary	85%	89%
Hong Kong	87%	74%	Slovenia ⁺	17%	2%
Singapore ⁺	58%	53%	Slovakia	97%	96%
Malaysia ⁺	81%	25%	Africa		
Thailand ⁺	41%	7%	South Africa ⁺	0%	14%
Indonesia ⁺	48%	25%	Morocco	52%	28%
Philippines ⁺	61%	29%	Egypt	11%	10%
Vietnam	56%	6%	Middle East		
Latin America			Turkey	12%	27%
Brazil	32%	43%	Iran	0%	0%
Mexico	75%	58%	United Arab Emirates	na	na
Chile	62%	63%	Saudi Arabia	na	na
Argentina	53%	35%	Lebanon ⁺	≥64%	≥35%
Venezuela	39%	50%	Kuwait ⁺	14%	14%
Colombia	38%	46%			

Notes: The foreign market share is calculated from the total premium volume of companies with a foreign majority stake. Latest available figures are used, which typically refer to 2003 (+2002 data; *2001 data); in India and Iran, foreign insurers are not allowed to hold majority stakes .

Source: Swiss Re Economic Research & Consulting

From a commercial viewpoint demand for insurance products is bound to grow as the economies move up the ladder of income per head. As the report put it (on page 16): Healthy economic growth and increased stability will favour insurance market development. Whereas developed economies are expected to grow by an annual average of less than 3% over the next decade, Asia is expected to achieve around 6% and even other regions 4% average growth.

Market potential for insurance can be greatly influenced by such factors as:

- The extent and nature of the informal economy
- The extent and relative wealth of the middle class
- The extent of monopolies on the introduction of new life products
- The proportion of women in work (which may reflect cultural and religious practices and beliefs)

When making comparisons between countries by examination of insurance performance, insurers must check on differences in the application of accounting principles and rules that can greatly affect international comparability of such data.

In summary, emerging markets have maintained rapid growth for the past decade, so that their improving economic fundamentals and rising household wealth will put them in the frontier of insurance markets during the 21st Century. In order to realise their potential, they will have to overcome key challenges which include overhauling their insurance regulations, promoting market competition and raising public confidence in, and awareness of, the benefits of insurance products. Insurers in these markets will have to introduce and promote new products and channels of distribution, whilst maintaining high professional standards.

In particular, China and India will have to tackle the following key issues:

- Insurers must be equipped with the technical and financial capabilities to deal with natural catastrophic risks to which both markets are exposed, requiring sophisticated risk management as insurance penetration deepens
- As price controls are lifted a new era of competitive pricing and rising volatility will have to be managed
- Private insurers will become admitted to the social security field
- Health and agricultural insurances will experience major developments.

5.6 Trends in the distribution of insurance products

When foreign insurers enter the BCIMR markets they can face a huge hurdle for the distribution of their products. Market liberalisation exposes incumbent companies to increased competitive pressure, as foreign firms have better underwriting skills, product knowledge and financial ratings, however they lack local experience and this is usually obtained by forming joint ventures. Local firms are usually in control of vast and well-established distribution networks and still derive benefit from former or partial state ownership. In both China and India foreign firms are using bancassurance to match the competitive advantage of the local firms, this being introduced in China as recently as 2001.

Bancassurance is attractive for new entrants as it bypasses the time consuming process of building up an agency force, while regulations on bancassurance are being relaxed and banks are receptive and open to the acquisition of a sales culture.

This report then describes some key characteristics of bancassurance:

Some observations on the practice of bancassurance in China and India:

- In both markets, bancassurance works mainly through pure distribution agreements or joint ventures. While this has allowed bancassurance to rapidly take off in these markets, it also limits the ability of banks and insurers to maximise synergies and cost savings. There are no signs of further integration of banking and insurance business, partly due to regulatory restrictions.
- Most products are yield-driven, close substitutes to deposit products, which renders sales vulnerable to fluctuations along spreads. Sales are predominated by life insurance products.
- Commissions required by banks are reportedly high.
- The ability of bank staff to sell complex insurance products is still very limited. This has thwarted, for example, desires of some life insurers in China to refocus on sales of traditional protection-type products while remaining reliant on bank branches as the main point of contact with clients.
- In both markets, there are insurers which specifically take on bancassurance as their primary distribution channel.

The need for large networks to widen distribution may involve the inclusion of post offices as well.

The report on the workshop on “Trade and Development Aspects of Insurance Services and Regulatory Frameworks” at UNCTAD held on 25 November 2005¹⁴³ recorded that in developing countries the distribution networks for insurance services are not as well developed as those for banking services, and are more difficult to manage. Therefore insurers are forging links with banks to distribute insurance products. This gives rise to questions about the nature of regulation across the financial services sector.

Foreign firms have also trained local financial advisors and introduced new products.

5.7 Will BCIMR nationally-owned insurers enter foreign markets?

A recent report on outward FDI made this forecast:

“Contrary to the experience of recent years and to widespread expectations about continued strong growth in emerging markets, the bulk of the increase in global FDI in 2006-10 is expected to take place in the developed countries.”¹⁴⁴

It is not clear in this report whether insurance will follow the expected overall trend, or increase above the mean rate, and in particular as part of the BCIMR outward FDI. The report does state that the globalisation trends already noted will include a further development in the increasingly two-way flow of investment. The share of the BCIMR in world outward investment will grow, and a recent study gives a first picture of this trend,¹⁴⁵ though existing data are not yet disaggregated sufficiently to show in each case the amounts being invested in the insurance sector.

Although all countries are affected by the general integration process, the investment report focuses on Brazil, China, India and Russia, the economies of which are seen as particularly important and promising and whose rise will transform the world economy. They have participated in this integration primarily through inward FDI whereby foreign firms make direct investments, creating China as the workshop of the world and India its back office. However, of greater interest, is that all four economies are now sources of outward FDI. Their firms are undertaking direct investment abroad, both in developed economies and in emerging markets, although this trend has been uneven, with some takeovers being of high profile, and some being strongly resisted. These outward looking firms desire to increase their competitiveness by acquiring portfolios of locational assets.

The governments of some emerging markets are adapting to the increasing liberalisation of international economic transactions, so as to ensure the competitiveness of their national firms. This puts restrictions on outward FDI in a new light, as any such limitations can hinder the ability of national firms to develop a portfolio of locational assets as a source of corporate competitiveness. Some governments have even promoted such investments, where balance-of-payments conditions permit, and this has tended to deepen their integration into the global economy. The investment report continues its analysis as follows:¹⁴⁶

¹⁴³ Document: UNCTAD/DITC/TNCD/2006/1, 19 April 2006

¹⁴⁴ “Special Edition, World Investment Prospects”, EIU/CPPII, 2006 (on www.cpii.columbia.edu).

¹⁴⁵ “New sources of FDI: the BRICS – outward FDI from Brazil, Russia, India and China”, Karl P Sauvart, The Journal of World Investment and Trade, 2006.

¹⁴⁶ ODFI = outward foreign direct investment. The footnote in the extract below is not shown here.

Although there are quite a number of TNCs (including small and medium-sized ones) headquartered in the BRICs, few of them are truly global players compared with those from developed countries and few command world industry leadership, possess global brand names, have world-class management skills and superior business models. Rather, many grapple with the issues that corporate transnationalization entails, ranging from various managerial and organizational matters to issues related to operating in often little-known and risky foreign markets. Also, many BRIC firms (including small and medium-sized enterprises) that face global competition at home have not yet made the step to transnationalize; however, if the experience of firms from other countries is a guide, they too will need to consider this step.

However, some developing country governments may face a special dilemma in this respect: as developing countries, they see themselves as capital-importing, not capital-exporting countries; at the same time, they have firms that are already internationally competitive and need to strengthen their competitiveness further through OFDI. In most cases, the solution to this dilemma may lie in a careful sequencing of policy reforms and the putting into place of various instruments – ranging from the liberalization of OFDI flows to the offering of support to outward investors and the establishment of a dedicated institution to help firms go abroad – in a phased manner.

5.8 Business and politics

An article in the Financial Times Special Report on China (12 December 2006) by Victor Mallet “China and India – the two differ in business as much as they do in politics”, alerts us to the causes of differences between the BCIMR countries. The following are direct, but not complete, quotations from this article.

The excitement among investors over the prospects of the ‘Brics’ – the big emerging markets of Brazil, Russia, India and China – has begun to metamorphose into a more realistic enthusiasm for ‘Chindia’. China and India, after all, are by the far the largest and fastest growing. Both economies are growing exceptionally fast, and both are increasingly dependent on imports of energy and raw materials.

The Indian economy [] is starting to become more like China’s. [] Now its savings rate is approaching 30 per cent, and exports are rising as a share of gross domestic product.

Yet some of the differences between the two are so vast that they undermine any attempt at a common analysis. China is a Communist dictatorship, while India is the world’s largest democracy. China’s population growth will stop in the next two decades, while India will have to find jobs for hundreds of millions of young job seekers as the number of its inhabitants exceeds China’s and heads towards 1.6bn.

Chinese leaders typically hand down orders for economic reform from the top, organise the rapid building of infrastructure and cater for the urbanisation that comes with economic growth. Indian governments generally resist reform, prevaricate over investing in infrastructure and – sentimental as they are about a non-existent ideal of rural Indian life – refuse to cater for the tens of millions of rural migrants flooding into the cities.

Indian financial markets are lively and robust (though not immune to bubbles), whereas Chinese markets are small and highly constrained by the limitations of the country’s private sector and tight government controls.

India's leading private companies have carved out niches in sectors such as information technology, pharmaceuticals and financial back-office outsourcing that would normally find a place in a much more advanced economy. And they have reacted to onerous labour regulations by developing capital-intensive businesses that would not normally exist in a country with low-cost, surplus labour. As a result a cohort of the best Indian companies boasts an international competitiveness that allows them to make outward investments in developed economies.

In China – although outsiders imagine a rampant capitalist sector thriving under the benign guidance of a nominally Communist government – domestic private companies remain constrained by the need to work with powerful provincial governments and the state-owned enterprises that dominate all the key sectors of the economy. Asked why the private sector could not be unleashed for the benefit of all, the economist replied: "It would be good for the economy, but not for the party."

India, they say, will be hamstrung by populism, a reluctance to open its economy and infrastructure bottlenecks. China's growth will be stunted by its dependence on the US and other uncertain foreign markets (one of the disadvantages of openness) and by the Communist Party's refusal to allow the rise of a real free-market economy.

Foreign insurers will have to take into account these differences when assessing growth potential and the mix of products, and other similar or disparate features and issues will have to be isolated in their take on the market potential of the relatively smaller markets of Brazil, Mexico and Russia.

"Dozens of recent statistical studies have shown that differences in economic growth rates across countries depends on a multiplicity of factors: initial incomes, education levels, fertility rates, climate, trade policy, disease, proximity to markets, and the quality of economic institutions, just to name a few of the relevant variables. The real challenge is to understand which of these many variables is posing particular obstacles in specific circumstances – what I mean precisely by 'differential diagnosis'."¹⁴⁷

"Economists from Adam Smith onwards have recognised that competition and struggle are but one side of economic life, and that trust, cooperation, and collective action in the provision of public goods are the obverse side. [] All successful economies are mixed economies, relying on both the public sector and the private sector for economic development. [] There is broad consensus on the case for public goods at the national level, even if there are heated debates on exactly where to draw the line between public and private activities. [] The same arguments that have prevailed at the national level – making the case for a mixed economy – will sooner or later, and hopefully sooner, prevail in international relations as well."

"The serpent in the life of the paradise of internationalisation is, according to J M Keynes: 'The projects and politics of militarism and imperialism, of racial and cultural rivalries, of monopolies, restrictions, and exclusion ...'¹⁴⁸

The CIA State Failure Task Force in 1994 "defines state failure as a case of revolutionary war, ethnic war, genocide, politicide, or adverse or disruptive regime change. [] Throughout history [failed states] have been seedbeds of violence, terrorism, international criminality, mass migration, refugee movements, drug trafficking, and disease."

¹⁴⁷ "The end of poverty", Jeffrey Sachs, (page 322) – the next paragraph is from page 327.

¹⁴⁸ Jeffrey Sachs (page 45) – the next paragraph is from page 332.

5.9 Industry-Regulator Dialogue

Dr. Josef Ackermann, Chairman of the Board of Directors of the Institute of International Finance (IIF) and Chairman of the Group Executive Committee of Deutsche Bank AG, stated recently that:

"We are now moving forward with a long-term, far-reaching dialogue between financial services firms and their regulators with the aim of developing more effective and efficient approaches to regulation. The principles that we are announcing today are designed to achieve a better overall international regulatory process on a sustained basis, as well as address specific issues of mutual concern to both the industry and the regulators."¹⁴⁹

Further extracts from this press release are as follows:

This is the first time that the global financial industry has developed and put forward a set of guiding principles to frame our relations with the regulators and to place them on a more consistent footing across the globe.

Our work on application of the principles will stress three areas of particular importance - global coordination of regulatory policies; enforcement practices; and, anti-money laundering issues.

The principles in our proposal are based on a survey of IIF member firms as well as informal meetings with many regulators. The survey shows that there is concern about the growing complexity of regulations and areas where regulation requires a large amount of resources relative to the apparent results achieved. Approaches which involve inefficiencies and inconsistencies may undermine critical regulatory objectives with regard to the safety, soundness and competitiveness of financial services institutions, and the delivery of services to customers.

As we look to the strategic dialogue that we are pursuing we are encouraged, for example, that the [authorities] should emphasize the need to find 'regulatory balance' that inspires the confidence of investors without imposing excessive costs or constraining growth.

Commenting on the origins of this initiative, IIF Managing Director Charles Dallara noted, "The need for a strategic approach to effective and efficient regulation reflects the recognition that there is an increasing contrast between the globalization of financial markets on the one hand while on the other hand regulation remains rooted in national policies. We are living in a period of exceptionally rapid innovation in the markets and in the industry. The tempo of change has placed pressures on regulators as well as firms to adapt to the new realities of globalised financial markets. We believe this dialogue can facilitate the process of adaptation by both regulators and firms."

¹⁴⁹ "Leaders of Global Financial Services Firms Set Dialogue with International Regulators to Secure Far-Reaching Reforms", Press release, IIF, New York, 13 December 2006.

5.10 Development and poverty

The current WTO trade negotiations are called the Doha Development Agenda, and also should be seen in the context of the UN Millennium Development Goals.

However, trade can only be one means for the relief of poverty, and may only help to lift parts of society out of poverty given improvements in other basic factors.

In their book "Fair Trade for All – how can trade promote development" the authors J E Stiglitz and A Charlton (OUP, 2005) wrote:

"Developing countries certainly do not have perfect markets. Many of their markets are missing or incomplete, particularly markets for insurance and credit. Public goods are undersupplied, coordination failures are rife, and the social benefits of entrepreneurship are larger than the expected private returns. The adjustment costs associated with liberalisation would be large and exacerbated by high unemployment and weak social safety nets." "For many of them, the issue is largely about which steps towards liberalisation make sense, and pacing and sequencing: what should be done before they liberalise, and how fast the liberalisation agenda should be pushed." (page 39)

"Another important assumption made in most of the analyses is that there is no uncertainty, no risk. But changes in trade regimes affect countries' exposure to risk. In the absence of good insurance markets, there can be first-order welfare effects arising from this increased exposure to risk." (page 70)

"The fact that implementation and adjustment costs are likely to be larger in developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poorer are all features of developing countries that have to be taken into account in conducting relative incidence analysis." (page 71)

"But as we noted earlier, these general equilibrium models need to be used with caution. They typically do not incorporate a host of market imperfections that characterise developing countries, and they almost never incorporate dynamic changes (eg those associated with the adoption of new technologies)." (page 196)

The UN adviser on poverty relief and the Millennium Development Goals, described this context as follows under the heading of 'Clinical economics':

"First, economies, like individuals, are complex systems. Like circulatory, respiratory, and other systems of a human being, societies have distinct systems for transport, power, communications, law enforcement, national defence, taxation, and other systems that must operate properly for the entire economy to function appropriately. As with a human being, the failure of one system can lead to cascades of failure in other parts of the economy."¹⁵⁰

It must be hoped that insurance services can add their weight to economic growth and so avoid the possibility in many developing countries of stagnation or decline, which can be caused, Sachs affirms, through eight major categories:

1. Poverty trap
2. Demographic trap

¹⁵⁰ Jeffrey Sachs, page 79.

3. Physical geography
4. Fiscal framework and fiscal trap
5. Governance patterns and failure
6. Cultural barriers
7. Geopolitics
8. Lack of innovation

Prognostications on the future evolutionary path of the BCIMR countries must bear in mind these dimensions. How quickly can China and India, the two low income countries in the group, achieve middle income levels, and how surely can Brazil, Mexico and Russia, the middle income countries, consolidate their position?

5.11 The background to insurance market trends¹⁵¹

The balance between economics and society is the central issue as capitalism undergoes a major mutation with the global rise of financiers and financial speculators taking advantage of market, capital and currency exchange liberalisation, and made possible by technological advances in telecoms and computing. This is creating great regulatory, social and political challenges.

Financial assets have soared from 109% of annual world output in 1980 to 316% in 2005, at \$ 140,000 billion – in the Eurozone the figure was 303% and in the US 405%. Capital markets perform more of the traditional bank intermediation functions, and the banks turn towards investment banking. Added to traditional bonds, equities, commodities and foreign exchange instruments are derivatives (options, futures and swaps eg on interest and currencies) transforming the ability to manage risk and now reaching six times global product at \$ 286,000 billion by end 2006. The new players are the hedge funds and private equity funds that act as arbitrageurs (with \$ 1,600 billion and \$ 432 billion respectively). The largest banks now act globally alongside these funds.

More of the assets and liabilities of the residents of the developed economies are international: up from 50% of GDP in 1970 to 330% in 2004.

Computing power enables the pricing and modelling and risk assessment for 24 hour trading around the world, against a background of central bank induced stability and relatively low interest rates and greatly increased official liquid assets.

Household debt has increased¹⁵² as has the value of global mergers and acquisitions (\$3,861 billion in 2006) and with this the control of shareholders over managers, and short-termism over long-term producers, greatly reducing traditional cross-holdings in Germany and Japan. These trends have consolidated the dominance of the New York and London financial centres and the rise of Hong Kong for Asia.

The open question is whether huge risks have been built up that are unidentified and uncontrolled, a concern of the Financial Stability Forum, while trades unions and citizens feel threatened by inhuman profit-seeking goliaths, and appalled at the grotesquely huge salaries and bonuses of a small band of financiers.

¹⁵¹ This section consists of a digest of some issues abstracted from "The new capitalism – how unfettered finance is fast reshaping the global economy", Martin Wolf, Financial Times, 19 June 2007.

¹⁵² In the US this is now at 135% of GDP.

Known Unknowns: risks and the recent volatility in the financial markets

The basic principle of pooling risks that underlies true insurance cannot be correctly ascribed to the 2007 summer gyrations in the investment, liquidity, capital, bank lending and stock markets even though certain risks were widely spread. True insurance involves calculation of risks and strict adherence to regulatory parameters to protect the premiums of consumers entrusted to the insurers.

The so-called sub-prime mortgage lending defaults arose from transactions where the risks were not properly calculated, if at all, and that were not properly regulated, if at all. The next step, which involved the passing on of these risks in securitised form, often with other elements bundled in, to give higher levels by rating agencies, exposed many purchasers to risks they were unaware of, both as to their nature and extent. Once it was realised that the amounts and spread of these risks was unknown, trust broke down and decisions on lending were put on hold, causing a general seizing up of the financial markets.

Increased collateral called for from leveraged funds and for bank loans triggered fire sales of portfolio holdings in falling stock markets, typical of cyclical volatile herd behaviour patterns.

Although some of the securitised instruments might have incorporated normal insured risks, it was the uninsured and unregulated risks that caused both the specific and the more general damage.

5.12 Concluding observations on future trends

The scale of the global insurance sector is likely to grow dramatically being given new impetus by the major potential markets of the BCIMR, perhaps achieving 5% cumulative annual rates in real terms as has historically been the case in western economies since the 1950s.¹⁵³ In 2005 worldwide insurance premiums totalled US\$ 3,426 billion, of which life insurance accounted for US\$ 1,452 billion or 42%. In developed economies the average expenditure on insurance premiums per head is already US\$ 3,300, and insurance premiums in relation to GDP can achieve up to more than 12%, resulting in the assets of insurers amounting to a range of between 40% and 97% of GDP.

Both businesses and governments will become more aware of the benefits of insurance not just for mandatory cover for third-party liability, pensions and long-term care, but also for the economy in general. The following aspects will continue as trends into the future. The sector is a major employer providing high-skilled and quality jobs, with good working conditions, and generates significant indirect work for agents, brokers, and other intermediaries and service companies such as in the IT, transport, accounting and consultancy sectors. Some of the huge financial assets are held over the long term, even across generations, and provide stability to market capitalisation and also act as a buffer when sudden surges in financial needs arise from natural disasters. In this way the sector is more stable systemically than the banking sector that potentially can suffer from a run on liquidity, threatening weaker banks with bankruptcy.

Furthermore, insurance increases the savings rate, creates deeper markets and decreases the level of unnecessary precautionary savings, thus helping to provide more available working capital. From the individual angle, insurance induces self-reliance and thus independence to entrepreneurs causing people to act more positively, given that insurers take appropriate steps to prevent moral hazard to prevent their customers adopting greater risk-prone behaviour.

In addition to the financial dimension, insurers act as information providers, for knowledge, education and training on complex products. They deploy experts in risk analysis and management and risk prevention or mitigation. These attributes can assist speedier reconstruction after catastrophes and stimulate reservoirs of support activities which step in straightaway following such disasters.

These skills will become increasingly valuable as nations attempt to cooperate in the face of growing global challenges posed by climate change, energy constraints, terrorism and fraudulent activities. These are positive externalities, in addition to mutual basic risk sharing and financial crisis-smoothing functions that the governments of developing countries should recognise and promote in the cause of sustainable development and the relief of poverty.

¹⁵³ This concluding section draws principally on an article by Patrick Liedtke, Secretary General and Managing Director, The Geneva Association: "What's Insurance to a Modern Economy?", Geneva Papers, Vol. 32 No. 2, April 2007, Palgrave Macmillan Ltd.

**ATTACHMENT to Chapter 5: GATS SPECIFIC COMMITMENTS of the
BCIMR countries**

Summary of key government restrictions to international trade in insurance services

BRAZIL

Horizontal measures

Mode 3: limitations on types of legal entity

Mode 4: restrictions on types of foreign workers and their proportion in firms

Foreign exchange controls on profit remittances and capital repatriation

Sectoral measures

Monopoly on reinsurance, and mandatory retrocession

Modes 1 and 2: Prohibition on cross-border trade

Restrictions on MAT insurance

Prohibition on broker and agency services

CHINA

Horizontal measures

Entry ban for contractual services suppliers for services auxiliary to insurance

Sectoral measures

Prohibition on broker services

Prohibition on associations of underwriters

Prohibition on statutory insurance

Discrimination on capitalisation, investments and use of foreign exchange funds

Mode 3: Lengthy approval processes for branching

INDIA

Horizontal measures

Mode 4: restriction on coverage for affiliated companies

Restriction on repatriation of earnings

Permission not granted for nationals to remit funds abroad for insurance covers

Sectoral measures

Unspecified entry requirements and terms and conditions

Prohibition on life insurance by foreign suppliers

Modes 1 and 2: Prohibition on MAT

Mode 3: Establishment on basis of reciprocity

Mode 3: Equity cap of 26% on foreign ownership

Mode 3: Prohibition on insurance intermediaries

Monopoly on reinsurance in non-life

Prohibition on associations of underwriters

Restrictions on foreign equity ownership

Equity cap on brokerage companies

MEXICO

Horizontal measures

Requirement for foreign investment to be in locally quoted neutral shares
Entry ban for contractual services suppliers for services auxiliary to insurance

Sectoral measures

Modes 1 and 2: Prohibition of supply
Mode 3: Equity cap of 20% on any individual foreign holding
Mode 3: Prohibition on branching
Discrimination on mandatory reinsurance cessions
Prohibition on obtaining cover abroad

RUSSIA

[Note: specific commitments upon accession to the WTO not yet made public]

Horizontal measures

Mode 3: Tax loopholes detrimental to insurance market development
Mode 4: Managing directors and finance directors must be resident

Sectoral measures

Prohibition on foreign insurers writing life business
[and life insurers may not offer non-life covers]
Modes 1 and 2: supply limited
Mode 3: JV participation capped at 49% for life, mandatory insurance and State procurement
Mode 3: Foreign equity capped at 25% of total investment in insurance sector
Mode 3: Branches are prohibited

ANNEX 1: BCIMR GATS SPECIFIC COMMITMENTS AND OFFERS**BRAZIL: GATS SPECIFIC COMMITMENTS****Official language**

The schedule of specific commitments of Brazil states that "This is authentic in English only." and its wording is given below unaltered.¹⁵⁴

Horizontal Commitments

The horizontal commitments relate to "All sectors included in this schedule" and are inscribed under the following headings and GATS modes of supply:

Movement of Natural Persons (Mode 4)
Investment (Mode 3)
Commercial Presence (Mode 3) and
Subsidies (all four modes)

as shown below.

Movement of Natural Persons (Mode 4): Limitations on market access

"Unbound, except for measures related to specialized technicians, highly qualified professionals, managers and directors.

"Foreign specialized technicians and highly qualified professionals may work under a temporary contract with legal entities, whether of national or foreign capital, established in Brazil. The pertinent contract must be approved by the Ministry of Labour. Approval of contracts of specialized technicians and highly qualified professionals takes into account the compatibility of their qualifications with the area business in which the company is engaged. The company must justify the need to contract such professionals and technicians in relation to similar professionals and technicians available in Brazil.

"Juridical persons must obey the proportionality of at least two Brazilians for three employees when engaged in the following activities: communications; land transportation; commercial stores in general; commercial offices; **insurance**; advertising; hotels and restaurants. [Emphasis added]

"Managers and Directors appointed to affiliates of foreign companies established in Brazil will be granted access under the following conditions: designation to a position with full decision-making power; vacancy of such position; existence of associate link between the service provider in the Brazilian territory and its headquarters abroad; proof by the service provider in Brazil that the Manager or Director is performing his duties after receiving the visa. Appointment of such Managers or Directors must be related to the provision of new technology, increase in productivity or the foreign company must have invested a minimum amount of US\$ 200,000.00 (amount may be adjusted in the future to a corresponding US\$ value of 1993) in Brazil.

"All other requirements, laws and regulations regarding entry, stay and work shall continue to apply."

¹⁵⁴ WTO document GATS/SC/13, 15 April 1994.

EC Request:**Specialised technicians and highly qualified professionals**

“Approval by the Ministry of Labour required and company concerned must justify necessity of transfer. **EC Request:** Eliminate for technical specialists and all highly qualified professionals transferring as intra-corporate transferees or entering as business visitors.”

Managers and Directors

“For managers and directors transferring as intra-corporate transferees, the transfer must be linked to the ‘provision of new technology, increase of productivity’ or a minimum investment in Brazil. **EC Request:** Eliminate.”

Intra-corporate transferees

“Confirm our understanding that labour market testing is not applied to ‘managers’ or ‘directors’.

The **EC requests** that a commitment be made to allow as intra-corporate transferees without requiring an economic needs test ‘persons with a university degree or equivalent technical qualification who are transferring for career development purposes or to obtain training in business techniques or methods’. The maximum prior employment requirement should be one year.”

Business Visitors

“A Business Visitor is a representative of a foreign service supplier who is seeking temporary entry into your country for one of the following purposes: (a) to hold meetings and/or to negotiate the sale of services; (b) to conclude contracts to sell services; or (c) to set up a Mode 3 presence. A Business Visitor does not himself directly provide services or sell to the public.

“The EC considers that Brazil’s horizontal Mode 4 commitments cover Business Visitors who are ‘managers’, ‘directors’, ‘specialised technicians’ or ‘highly qualified professionals’. **EC Request:**

- Please confirm this understanding
- For Type (a) and (b) Business Visitors extend the commitments to all such Business Visitors. The maximum length of stay should be at least 90 days in any 12 month period.
- For other Business Visitors, clarify whether there are any limitations on the length of stay.”

Other

“The EC considers that Brazil’s commitments cover the provision of services under contract where the service supplier has no commercial presence in Brazil and where that service is provided by ‘managers’, ‘directors’, ‘specialised technicians’ and/or ‘highly qualified professionals’. **EC Request:**

- Please confirm this understanding and clarify whether there are any limitations on the length of stay.”

“In certain sectors, at least 2/3 of workforce must be Brazilian.” **EC Request:** “Eliminate this requirement in relation to intra-corporate transfers of the categories covered by Brazil’s commitments (i.e. technical specialists, highly qualified professionals, managers and directors), as well as where the service supplier has no commercial presence in Brazil.”

“It is not clear what is meant by the terms ‘technical specialists’, ‘highly qualified professionals’, ‘managers’ and ‘directors’.” “Define these terms.”

Additional commitments

“Difficulties are experienced as a result of the length of time taken to process work and residence permits as well as with the notarisation of documents. The EC wishes to discuss the possibility of taking additional commitments to address this issue.”

Movement of Natural Persons (Mode 4): Limitations on national treatment

“Unbound, except as indicated in the market access column”.

Investment (Mode 3): Limitations on market access

“In accordance with laws and regulations governing foreign investment, all foreign capital invested in Brazil must be registered with the Central Bank of Brazil to be eligible for remittances. The Central Bank establishes procedures related to remittances and transfer of funds abroad.”

EC Request: “Clarification of the horizontal commitment is requested. If the term ‘procedures’ comprises any kind of restriction, it should be eliminated on grounds that it was not scheduled.” [!!]

Investment (Mode 3): Limitations on national treatment

“None”.

Commercial Presence (Mode 3): Limitations on market access

“Foreign service suppliers wishing to supply a service as a juridical person must be organized as a legal entity foreseen by the Brazilian law. The Brazilian law establishes for juridical persons a separate existence from the person of its holders, thus granting the juridical person with individual existence. Consequently, a juridical person has full title and responsibility for its patrimonial rights and obligations. An entity earns the conditions of private law juridical person when the correspondent incorporation act (By-Laws and/or Articles of Association) is duly filed with the appropriate Entities’ Public Registry (EPR).”

“It is mandatory that the EPR records contain the following data on the juridical person:

- i) its denomination, purpose and location of head offices;
- ii) the description of its management, including active and passive, judicial and extra-judicial representation;
- iii) the process of amendment of the management provisions;
- iv) the provisions regarding the liability of the officers for its acts; and
- v) the provisions concerning its termination, including the destination of its assets.

“The juridical persons referred as ‘sole proprietorship’ and ‘partnership’ in Article XXVIII, item (l) of the General Agreement on Trade in Services are not considered as such under Brazilian law.”

“A joint venture may be accomplished by a capital association through the formation of any type of business organization as set forth in the Brazilian law (usually a Private Limited Liability Company – *Limitada* – or a Corporation – *Sociedade Anônima*). A joint venture may also be carried out through a *consórcio*, which is neither a juridical person nor a form of capital association. A *consórcio* is used mainly with major contracts for rendering of services. It is a contract of two or more enterprises for a joint accomplishment of one specific undertaking. Each associate in a *consórcio* maintain its respective organizational structure.”

EC Request: “The reference included in Article XXVIII is non-exhaustive ... and the elimination of sole-proprietorship and partnership does not clarify if Brazilian law limits the possibility of establishing juridical persons or if similar forms of commercial presence appear under Brazilian law under different statutes/ denominations. Eliminate this restriction.”

Commercial Presence (Mode 3) : Limitations on national treatment

“None”.

Subsidies (Modes 1, 2, 3, 4): Limitations on market access

“Unbound”.

EC Request: “Undertake commitments with regard to subsidisation of the private sector.”

Subsidies (Modes 1, 2, 3, 4) : Limitations on national treatment

“Unbound for subsidies for Research and Development”.

EC Request: “Clarify the applicability and scope of the regime.”

There are no ‘**Additional Commitments**’ in the horizontal part of the schedule.

“7 FINANCIAL SERVICES”¹⁵⁵

GATS Article II Exemptions

None of the listed MFN Exemptions relate to the insurance sector.

EC Request: “General”

“Brazil has not yet accepted the Fifth protocol. **Request:** Ratify.”

“Undertake commitments in accordance with the Understanding on Commitments in Financial Services.”

“A All insurance and insurance-related services”

- Life insurance
- Insurance on freight
- Property insurance
- Medical care insurance
- Liability insurance
- Body, machinery and civil liability insurance for vessels” [Body = hull? – JA]

¹⁵⁵ WTO document GATS/SC/13/Suppl.3, 26 February 1998.

Mode 1: Limitations on Market Access

“Unbound except for:

- insurance on freight: none.

However, commercial presence is required for contracts on, and any liability arising from, imported goods.

- body, machinery and civil liability insurance may be authorized for vessels registered in the Brazilian Special Registry (REB), depending on internal supply conditions.”

EC Request: [referring to MAT insurance] “Take full commitments in accordance with the Understanding.”

Mode 1: Limitations on National Treatment

“None for:

- insurance on freight, except for contracts, on and any liability arising from, imported goods;
- body, machinery and civil liability insurance may be authorized for vessels registered in the Brazilian Special Registry (REB)

Unbound for other services.”

EC Request: [referring to MAT insurance] “Take full commitments in accordance with the Understanding.”

Mode 2: Limitations on Market Access

“Unbound.”

EC Request: [referring to MAT insurance] “Take full commitments in accordance with the Understanding.”

Mode 2: Limitations on National Treatment

“Unbound.”

EC Request: [referring to MAT insurance] “Take full commitments in accordance with the Understanding.”

Mode 3: Limitations on Market Access

“Incorporation under Brazilian law, in the form of a ‘*sociedade anônima*’, and the enactment of a Presidential decree, are required.”

EC Request: “Allow direct branching.”

[in the case of life and non-life insurance, referring to the “requirement of enactment of a Presidential decree for the establishment of a commercial presence (i.e. case-by-case authorisation by the Executive Branch] “Eliminate this requirement.”

Mode 3: Limitations on National Treatment

“None.”

EC Request: “Allow direct branching.”

Mode 4: Limitations on market access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section.”

- **Work accident insurance.**

Mode 1: Limitations on Market Access

“Unbound.”

Mode 1: Limitations on National Treatment

“Unbound.”

Mode 2: Limitations on Market Access

“Unbound.”

Mode 2: Limitations on National Treatment

“Unbound.”

Mode 3: Limitations on Market Access

“The National Social Security Institute (INSS) is the sole authorized supplier.”

Mode 3: Limitations on National Treatment

“Unbound.”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound.”

Additional commitments

“Brazil will undertake commitments regarding commercial presence in the work accident insurance market within two years after the adoption by the National Congress of legislation regulating such presence.”

- **Reinsurance and retrocession.**

Mode 1: Limitations on Market Access

“Unbound.”

EC Request: “Take full commitments.”

Mode 1: Limitations on National Treatment

“Unbound.”

EC Request: “Take full commitments.”

Mode 2: Limitations on Market Access

“Unbound.”

EC Request: “Take full commitments.”

Mode 2: Limitations on National Treatment

“Unbound.”

EC Request: “Take full commitments.”

Mode 3: Limitations on Market Access

“Future regulations will permit supply by private institutions. Meanwhile, it is of the exclusive competence of the Brazilian reinsurance institution (IRB – Brasil Resseguros S.A.) to accept mandatory or facultative reinsurance, in Brazil or abroad, as well as to distribute reinsurance it does not retain.”

EC Request: [referring to the State monopoly on reinsurance and retrocession services] “Open to competition and undertake full commitments for reinsurance and retrocession services.”

Mode 3: Limitations on National Treatment

“Unbound.”

EC Request: “Allow direct branching”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound.”

Additional commitments

“Brazil will undertake commitments regarding commercial presence in the reinsurance and retrocession markets in less than two years after the adoption by the National Congress of legislation regulating such presence.”

- Auxiliary services – agencies and brokers

Mode 1: Limitations on Market Access

“Unbound.”

Mode 1: Limitations on National Treatment

“Unbound.”

EC Request: “Commit intermediation of reinsurance and of MAT insurance in accordance with the Understanding.”

Mode 2: Limitations on Market Access

“Unbound.”

EC Request: “Commit intermediation of reinsurance and of MAT insurance in accordance with the Understanding.”

Mode 2: Limitations on National Treatment

“Unbound.”

Mode 3: Limitations on Market Access

“For legal persons, incorporation under Brazilian law is required.”

Mode 3: Limitations on National Treatment

“None.”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section.”

- Auxiliary services – consultancy, actuarial and surveys.

Mode 1: Limitations on Market Access

“None.”

Mode 1: Limitations on National Treatment

“None.”

Mode 2: Limitations on Market Access

“None.”

Mode 2: Limitations on National Treatment

“None.”

Mode 3: Limitations on Market Access

“None.”

Mode 3: Limitations on National Treatment

“None.”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section.”

EC Request: [referring to insurance intermediation (agencies and brokers)] “Commit intermediation of reinsurance and of MAT insurance in accordance with the Understanding.”

Classification of services products in the schedules of specific commitments

The EC Request did not specifically point out that the Brazilian specific commitments made no reference to the GNS W/120 and/or to the UN Provisional Central Product Classification (CPC). However, the ‘General Remarks’ that prefaced the EC specific requests stated as follows:

“The EC further requests that commitments are entered in accordance with the scheduling guidelines adopted by the Council of Trade in Services on 23 March 2001 (S/L/92). In particular, for each commitment or limitation entered the **EC requests:**

- that the sector and sub-sector are clearly identified in accordance with the classification list in Document MTN.GNS/W/120 or other internationally recognised classification (e.g. Financial Services Annex) and corresponding CPC number. If this is not possible, the schedule should contain a sufficiently detailed definition to avoid any ambiguity as to the scope of the commitment.”

BRAZIL: INITIAL CONDITIONAL OFFER

(WTO document TN/S/O/BRA, 21 July 2004) (The original is in English.)

Horizontal Commitments

The changes together constitute “a technical refinement that does not alter the scope of substance of an existing commitment.”

Specific Commitments for Insurance services

The bindings have been recast to align with the GNS W/120 list and CPC classification codes, and some restrictions would be removed. The new wording is as follows:

Insurance on Freight (CPC 81293)

Mode 1: Limitations on Market Access

“Imports can only be insured with established companies”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Unbound”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“Specific type of legal entity (Soceidade Anônima – S.A.) required. Foreign participation is limited to 50 per cent of the capital of a company and to 1/3 of its voting stock.”

Mode 3: Limitations on National Treatment

“None.”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section.”

Life insurance (CPC 81211)

Medical care (CPC 81291)

Property insurance (CPC 81292, CPC 81294, CPC 81295, CPC 81296)

Liability insurance (CPC 81297)

Mode 1: Limitations on Market Access

“Unbound”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Unbound”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“None.”

Mode 3: Limitations on National Treatment

“None.”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section.”

[Note: previously the wording for the above services was the same as for Insurance on Freight.]

Auxiliary services – agencies and brokers (CPC 81401)

Mode 1: Limitations on Market Access

“Unbound”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Unbound”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“Natural persons only”

Mode 3: Limitations on National Treatment

“None.”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section.”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section.”

[Note: the only change is in Mode 3 market access. The CPC number has been added also.]

Auxiliary services – consultancy, actuarial and surveys (CPC 81401, 81404)

[Note: the only difference is the addition of the CPC numbers.]

CHINA: GATS SPECIFIC COMMITMENTS

Official language

The English version of schedule of specific commitments of China upon accession in 2001 has been used here and its wording is given below unaltered.¹⁵⁶

Horizontal Commitments

The horizontal commitments relate to “All sectors included in this schedule” and are inscribed under the GATS modes of supply 3 and 4, as shown below.

Mode 3: Limitations on market access

“In China, foreign invested enterprises include foreign capital enterprises (also referred to as wholly foreign-owned enterprises) and joint venture enterprises and there are two types of joint venture enterprises: equity joint ventures and contractual joint ventures.¹⁵⁷”

“The proportion of foreign investment in an equity joint venture shall be no less than 25 per cent of the registered capital of the joint venture.

“The establishment of branches by foreign enterprises is unbound, unless otherwise indicated in specific sub-sectors, as the laws and regulations on branches of foreign enterprises is under formulation.

Representative offices of foreign enterprises are permitted to be established in China, but they shall not engage in any profit-making activities except for the representative offices under CPC 861, 862, 863, 865 in the sectoral specific commitments.

“The conditions of ownership, operation and scope of activities, as set out in the respective contractual or shareholder agreement or in a licence establishing or authorising the operation or supply of services by an exiting foreign service supplier, will not be made more restrictive than they exist as of the date of China’s accession to the WTO.

“The land in the People’s Republic of China is State-owned. Use of land by enterprises and individuals is subject to the following maximum term limitations:

- (a) 70 years for residential purposes;
- (b) 50 years for industrial purposes;
- (c) 50 years for the purpose of education, science, culture, public health and physical education;
- (d) 40 years for commercial, tourist and recreational purposes;
- (e) 50 years for comprehensive utilisation or other purposes.

[The establishment of branches by foreign enterprises is unbound, unless otherwise indicated in specific sub-sectors, as the legislation was under formulation at the time of WTO accession.]

EC Request: delete this requirement.

¹⁵⁶ WTO document reference WT/ACC/CHN/49/Add.2, 1 October 2001

¹⁵⁷ “The terms of the contract, concluded in accordance with China’s laws, regulations and other measures, establishing a ‘contractual joint venture’ govern matters such as the manner of operation and management of the joint venture as well as the investment or other contributions of the joint venture parties. Equity participation by all parties to the contractual joint venture is not required, but is determined pursuant to the joint venture contract.”

Mode 3: Limitations on national treatment

“Unbound for all the existing subsidies to domestic services suppliers in the sectors of audio-visual, aviation and medical services.”

Mode 4: Limitations on market access

“Unbound except for measures concerning the entry and temporary stay of natural persons who fall into one of the following categories:

- (a) Managers, executives and specialists defined as senior employees of a corporation of a WTO Member that has established a representative office, branch or subsidiary in the territory of the People's Republic of China, temporarily moving as intra-corporate transferees, shall be permitted entry for an initial stay of three years;
- (b) Managers, executives and specialists defined as senior employees of a corporation of WTO Members, being engaged in the foreign invested enterprises in the territory of the People's Republic of China for conducting business, shall be granted a long-term stay permit as stipulated in the terms of contracts concerned or an initial stay of three years, whichever is shorter;
- (c) Service salespersons – persons not based in the territory of the People's Republic of China and receiving no remuneration from a source located within China, and who are engaged in activities related to representing a service supplier for the purpose of negotiation for the sale of services of that supplier where:
 - (a) such sales are not directly made to the general public and
 - (b) the salesperson is not engaged in supplying the service: entry for salespersons is limited to a 90-day period.”

EC Request:**“Definitions:**

- It is not clear what is meant by the definitions of ‘managers’, ‘executives’ and ‘specialists’. **EC Request:** Please define these terms.

“Intra-corporate transferees:

- Minimum prior employment requirement not specified. **EC Request:** Please indicate whether there are any limitations in relation to this.
- Only transfers to representative offices, branches or subsidiaries are covered. **EC Request:** Extend coverage to include all affiliated companies and offices.
- The **EC also requests** that a commitment be made to allow as intra-corporate transferees without requiring an economic needs test ‘persons with a university degree or equivalent technical qualification who are transferring for career development purposes or to obtain training in business techniques or methods’. The maximum prior employment requirement should be one year.”

“Business Visitors:

- No commitment has been made for Business Visitors who are not entering to themselves supply a service, but rather to establish a commercial presence. **EC request:** Make a specific commitment to this effect. The maximum length of stay should be at least 90 days in any 12 month period.

“Contractual Services Suppliers:

- A contractual service supplier is a juridical person with no commercial presence in China, who has obtained a service contract in China which requires the presence of

its employees in China in order to fulfil that contract. **EC request:** Take commitments for natural persons employed in the service sectors listed below and seeking temporary entry as contractual service suppliers. Such natural persons can be required to have a university degree or equivalent technical qualification – plus the appropriate professional qualifications where this is required by domestic law. The length of stay may be limited in time.”

7. Financial Services

Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Advisory, intermediation and other auxiliary financial services on all the activities listed in the subparagraphs (v) to (xv) of the classification of the Annex on Financial Services, including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

“Additional commitments

“Difficulties are experienced as a result of the length of time taken to process work and residence permits as well as with the notarisation of documents. The EC wishes to discuss the possibility of taking additional commitments to address this issue.”

Mode 4: Limitations on national treatment

“Unbound except for the measures concerning the entry and temporary stay of natural persons who fall into the categories referred to in the market access column.”

INSURANCE SECTOR COMMITMENTS

GATS Article II Exemptions

None of the listed MFN Exemptions relate to the insurance sector.¹⁵⁸

¹⁵⁸ WTO document reference GATS/EL/135, 14 February 2002

“7 FINANCIAL SERVICES**A. All Insurance and Insurance-Related Services¹⁵⁹**

- a. Life, health and pension/annuities insurance
- b. Non-life insurance
- c. Reinsurance
- d. Services auxiliary to insurance

Mode 1: Limitations on Market Access

“Unbound except for:

- a) reinsurance;
- b) international marine, aviation, and transport insurance; and
- c) brokerage for large scale commercial risks, international marine, aviation, and transport insurance, and reinsurance.

EC Request: [referring to: “Services auxiliary to insurance are not committed.”]
“Take full commitments.”

Mode 1: Limitations on National Treatment

“None”

Mode 2: Limitations on Market Access

“Unbound for brokerage. Other, none.”

EC Request: [referring to: “Unbound for brokerage.”] “Take full commitments.”

Mode 2: Limitations on National Treatment

“None”

Mode 3: Limitations on Market Access**“A. Form of establishment**

Foreign non-life insurers will be permitted to establish as a branch or as a joint venture with 51 per cent foreign ownership.

Within two years after China's accession, foreign non-life insurers will be permitted to establish as a wholly-owned subsidiary; i.e., with no form of establishment restrictions.

Upon accession, foreign life insurers will be permitted 50 per cent foreign ownership in a joint venture with the partner of their choice.

The joint venture partners can freely agree the terms of their engagement, provided they remain within the limits of the commitments contained in this schedule.

For brokerage for insurance of large scale commercial risks and brokerage for reinsurance and brokerage for international marine, aviation, and transport insurance and reinsurance: upon accession, joint venture with foreign equity no more than 50 per cent will be permitted; within three years after China's accession, foreign equity share shall be increased to 51 per cent; within five years after China's accession, wholly foreign owned subsidiary will be permitted. For other brokerage services: Unbound.

¹⁵⁹ “Any further authorisation provided to foreign insurers after accession under more favourable conditions than those contained in this schedule (including the extension of grandfathered investments through branching, sub-branching or any other legal form), will be made available to other foreign service suppliers which so requested.”

Internal branching for an insurance firm will be permitted consistent with the phase out of geographic restrictions.

B. Geographic Coverage

Upon accession, foreign life and non-life insurers, and insurance brokers will be permitted to provide services in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan. Within two years after China's accession, foreign life and non-life insurers, and insurance brokers will be permitted to provide services in the following cities: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. Within three years after China's accession, there will be no geographic restrictions.

C. Business Scope

Upon accession, foreign non-life insurers will be permitted to provide "master policy" insurance/insurance of large scale commercial risks, which has no geographic restrictions. In accordance with national treatment, foreign insurance brokers will be permitted to provide "Master policy" no later than Chinese brokers, under conditions no less favourable.

Foreign non-life insurers are permitted to provide insurance of enterprises abroad as well as property insurance, related liability insurance and credit insurance of foreign-invested enterprises in China upon accession. Within 2 years after China's accession, foreign non-life insurers will be permitted to provide the full range of non-life insurance services to both foreign and domestic clients.

Foreign insurers are permitted to provide individual (not group) insurance to foreigners and Chinese citizens; within three years after accession, foreign insurers will be permitted to provide health insurance, group insurance and pension/annuities insurance to foreigners and Chinese.

Upon accession, foreign insurers will be permitted to provide reinsurance services for life and non-life insurance as a branch, joint venture, or wholly foreign-owned subsidiary, without geographic or quantitative restrictions on the number of licenses issued.

D. Licenses

Upon accession, licenses will be issued with no economic needs test or quantitative limits on licenses. Qualifications for establishing a foreign insurance institution are as follows:

- the investor shall be a foreign insurance company with more than 30 years of establishment experience in a WTO member;
- it shall have a representative office for two consecutive years in China;
- it shall have total assets of more than US \$5 billion at the end of the year prior to application, except for insurance brokers.

Insurance brokers shall have total assets of more than US\$ 500 million. Within one year after accession, they shall have total assets of more than US\$ 400 million. Within two years after accession, they shall have total assets of more than US\$ 300 million. Within four years after accession, they shall have total assets of more than US\$ 200 million.

EC Request: [referring to: "The legal form of establishment is limited to companies."]
"Allow the establishment of associations of underwriters."

[referring to: "Life insurance business is allowed only through 50% joint-ventures."]
"Allow wholly-owned subsidiaries and direct branching."

[referring to: "Brokerage activities of foreign companies are limited to certain lines."]
"Commit all brokerage activities."

Mode 3: Limitations on National Treatment

“None, except for:

- Foreign insurance institutions shall not engage in the statutory insurance business.
- Upon accession, a 20 per cent cession of all lines of the primary risks for non-life, personal accident and health insurance business with an appointed Chinese Reinsurance Company shall be required; one year after accession, 15 per cent shall be required; two years after accession, ten per cent shall be required; and three years after accession, five per cent shall be required; and four years after accession, no compulsory cession shall be required.

EC Request: [referring to: “Statutory insurance business is closed to organisation companies.”] “Open this line of business to foreign companies.”

Mode 4: Limitations on market access

“Unbound except as indicated in Horizontal Commitments.”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in Horizontal Commitments.”

“ANNEX 3**Insurance: Definition of ‘Master Policy’**

Master policy is the policy that provides blanket coverage for the same legal person's property and liabilities located in different places. Master policy may only be issued by the business department of an insurer's head office or that of its authorised province-level branch offices. Other branches are not allowed to issue master policy.

Master policy business with the state key construction projects as its subject-matter insured. If investors on the state key construction projects (i.e., projects that are so listed and annually announced by the State Development and Planning Commission) meet either of the following requirements, they may purchase master policy from insurers that are located in the same place as the investors' legal persons do.

The investment on the subject-matter insured is all from China (including the reinvestment from the foreign-invested enterprises in China), and the sum of investment of the investor accounts for over 15 per cent of the total investment.

The investment is partially from abroad, and partially from China (including the reinvestment from the foreign-invested enterprises in China), and the sum of investment of the Chinese investor accounts for over 15 per cent for the total domestic investment.

For those projects that draw investment all from abroad, every insurer may provide coverage in the form of master policies.

Master policy covering different subjects-matter insured of the same legal person. For those subjects-matter insured located in different places and owned by the same legal person (excluding financial, railway, and post and telecommunications industries and enterprises), master policy may be issued on the basis of either of the following conditions.

For the sake of payment of premium tax, insurance companies incorporated where the legal person or accounting unit of the insurance applicant is located are allowed to issue master policy.

If over 50 per cent of insurance amount of the subject-matter insured is from a larger or medium sized city, then insurers in that city are allowed to issue master policy, no matter whether the insurance applicant's legal person or accounting unit is located in the city.

Motor insurance, credit insurance, employer liabilities insurance, statutory insurance, and other insurance business excluded by the CIRC can not be underwritten or co-insured by insurers located other than where the subject-insured are located, or covered under a master policy.

_____”

Classification of services products in the schedules of specific commitments

The EC Request did not specifically point out that the specific commitments of China made no reference to the GNS W/120 and/or to the UN Provisional Central Product Classification (CPC). However, the ‘General Remarks’ that prefaced the EC specific requests stated as follows:

“The EC further requests that commitments are entered in accordance with the scheduling guidelines adopted by the Council of Trade in Services on 23 March 2001 (S/L/92). In particular, for each commitment or limitation entered the **EC requests:**

- that the sector and sub-sector are clearly identified in accordance with the classification list in Document MTN.GNS/W/120 or other internationally recognised classification (e.g. Financial Services Annex) and corresponding CPC number. If this is not possible, the schedule should contain a sufficiently detailed definition to avoid any ambiguity as to the scope of the commitment.”

CHINA: REVISED OFFER OF SERVICES SPECIFIC COMMITMENTS

In July 2005 China tabled a revised offer (WTO document: TN/S/O/CHN/Rev.1).

The changes shown in this document amount merely to a 'cleaning up' of the wording to reflect the fact that the phased-in commitments shown in their accession schedule had now been implemented. It does not offer any further liberalisation commitments.

The European Services Forum issued comments on China's revised offer for services sector specific commitments in March 2006. It characterised the offer for insurance and insurance-related services as "Weak". It stated that the offer "maintains Mode 2 market access limitations for foreign brokerages." The statutory insurance business remains "closed to foreign insurance companies" and "foreign life insurers are only allowed through 50% ownership joint ventures. In addition, foreign insurers are only permitted to operate in a limited amount of the business."

INDIA: GATS SPECIFIC COMMITMENTS**Official language**

The schedule of specific commitments of India states that “This is authentic in English only.” and its wording is given below unaltered.¹⁶⁰

Horizontal Commitments

The horizontal commitments relate to “All sectors included in this schedule” and are inscribed under the GATS modes of supply 3 and 4, as shown below.

Mode 3: Limitations on national treatment

“In case of collaboration with public sector enterprises or government undertakings as joint venture partners, preference in access will be given to foreign service suppliers/ entities which offer the best terms for transfer of technology.”

EC Request: [“In joint ventures involving public sector enterprises, degree of technology transfer is the determining factor in choosing the foreign partner.”] “Clarify the meaning and effect of this requirement.”

Mode 4: Limitations on market access

“Unbound except for measures affecting the entry and temporary stay of natural persons who fall in any of the following categories:

a) Business Visitors

Persons who visit India for the purposes specified in (i) and (ii) below and who will not receive remuneration from within India:

- i) for business negotiations, or
- ii) for preparatory work for establishing a commercial presence in India

Entry for persons in this category shall be for a period of not more than 90 days

b) Intra-corporate transferees

At the level of Managers, Executives and Specialists who have been in the employment of a juridical person of another Member for a period not less than one year prior to the date of application for entry into India and are being transferred to a branch or a representative office or a juridical person owned or controlled by the aforesaid juridical person

Managers are:

Persons who direct a branch office or one or more departments as their head, or supervise or control the work of other supervisory, professional or managerial personnel and have the authority to appoint or remove the personnel and powers to exercise discretionary authority over day-to-day operations

¹⁶⁰ WTO document GATS/SC/42, 15 April 1994.

Executives are:

Persons who are in senior positions within a juridical person including a branch who primarily direct the management, have wide decision-making powers and are either members of the board of directors or receive directions from the board or the general body of shareholders

Specialists are:

Persons who possess high qualifications and knowledge at an advanced level relevant to the organisation's research equipment, techniques or management and may include persons who are members of accredited professional bodies

Entry for persons in the above categories shall be for a maximum period of 5 years

c) Professionals

Natural persons to be engaged by a juridical person in India as part of a services contract for rendering professional services for which he/she possesses the necessary academic credentials and professional qualifications with three years experience in the field of physical sciences, engineering or other natural sciences

Entry and stay in this category shall be for a maximum period of one year"

EC Request: ["Commitments only cover transfers to subsidiaries, branches and representative offices."] "Extend coverage to include all affiliated companies and offices."

"The **EC also requests** that a commitment be made to allow as intra-corporate transferees without requiring an economic needs test 'persons with a university degree or equivalent technical qualification who are transferring for career development purposes or to obtain training in business techniques or methods'. The maximum prior employment requirement should be one year."

"Contractual Services Suppliers:

- A contractual service supplier is a juridical person with no commercial presence in India, who has obtained a service contract in India which requires the presence of its employees in India in order to fulfil that contract. **EC request:** Take commitments for natural persons employed in the service sectors listed below and seeking temporary entry as contractual service suppliers. Such natural persons can be required to have a university degree or equivalent technical qualification – plus the appropriate professional qualifications where this is required by domestic law. The length of stay may be limited in time.

7. Financial Services

Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Advisory, intermediation and other auxiliary financial services on all the activities listed in the subparagraphs (v) to (xv) of the classification of the Annex on Financial Services, including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

Mode 4: Limitations on national treatment

"Unbound except for measures referred to under Market Access"

Other:

EC Request: ["Repatriation of earnings by foreign nationals in India requires the consent of the Reserve Bank of India."] "Eliminate this requirement."

FINANCIAL SERVICES¹⁶¹**GATS Article II Exemptions**

Sector:

"Other financial services including insurance"

Description of measure indicating its inconsistency with Article II:

"Favourable treatment relating to the approval for the establishment of commercial presence including foreign equity participation by foreign service suppliers in Indian companies will be granted on the basis of reciprocity."

Countries to which the measure applies:

"All countries"

Intended duration:

"The reciprocity requirements will remain in place till similar measures maintained by other countries in this sector are removed."

Conditions creating the need for the exemption:

"To enable favourable treatment to be accorded to another Member which is based on the treatment or access accorded by that member to India."

"The commitments in financial services are made in accordance with the General Agreement on Trade in Services and the Annex on Financial Services. All the commitments are subject to entry requirements, domestic laws, rules and regulations and the terms and conditions of the Reserve Bank of India, Securities and Exchange Board of India and any other competent authority in India."

General

"EC Request: Take commitments in accordance with the Understanding on Commitments in Financial Services."

"EC Request: Remove those elements." [ie for "All financial services are subject to unspecified entry requirements and terms and conditions."]

"A Insurance and Insurance-related services**[Life insurance]**

EC Request: ["Life insurance is not committed."] "Take full commitments in mode 3, i.e. schedule "none". Commit as referred to in the section "Horizontal commitments" in mode 4."

"Non-life, limited to insurance of freight Ex. 5(a)(i)(B)¹⁶²

¹⁶¹ WTO document GATS/SC/42/Suppl.4, 26 February 1998.

¹⁶² [The notation Ex.5(a)(i)(B) refers to the paragraph number and its categories in the GATS Annex on Financial Services –JA]

Mode 1: Limitations on Market Access

“Unbound except in the case of insurance of freight, where there is no requirement that goods in transit to and from India should be insured with Indian insurance companies only. Insurance is taken by the buyer or seller in accordance with the terms of the contract. This position will be maintained. Once under a contract the Indian importer or exporter agrees to assume the responsibility for insurance such as in the case of f.o.b. contracts for imports into India or c.i.f. contracts for exports from India, insurance has to be taken only with an India insurance company.”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Unbound”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“Unbound”

Mode 3: Limitations on National Treatment

“Unbound”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section”

EC Request: [“In non-life insurance, commitments are limited to insurance on freight for mode 1 in the market access column.”] “Take full commitments in modes 1 and 2 for MAT insurance in accordance with the Understanding, and in mode 3 for all non-life insurance.”

Reinsurance and retrocession 5(a)(ii)**Mode 1: Limitations on Market Access**

“Reinsurance can be taken with foreign reinsurers to the extent of the residual risk after obligatory uncovered risk after obligatory or statutory placements domestically with Indian insurance companies. At present this amounts to 10 per cent of the premium of the market overall being reinsured abroad. This will be maintained.”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Reinsurance can be taken with foreign reinsurers to the extent mentioned above”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“Unbound”

Mode 3: Limitations on National Treatment

“Unbound”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section”

EC Request: [“In reinsurance, commitments are limited to modes 1 and 2 in the market access columns.”] “Take full commitments in modes 1, 2 and 3.”

Insurance intermediation, limited to reinsurance Ex. 5(a)(iii)

Mode 1: Limitations on Market Access

“Reinsurance of domestic risks can be placed with foreign reinsurers through overseas brokers, to the extent mentioned under reinsurance and retrocession”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Same as above”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“(i) Overseas brokers are allowed to have resident representatives and representative offices who can procure reinsurance business from Indian insurance companies to the extent mentioned above. They can also place reinsurance business from abroad with Indian insurance companies.

(ii) Except for the business indicated above, the resident representatives and representative offices cannot undertake any other activity in India.

(iii) All expenses of the resident representatives and representative offices have to be met by remittances from abroad and no income can be received in India from Indian residents.”

Mode 3: Limitations on National Treatment

“Unbound”

Mode 4: Limitations on Market Access

“Unbound except as indicated in the horizontal section”

Mode 4: Limitations on National Treatment

“Unbound except as indicated in the horizontal section”

EC Request: [“In reinsurance intermediation, commitments are limited to reinsurance intermediation.”] “Take full commitments in modes 1 and 2 for intermediation of reinsurance and of MAT insurance in accordance with the Understanding, and in mode 3 for the whole subsector.”

Services auxiliary to insurance

EC Request: “Take full commitments in modes 1, 2 and 3.” Commit as referred to in the section “Horizontal commitments” in mode 4.” [“Services auxiliary to insurance are not committed.”]

Classification of services products in the schedules of specific commitments

The EC Request did not specifically point out that the Indian specific commitments made no reference to the GNS W/120 and/or to the UN Provisional Central Product Classification (CPC). However, the ‘General Remarks’ that prefaced the EC specific requests stated as follows:

“The EC further requests that commitments are entered in accordance with the scheduling guidelines adopted by the Council of Trade in Services on 23 March 2001 (S/L/92). In particular, for each commitment or limitation entered the **EC requests:**

- that the sector and sub-sector are clearly identified in accordance with the classification list in Document MTN.GNS/W/120 or other internationally recognised classification (e.g. Financial Services Annex) and corresponding CPC number. If this is not possible, the schedule should contain a sufficiently detailed definition to avoid any ambiguity as to the scope of the commitment.”

INDIA: REVISED OFFER ON SERVICES SPECIFIC COMMITMENTS

In August 2005 India tabled a revised offer of specific commitments (WTO document: TN/S/O/IND/Rev.1).

This stated that: "To the extent possible, the individual sectors and sub-sectors are identified in accordance with the Services Sectoral Classification List (MTN.GNS/W/120) and the corresponding UN Provisional CPC numbers." And further that: "India has offered to undertake extensive commitments in a number of new sectors/sub-sectors including [] life insurance services; services auxiliary to insurance; []" Also: "India had already made a substantial mode 4 initial offer by including all the categories of natural persons like intra-corporate transferees, business visitors, contractual service suppliers and independent professionals. Further improvements have been made in the sectoral coverage of both the contractual service suppliers and independent professionals and the definition and parameters of all these categories have been brought in line with the common categories paper submitted by a number of members including India."

Horizontal commitments

Business visitors would be allowed to stay for up to 180 days [previously 90 days].

Intra-corporate transferees: a condition relating to Managers, Executives and Specialists would be removed [solely here shown in bold for clarity]: "who have been in the employment of a juridical person of another Member **for a period not less than one year prior to the date of application for entry into India** and are being transferred temporarily to a branch or a representative office or a juridical person owned or controlled by the aforesaid juridical person", and the following wording added "in the context of provision of a service in India."

New commitments have been inscribed for "Contractual Service Suppliers – Employees of juridical persons" and "Independent professionals", as follows:

Contractual Service Suppliers – Employees of juridical persons

- (i) Employees of a foreign based company or partnership who travel to India *temporarily* for short periods of stay of up to one year in order to perform a service pursuant to a contract between their employer and a client(s) located in India where the employer does not have an affiliate office and where remuneration must be paid solely to the employer and
- (ii) Employees of a foreign based company or partnership who travel to India *temporarily* for short periods of stay of up to one year in order to fulfil qualification and licensing requirements where presence in India is an essential condition for the fulfilment of these requirements.

The service contract has to be obtained in one of the sectors listed below and subject to additional conditions mentioned in the sub-sector :

- Engineering Services
- Integrated Engineering Services
- Architectural Services
- Urban Planning and landscape Architectural Services
- Computer and Related Services
- R & D Services
- Management Consulting Services (excluding all services relating to legal consultancy)
- Services related to Management consulting (excluding all services relating to legal consultancy)

- Hotel and Restaurant services
- Travel agency and tour operator services
- Tourist guides Services

Access shall be available under this category only in the specific service sector in which contract has been entered into and employees should have appropriate educational and professional qualifications relevant to the services to be provided.

Independent professionals

- (i) Natural persons who travel to India temporarily for short periods of stay, up to twelve months with permission for extending for a maximum of three months in order to perform a service pursuant to a contract(s) between them and a client(s) located in India for which he or she possesses the necessary academic credentials and qualifications and has obtained, wherever necessary, registration with the professional body and remuneration is to be paid solely to the natural person; and
- (ii) Natural persons who travel to India temporarily for short periods of stay, up to twelve months in order to fulfil qualification and licensing requirements, where presence in India is an essential condition for the fulfilment of these requirements.

The service contract has to be obtained in one of the sectors listed below and subject to additional conditions mentioned in the sub-sector :

- Accounting and Book-keeping services
- Engineering Services
- Integrated Engineering Services
- Architectural Services
- Urban Planning and landscape Architectural Services
- Computer and Related Services
- R & D Services
- Management Consulting Services (excluding all services relating to legal consultancy)
- Services related to Management consulting (excluding all services relating to legal consultancy)
- Hotel and Restaurant services
- Travel agency and tour operator services
- Tourist Guides Services

Access shall be available under this category only in the specific service sector in which contract has been entered into.

Note: These categories have been listed in full here for the sake of completeness, even though only a few of such services may be of interest to insurance enterprises.

Sectoral commitments

Life insurance [5(a) (i) (A)]

Mode 1: Limitations on Market Access

“Unbound”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Unbound”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“None, except establishment would be through incorporation with foreign equity not exceeding 26 per cent and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.”

Mode 3: Limitations on National Treatment

“None”

Mode 4: Limitations on Market Access

“Unbound except as in the horizontal section”

Mode 4: Limitations on National Treatment

“Unbound except as in the horizontal section”

[Note: this offer for life insurance would be additional liberalisation.]

Non-life insurance [5(a) (i) (B)]

[Note: The commitments in Modes 1, 2 and 4 would remain unchanged.]

Mode 3: Limitations on Market Access

“Unbound” would be replaced by “None, except establishment would be through incorporation with foreign equity not exceeding 26 per cent and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.”

Mode 3: Limitations on National Treatment

“Unbound” would be replaced by “None”.

Reinsurance and retrocession [5(a)(ii)]

[Note: The commitments in Modes 1, 2 and 4 would remain unchanged.]

Mode 3: Limitations on Market Access

“Unbound” would be replaced by “None, except establishment would be through incorporation with foreign equity not exceeding 26 per cent and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.”

Mode 3: Limitations on National Treatment

“Unbound” [Note: no change]

For the following categories, the improved offer consisted of:

Services auxiliary to insurance, such as consultancy, actuarial, risk assessment Ex.[5 (a) (iv)]

Mode 1: Limitations on Market Access

“None”

Mode 1: Limitations on National Treatment

“None”

Mode 2: Limitations on Market Access

“Unbound”

Mode 2: Limitations on National Treatment

“None”

Mode 3: Limitations on Market Access

“None subject to the conditions that foreign companies can be established through incorporation with foreign equity not exceeding 51 per cent and further subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.
In the case of Actuarial and Advisory Services, formal certification by Actuarial Society of India would be required.”

Mode 3: Limitations on National Treatment

“Unbound”

[Note: this offer for services auxiliary to insurance would be additional liberalisation.]

MEXICO: GATS SPECIFIC COMMITMENTS**Official language**

The original schedule of specific commitments of Mexico (1994) is in English and states that "This is authentic in Spanish only" and the wording from the English version is given below unaltered.¹⁶³ The Financial Services section was replaced in 1998 by a new version in Spanish which states that "Esta lista es auténtica en español únicamente" (ie This is authentic in Spanish only).¹⁶⁴ The wording below in English is a translation by the present author and is not official.

Horizontal Commitments

The horizontal commitments relate to "All sectors included in this schedule" and are inscribed under the GATS modes of supply 1, 2, 3 and 4, as shown below.

Mode 1: Limitations on Market Access

"None"

Mode 1: Limitations on National Treatment

"None"

Mode 2: Limitations on Market Access

"None"

Mode 2: Limitations on National Treatment

"None"

Mode 3: Limitations on Market Access

"Foreign investment in activities reserved for Mexican nationals must be through neutral shares, whose purchase must be quoted on the Mexican Stock Exchange."

Mode 3: Limitations on National Treatment

"Foreigners may not acquire direct ownership of land and water in a 50km strip of the coastline and 100km strip along the frontiers. Unbound for research and development subsidies and incentives to small service enterprises owned by Mexican nationals."

Mode 4: Limitations on Market Access

"Unbound, except for measures affecting the entry and temporary stay of natural persons in the following categories: a) persons directly responsible for the sale of a service; and b) persons transferred within the same enterprise, provided they are executives, managers or specialists"

¹⁶³ WTO document GATS/SC/56, 15 April 1994.

¹⁶⁴ WTO document GATS/SC/56/Suppl.3, 26 February 1998.

“For the purposes of this offer:

a) persons directly responsible for the sale of a service, means persons representing an enterprise that carries on an activity in a country party to the Agreement who is temporarily to enter Mexican territory (for up to 90 days) in order to sell or negotiate the sale of a service or conclude agreements for the sale of the said service on behalf of the enterprise they represent, provided this does not in any case constitute a direct sale to the general public

b) persons transferred within the same enterprise, means the employees of an enterprise who have been employed by that enterprise for at least a year proceeding the obtention of temporary entry into Mexican territory (one year with option of renewal) in order to continue providing their services in that enterprise or subsidiary of that enterprise in accordance with national laws on the subject. This offer is confined to the categories of executives, managers and specialists.

- executives, are persons in an enterprise who primarily direct the management of the enterprise or establish its goals and policies or those of any of its main components or activities, exercise wide latitude in decision-making and receive only general supervision and instructions from higher level executives, the Board of Directors, or shareholders of the enterprise.

- managers, are persons in an enterprise who primarily direct the enterprise or its departments or divisions, supervise and control the work of other supervisory, professional or managerial staff, have the authority to hire, fire and take other personnel actions, and exercise discretionary authority over higher level day-to-day operations

- specialists, are persons within an enterprise who possess knowledge at an advanced level and proprietary knowledge of the enterprise’s production, services, research equipment, techniques or management”

EC Request: “General”

“Mode 3: Foreign investment in activities reserved for Mexican nationals must be through neutral shares, whose purchase must be quoted on the Mexican Stock Exchange. **EC request:** remove such restriction.”

“Mode 3: Foreigners may not acquire direct ownership of land or water in a 50km. strip on the coastline and 100 km. strip along the frontiers. **EC request:** remove such restriction or apply on a national treatment basis.”

“Mode 3 – NT: National treatment is unbound for research and development subsidies. **EC Request:** Clarify the applicability and scope of the regime.”

“Mode 3 – NT: National treatment is unbound for incentives to small service enterprises owned by Mexican nationals. **EC Request:** commit national treatment for foreign owned small service enterprises”

“Mode 4

“Intra-corporate transferees

- The **EC requests** that a commitment be made to allow as intra-corporate transferees without requiring an economic needs test ‘persons with a university degree or equivalent technical qualification who are transferring for career development purposes or to obtain training in business techniques or methods’. The maximum prior employment requirement should be one year.”

“Business Visitors

- No specific commitment has been made for Business Visitors who are not entering themselves to supply a service, but rather to establish a commercial presence. **EC request:** Make a specific commitment to this effect. Economic needs tests should not be applied. The maximum length of stay should be at least 90 days in any 12 month period.”

“Contractual Services Suppliers

- A contractual service supplier is a juridical person with no commercial presence in Mexico, who has obtained a service contract in Mexico which requires the presence of its employees in Mexico in order to fulfil that contract. **EC request:** Take commitments for natural persons employed in the service sectors listed below and seeking temporary entry as contractual service suppliers. Such natural persons can be required to have a university degree or equivalent technical qualification – plus the appropriate professional qualifications where this is required by domestic law. The length of stay may be limited in time.

7. Financial Services

Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Advisory, intermediation and other auxiliary financial services on all the activities listed in the subparagraphs (v) to (xv) of the classification of the Annex on Financial Services, including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

Mode 4: Limitations on National Treatment

“Unbound, except for the conditions related to the categories of natural persons inscribed in the market access column. Employment in the following activities is reserved for Mexican nationals: ship captains, airline pilots, ship employers, engineers and mechanics, and crews of Mexican flagged ships and airlines, airport directors, port pilots, customs agents, and railway crews. Subsidies for natural persons are limited to Mexican citizens.”

Additional commitments

There are no ‘**Additional Commitments**’ in the horizontal part of the schedule of Mexico.

[EC Request] “Difficulties are experienced as a result of the length of time taken to process work and residence permits as well as with the notarisation of documents. **The EC wishes** to discuss the possibility of taking additional commitments to address this issue.”

FINANCIAL SERVICES**GATS Article II Exemptions**

None of the listed MFN Exemptions relate to the insurance sector.

A. All insurance and insurance-related services

- a. Life, accident and health insurance services (CPC 8121)
- b. Non-life insurance services (CPC 8129)

Mode 1: Limitations on Market Access

“Unbound”

EC Request: [On MAT insurance.] “Take full commitments in accordance with the Understanding.”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Unbound”

EC Request: [On “MAT insurance.”] “Take full commitments in accordance with the Understanding.”

[On “cross-border insurance of larger non-MAT risks.”] “Take commitments on insurance of larger risks, based on a definition to be determined in negotiations and accompanied by appropriate prudential regulations adopted by the regulatory authorities of the host country and protecting policy-holders, avoiding discrimination between operators, in line with the principles agreed in the OECD Framework for Insurance Market Liberalisation.”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“Foreign investment may be up to 40% of paid up capital and up to 30% of paid up capital with no voting rights. Investment by foreign governments and official entities is not permitted. The limit for individual share holdings is 10% of paid up capital or up to 20% of paid up capital with the authorisation of the Ministry of Finance and Inland Revenue. Mexican investors must maintain effective control of companies.”

EC Request: “Eliminate all these caps.”

EC Request: “Commit direct branching”

Mode 3: Limitations on National Treatment

“None”

EC Request: “Commit direct branching”

Mode 4: Limitations on Market Access

“Unbound”

Mode 4: Limitations on National Treatment

“Unbound”

c. Reinsurance and retrocession (CPC 81299*)**Mode 1: Limitations on Market Access**

“Foreign reinsurance companies can participate in the reinsurance activities indicated. In accordance with the applicable laws, these companies must be inscribed in the registry maintained by the Ministry of Finance and Inland Revenue, which authorises or denies such inscription.”

EC Request: Take full commitments, i.e. schedule ‘none’.”

Mode 1: Limitations on National Treatment

“None”

“Existence of an excise tax on reinsurance premiums ceded abroad. **EC Request:** ‘None’ has been scheduled, but EU industry raises this issue. Please explain.”

Mode 2: Limitations on Market Access

“Unbound”

EC Request: Take full commitments, i.e. schedule ‘none’.”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“This activity is under the supervision of the State Insurance Authority. Foreign investment may be up to 40% of paid up capital and up to 30% of paid up capital with no voting rights. Investment by foreign governments and official entities is not permitted. The limit for individual share holdings is 10% of paid up capital or up to 20% of paid up capital with the authorisation of the Ministry of Finance and Inland Revenue. Mexican investors must maintain effective control of companies.”

“Foreign reinsurance companies registered with the Ministry of Finance and Inland Revenue, may establish representative offices in the country with the authorisation of the said Ministry. The offices of foreign reinsurance companies, under the applicable laws, may not deal directly or offer direct insurance operations.”

Mode 3: Limitations on National Treatment

“None”

Mode 4: Limitations on Market Access

“Unbound”

Mode 4: Limitations on National Treatment

“Unbound”

d. Services auxiliary to insurance, as follows:

- broking and agency services (CPC 8140)

Mode 1: Limitations on Market Access

“Unbound”

“**EC Request:** Take full commitments on intermediation of MAT insurance and on reinsurance in accordance with the Understanding, and on other services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.”

Mode 1: Limitations on National Treatment

“Unbound”

Mode 2: Limitations on Market Access

“Unbound”

Mode 2: Limitations on National Treatment

“Unbound”

Mode 3: Limitations on Market Access

“Foreign investment may be up to 40% of paid up capital and up to 30% of paid up capital with no voting rights. Investment by foreign governments and official entities is not permitted. The limit for individual share holdings is 10% of paid up capital or up to 20% of paid up capital with the authorisation of the Ministry of Finance and Inland Revenue. Mexican investors must maintain effective control of companies.”

Mode 3: Limitations on National Treatment

“None”

Mode 4: Limitations on Market Access

“Unbound”

Mode 4: Limitations on National Treatment

“Unbound”

“GENERAL

- **EC Request:** Undertake commitments in accordance with the Understanding on Commitments in Financial Services
- **EC Request:** Follow the classification of the Annex on Financial Services.
- Mode 4: MA and NT – Generally unbound. **EC Request:** Schedule ‘Unbound except as indicated under horizontal commitments’ instead.”

MEXICO: REVISED GATS CONDITIONAL SERVICES OFFER

In July 2005 Mexico tabled its revised conditional offer for services (WTO document No. TN/S/O/MEX/Rev.1, and its original language is Spanish.

Horizontal commitments**Mode 4: Limitations on Market Access**

Two categories of natural persons are to be permitted temporary entry have been added to the existing two: c) investors, and d) business visitors. Thus now “authorisation for entry and temporary stay will also be authorised for board members and auditors.”

The coverage of ‘specialists’ is explicitly to cover persons “who possess technological knowledge in the physical sciences, engineering or other natural sciences; and those with advanced knowledge in jurisprudence, economics, sales administration, accounting and other human sciences.” The activities that require such skills relate to those “where nationals do not have the capacity to undertake them” and where a “university education (at graduate level) or higher education” is necessary.

The categories of investor and business visitor are spelt out in some detail. Those in the investor category would be allowed entry for one year, with up to four one year extensions, and business visitors would be allowed 30 days, which could be extended. The latter would need to show proof of nationality, evidence of relevant experience, and to prove no intention of entering the labour market, such as source of remuneration and principal place of business, as evidenced by an employer’s letter.

All four categories may be required to obtain a visa or entry permit before arrival in Mexico.

Mode 4: Limitations on National Treatment

[No change.]

Sector commitments

There are no changes in the sub-sectors offered for the insurance sector, and there are no changes to Modes 1 and 2 in the market access and national treatment columns.

In the Mode 3 market access column the restrictions would be eased a little, with the new standard wording for each of the sub-sectors. Up to 49% of paid up capital could be acquired by foreign companies and up to 100% of additional capital, with a limit of 30% of the voting rights of the ordinary capital. Mexican investors must maintain both management and effective control. Entities which exercise the functions of governmental authority would not be permitted to acquire shares.

In the Mode 3 national treatment column there is no change.

In Mode 4 in the market access and national treatment columns, in every case, the wording has been changed from “Unbound” to “Unbound, except as indicated in the horizontal commitments”.

ANNEX 2: GATS Annex on Article II Exemptions

Scope

1. This Annex specifies the conditions under which a Member, at the entry into force of this Agreement, is exempted from its obligations under paragraph 1 of Article II.
2. Any new exemptions applied for after the date of entry into force of the WTO Agreement shall be dealt with under paragraph 3 of Article IX of that Agreement.

Review

3. The Council for Trade in Services shall review all exemptions granted for a period of more than 5 years. The first such review shall take place no more than 5 years after the entry into force of the WTO Agreement.
4. The Council for Trade in Services in a review shall:
 - (a) examine whether the conditions which created the need for the exemption still prevail; and
 - (b) determine the date of any further review.

Termination

5. The exemption of a Member from its obligations under paragraph 1 of Article II of the Agreement with respect to a particular measure terminates on the date provided for in the exemption.
6. In principle, such exemptions should not exceed a period of 10 years. In any event, they shall be subject to negotiation in subsequent trade liberalizing rounds.
7. A Member shall notify the Council for Trade in Services at the termination of the exemption period that the inconsistent measure has been brought into conformity with paragraph 1 of Article II of the Agreement.

Lists of Article II Exemptions

[The agreed lists of exemptions under paragraph 2 of Article II will be annexed here in the treaty copy of the WTO Agreement.]

ANNEX 3: GATS Annex on Financial Services

ANNEX ON FINANCIAL SERVICES

1. *Scope and Definition*

(a) This Annex applies to measures affecting the supply of financial services. Reference to the supply of a financial service in this Annex shall mean the supply of a service as defined in paragraph 2 of Article I of the Agreement.

(b) For the purposes of subparagraph 3(b) of Article I of the Agreement, "services supplied in the exercise of governmental authority" means the following:

- (i) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies;
- (ii) activities forming part of a statutory system of social security or public retirement plans; and
- (iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government.

(c) For the purposes of subparagraph 3(b) of Article I of the Agreement, if a Member allows any of the activities referred to in subparagraphs (b)(ii) or (b)(iii) of this paragraph to be conducted by its financial service suppliers in competition with a public entity or a financial service supplier, "services" shall include such activities.

(d) Subparagraph 3(c) of Article I of the Agreement shall not apply to services covered by this Annex.

2. *Domestic Regulation*

(a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.

(b) Nothing in the Agreement shall be construed to require a Member to disclose information relating to the affairs and accounts of individual customers or any confidential or proprietary information in the possession of public entities.

3. *Recognition*

(a) A Member may recognize prudential measures of any other country in determining how the Member's measures relating to financial services shall be applied. Such recognition, which may be achieved through harmonization or otherwise, may be based upon an agreement or arrangement with the country concerned or may be accorded autonomously.

(b) A Member that is a party to such an agreement or arrangement referred to in subparagraph (a), whether future or existing, shall afford adequate opportunity for other interested Members to negotiate their accession to such agreements or arrangements, or to negotiate comparable ones with it, under circumstances in which there would be equivalent regulation, oversight, implementation of such regulation, and, if appropriate, procedures concerning the sharing of information between the parties to the agreement or arrangement. Where a Member accords recognition autonomously, it shall afford adequate opportunity for any other Member to demonstrate that such circumstances exist.

(c) Where a Member is contemplating according recognition to prudential measures of any other country, paragraph 4(b) of Article VII shall not apply.

4. *Dispute Settlement*

Panels for disputes on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial service under dispute.

5. *Definitions*

For the purposes of this Annex:

(a) A financial service is any service of a financial nature offered by a financial service supplier of a Member. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance). Financial services include the following activities:

Insurance and insurance-related services

- (i) Direct insurance (including co-insurance):
 - (A) life
 - (B) non-life
- (ii) Reinsurance and retrocession;
- (iii) Insurance intermediation, such as brokerage and agency;
- (iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Banking and other financial services (excluding insurance)

- (v) Acceptance of deposits and other repayable funds from the public;
- (vi) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction;
- (vii) Financial leasing;
- (viii) All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts;
- (ix) Guarantees and commitments;
- (x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:
 - (A) money market instruments (including cheques, bills, certificates of deposits);
 - (B) foreign exchange;

- (C) derivative products including, but not limited to, futures and options;
 - (D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
 - (E) transferable securities;
 - (F) other negotiable instruments and financial assets, including bullion.
- (xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;
 - (xii) Money broking;
 - (xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;
 - (xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;
 - (xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;
 - (xvi) Advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

(b) A financial service supplier means any natural or juridical person of a Member wishing to supply or supplying financial services but the term "financial service supplier" does not include a public entity.

(c) "Public entity" means:

- (i) a government, a central bank or a monetary authority, of a Member, or an entity owned or controlled by a Member, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms; or
- (ii) a private entity, performing functions normally performed by a central bank or monetary authority, when exercising those functions.

ANNEX 4: GATS Understanding on Commitments in Financial Services

UNDERSTANDING ON COMMITMENTS IN FINANCIAL SERVICES

Participants in the Uruguay Round have been enabled to take on specific commitments with respect to financial services under the General Agreement on Trade in Services (hereinafter referred to as the "Agreement") on the basis of an alternative approach to that covered by the provisions of Part III of the Agreement. It was agreed that this approach could be applied subject to the following understanding:

- (i) it does not conflict with the provisions of the Agreement;
- (ii) it does not prejudice the right of any Member to schedule its specific commitments in accordance with the approach under Part III of the Agreement;
- (iii) resulting specific commitments shall apply on a most-favoured-nation basis;
- (iv) no presumption has been created as to the degree of liberalization to which a Member is committing itself under the Agreement.

Interested Members, on the basis of negotiations, and subject to conditions and qualifications where specified, have inscribed in their schedule specific commitments conforming to the approach set out below.

A. *Standstill*

Any conditions, limitations and qualifications to the commitments noted below shall be limited to existing non-conforming measures.

B. *Market Access*

Monopoly Rights

1. In addition to Article VIII of the Agreement, the following shall apply:

Each Member shall list in its schedule pertaining to financial services existing monopoly rights and shall endeavour to eliminate them or reduce their scope. Notwithstanding subparagraph 1(b) of the Annex on Financial Services, this paragraph applies to the activities referred to in subparagraph 1(b)(iii) of the Annex.

Financial Services purchased by Public Entities

2. Notwithstanding Article XIII of the Agreement, each Member shall ensure that financial service suppliers of any other Member established in its territory are accorded most-favoured-nation treatment and national treatment as regards the purchase or acquisition of financial services by public entities of the Member in its territory.

Cross-border Trade

3. Each Member shall permit non-resident suppliers of financial services to supply, as a principal, through an intermediary or as an intermediary, and under terms and conditions that accord national treatment, the following services:

- (a) insurance of risks relating to:
 - (i) maritime shipping and commercial aviation and space launching and freight (including satellites), with such insurance to cover any or all of the following: the goods being transported, the vehicle transporting the goods and any liability arising therefrom; and
 - (ii) goods in international transit;
- (b) reinsurance and retrocession and the services auxiliary to insurance as referred to in subparagraph 5(a)(iv) of the Annex;
- (c) provision and transfer of financial information and financial data processing as referred to in subparagraph 5(a)(xv) of the Annex and advisory and other auxiliary services, excluding intermediation, relating to banking and other financial services as referred to in subparagraph 5(a)(xvi) of the Annex.

4. Each Member shall permit its residents to purchase in the territory of any other Member the financial services indicated in:

- (a) subparagraph 3(a);
- (b) subparagraph 3(b); and
- (c) subparagraphs 5(a)(v) to (xvi) of the Annex.

Commercial Presence

5. Each Member shall grant financial service suppliers of any other Member the right to establish or expand within its territory, including through the acquisition of existing enterprises, a commercial presence.

6. A Member may impose terms, conditions and procedures for authorization of the establishment and expansion of a commercial presence in so far as they do not circumvent the Member's obligation under paragraph 5 and they are consistent with the other obligations of the Agreement.

New Financial Services

7. A Member shall permit financial service suppliers of any other Member established in its territory to offer in its territory any new financial service.

Transfers of Information and Processing of Information

8. No Member shall take measures that prevent transfers of information or the processing of financial information, including transfers of data by electronic means, or that, subject to importation rules consistent with international agreements, prevent transfers of equipment, where such transfers of information, processing of financial information or transfers of equipment are necessary for the conduct of the ordinary business of a financial service supplier. Nothing in this paragraph restricts the right of a Member to protect personal

data, personal privacy and the confidentiality of individual records and accounts so long as such right is not used to circumvent the provisions of the Agreement.

Temporary Entry of Personnel

9. (a) Each Member shall permit temporary entry into its territory of the following personnel of a financial service supplier of any other Member that is establishing or has established a commercial presence in the territory of the Member:
- (i) senior managerial personnel possessing proprietary information essential to the establishment, control and operation of the services of the financial service supplier; and
 - (ii) specialists in the operation of the financial service supplier.
- (b) Each Member shall permit, subject to the availability of qualified personnel in its territory, temporary entry into its territory of the following personnel associated with a commercial presence of a financial service supplier of any other Member:
- (i) specialists in computer services, telecommunication services and accounts of the financial service supplier; and
 - (ii) actuarial and legal specialists.

Non-discriminatory Measures

10. Each Member shall endeavour to remove or to limit any significant adverse effects on financial service suppliers of any other Member of:
- (a) non-discriminatory measures that prevent financial service suppliers from offering in the Member's territory, in the form determined by the Member, all the financial services permitted by the Member;
 - (b) non-discriminatory measures that limit the expansion of the activities of financial service suppliers into the entire territory of the Member;
 - (c) measures of a Member, when such a Member applies the same measures to the supply of both banking and securities services, and a financial service supplier of any other Member concentrates its activities in the provision of securities services; and
 - (d) other measures that, although respecting the provisions of the Agreement, affect adversely the ability of financial service suppliers of any other Member to operate, compete or enter the Member's market;

provided that any action taken under this paragraph would not unfairly discriminate against financial service suppliers of the Member taking such action.

11. With respect to the non-discriminatory measures referred to in subparagraphs 10(a) and (b), a Member shall endeavour not to limit or restrict the present degree of market opportunities nor the benefits already enjoyed by financial service suppliers of all other Members as a class in the territory of the Member, provided that this commitment does not

result in unfair discrimination against financial service suppliers of the Member applying such measures.

C. *National Treatment*

1. Under terms and conditions that accord national treatment, each Member shall grant to financial service suppliers of any other Member established in its territory access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. This paragraph is not intended to confer access to the Member's lender of last resort facilities.

2. When membership or participation in, or access to, any self-regulatory body, securities or futures exchange or market, clearing agency, or any other organization or association, is required by a Member in order for financial service suppliers of any other Member to supply financial services on an equal basis with financial service suppliers of the Member, or when the Member provides directly or indirectly such entities, privileges or advantages in supplying financial services, the Member shall ensure that such entities accord national treatment to financial service suppliers of any other Member resident in the territory of the Member.

D. *Definitions*

For the purposes of this approach:

1. A non-resident supplier of financial services is a financial service supplier of a Member which supplies a financial service into the territory of another Member from an establishment located in the territory of another Member, regardless of whether such a financial service supplier has or has not a commercial presence in the territory of the Member in which the financial service is supplied.

2. "Commercial presence" means an enterprise within a Member's territory for the supply of financial services and includes wholly- or partly-owned subsidiaries, joint ventures, partnerships, sole proprietorships, franchising operations, branches, agencies, representative offices or other organizations.

3. A new financial service is a service of a financial nature, including services related to existing and new products or the manner in which a product is delivered, that is not supplied by any financial service supplier in the territory of a particular Member but which is supplied in the territory of another Member.

ANNEX 5: Hong Kong Ministerial Declaration – Annex C**Services****Objectives**

1. In order to achieve a progressively higher level of liberalization of trade in services, with appropriate flexibility for individual developing country Members, we agree that Members should be guided, to the maximum extent possible, by the following objectives in making their new and improved commitments:

Mode 1

commitments at existing levels of market access on a non-discriminatory basis across sectors of interest to Members

removal of existing requirements of commercial presence

Mode 2

commitments at existing levels of market access on a non-discriminatory basis across sectors of interest to Members

commitments on mode 2 where commitments on mode 1 exist

Mode 3

commitments on enhanced levels of foreign equity participation

removal or substantial reduction of economic needs tests

commitments allowing greater flexibility on the types of legal entity permitted

Mode 4

new or improved commitments on the categories of Contractual Services Suppliers, Independent Professionals and Others, de-linked from commercial presence, to reflect *inter alia*:

removal or substantial reduction of economic needs tests

indication of prescribed duration of stay and possibility of renewal, if any

new or improved commitments on the categories of Intra-corporate Transferees and Business Visitors, to reflect *inter alia*:

removal or substantial reduction of economic needs tests

indication of prescribed duration of stay and possibility of renewal, if any

MFN Exemptions

removal or substantial reduction of exemptions from most-favoured-nation (MFN) treatment

clarification of remaining MFN exemptions in terms of scope of application and duration

Scheduling of Commitments

ensuring clarity, certainty, comparability and coherence in the scheduling and classification of commitments through adherence to, *inter alia*, the Scheduling Guidelines pursuant to the Decision of the Council for Trade in Services adopted on 23 March 2001

ensuring that scheduling of any remaining economic needs tests adheres to the Scheduling Guidelines pursuant to the Decision of the Council for Trade in Services adopted on 23 March 2001.

2. As a reference for the request-offer negotiations, the sectoral and modal objectives as identified by Members may be considered.¹⁶⁵

3. Members shall pursue full and effective implementation of the Modalities for the Special Treatment for Least-Developed Country Members in the Negotiations on Trade in Services (LDC Modalities) adopted by the Special Session of the Council for Trade in Services on 3 September 2003, with a view to the beneficial and meaningful integration of LDCs into the multilateral trading system.

4. Members must intensify their efforts to conclude the negotiations on rule-making under GATS Articles X, XIII, and XV in accordance with their respective mandates and timelines:

- (a) Members should engage in more focused discussions in connection with the technical and procedural questions relating to the operation and application of any possible emergency safeguard measures in services.
- (b) On government procurement, Members should engage in more focused discussions and in this context put greater emphasis on proposals by Members, in accordance with Article XIII of the GATS.
- (c) On subsidies, Members should intensify their efforts to expedite and fulfil the information exchange required for the purpose of such negotiations, and should engage in more focused discussions on proposals by Members, including the development of a possible working definition of subsidies in services.

5. Members shall develop disciplines on domestic regulation pursuant to the mandate under Article VI:4 of the GATS before the end of the current round of negotiations. We call upon Members to develop text for adoption. In so doing,

¹⁶⁵ As attached to the Report by the Chairman to the Trade Negotiations Committee on 28 November 2005, contained in document TN/S/23. This attachment has no legal standing.

Members shall consider proposals and the illustrative list of possible elements for Article VI:4 disciplines.¹⁶⁶

Approaches

6. Pursuant to the principles and objectives above, we agree to intensify and expedite the request-offer negotiations, which shall remain the main method of negotiation, with a view to securing substantial commitments.

7. In addition to bilateral negotiations, we agree that the request-offer negotiations should also be pursued on a plurilateral basis in accordance with the principles of the GATS and the Guidelines and Procedures for the Negotiations on Trade in Services. The results of such negotiations shall be extended on an MFN basis. These negotiations would be organized in the following manner:

- (a) Any Member or group of Members may present requests or collective requests to other Members in any specific sector or mode of supply, identifying their objectives for the negotiations in that sector or mode of supply.
- (b) Any Member or group of Members who have made such requests in a specific sector or mode of supply, together with Members to whom such requests have been made, and any other interested Member, shall consider such requests in accordance with Article XIX:4 of the GATS and paragraph 11 of the Guidelines and Procedures for the Negotiations on Trade in Services.
- (c) Plurilateral negotiations should be organised with a view to facilitating the participation of all Members, taking into account the limited capacity of smaller delegations to participate in such negotiations.

8. Due consideration shall be given to proposals on trade-related concerns of small economies.

9. Members, in the course of negotiations, shall develop methods for the full and effective implementation of the LDC Modalities, including expeditiously:

- (a) Developing appropriate mechanisms for according special priority including to sectors and modes of supply of interest to LDCs in accordance with Article IV:3 of the GATS and paragraph 7 of the LDC Modalities.
- (b) Undertaking commitments, to the extent possible, in such sectors and modes of supply identified, or to be identified, by LDCs that represent priority in their development policies in accordance with paragraphs 6 and 9 of the LDC Modalities.
- (c) Assisting LDCs to enable them to identify sectors and modes of supply that represent development priorities.

¹⁶⁶ As attached to the Report of the Chairman of the Working Party on Domestic Regulation to the Special Session of the Council for Trade in Services on 15 November 2005, contained in document JOB(05)/280.

- (d) Providing targeted and effective technical assistance and capacity building for LDCs in accordance with the LDC Modalities, particularly paragraphs 8 and 12.
- (e) Developing a reporting mechanism to facilitate the review requirement in paragraph 13 of the LDC Modalities.

10. Targeted technical assistance should be provided through, *inter alia*, the WTO Secretariat, with a view to enabling developing and least-developed countries to participate effectively in the negotiations. In particular and in accordance with paragraph 51 on Technical Cooperation of this Declaration, targeted technical assistance should be given to all developing countries allowing them to fully engage in the negotiation. In addition, such assistance should be provided on, *inter alia*, compiling and analyzing statistical data on trade in services, assessing interests in and gains from services trade, building regulatory capacity, particularly on those services sectors where liberalization is being undertaken by developing countries.

Timelines

11. Recognizing that an effective timeline is necessary in order to achieve a successful conclusion of the negotiations by [...], we agree that the negotiations shall adhere to the following dates:

- (a) Any outstanding initial offers shall be submitted as soon as possible.
- (b) Groups of Members presenting plurilateral requests to other Members should submit such requests by [February 2006] or as soon as possible thereafter.
- (c) A second round of revised offers shall be submitted by [date].
- (d) Final draft schedules of commitments shall be submitted by [date].
- (e) Members shall strive to complete the requirements in 9(a) before the date in 11(c).

Review of Progress

12. The Special Session of the Council for Trade in Services shall review progress in the negotiations and monitor the implementation of the Objectives, Approaches and Timelines set out in this Annex.

ANNEX 6: GATS: Financial Services Collective Request**Financial Services Collective Request**Introduction:

1. In view of the importance of financial services liberalization for global economic growth, stability and development, the following collective request is presented to [] on behalf of Australia, Canada, the European Communities, Ecuador, Hong Kong China, Japan, the Republic of Korea, Norway, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, and the United States to identify our shared objectives for financial services liberalization. This collective request is intended to complement the ongoing bilateral request-offer negotiations, and the specificity of bilateral requests.
2. This request identifies specific objectives for the financial services sector liberalization. The aforementioned interested Members are also to be recipients of this request.
3. The Mission of Canada has the further pleasure to invite [] to participate in a plurilateral discussion of this request, which will be organized in Geneva during the Services cluster taking place from 27 March to 7 April, 2006.
4. Please note that a number of other Members have received this collective request in the financial services sector from the aforementioned group of interested Members, and have also been invited to this plurilateral meeting.
5. Any comments regarding this request, including written questions of a technical nature in advance of the plurilateral meeting, may be addressed to:

Colleen Barnes, Department of Finance, Government of Canada: 613-992-4982;
Barnes.Colleen@fin.gc.ca; or,

Dean Corno, Department of Finance, Government of Canada: 613-947-2086;
Corno.Dean@fin.gc.ca.

Collective Request:

6. The GATS provides a framework under which countries can undertake financial services liberalization while enabling regulators to protect the stability and integrity of the financial system. Improved GATS commitments should include and build upon existing financial services liberalization as appropriate.
7. The following objectives should help WTO Members consider the scheduling of meaningful GATS commitments:
 - Definitions: Use the agreed definitions in the GATS Annex on Financial Services for scheduling commitments (see attachment).
 - Mode 1: undertake commitments for marine, aviation and transport insurance; reinsurance; insurance intermediation, insurance auxiliary services; financial advisory services and financial information and data processing services.

- Mode 2: undertake commitments for marine, aviation and transport insurance; reinsurance; insurance intermediation, insurance auxiliary services; and all non-insurance financial services (subsectors v-xvi).
- Modes 1 and 2: there can be advantages of additional liberalization, especially where the consuming agent is sophisticated, for example, an institutional consumer of securities services.
- Mode 3: for all financial services sectors, undertake commitments encompassing rights to establish new and acquire existing companies, in the form of wholly-owned subsidiaries, joint ventures and branches.
- Modes 1, 2 and 3: remove discrimination between domestic and foreign suppliers regarding application of laws and regulations ("national treatment").
- Modes 1, 2 and 3: remove limitations such as monopolies, numerical quotas or economic needs tests and mandatory cessions.
- Transparency in development and application of laws and regulations, transparent and speedy licensing procedures, and other regulatory issues should be addressed in the negotiations.

Attachment: Definitions:

Insurance and insurance-related services

- (i) Direct insurance (including co-insurance):
 - (A) life
 - (B) non-life
- (ii) Reinsurance and retrocession;
- (iii) Insurance intermediation, such as brokerage and agency;
- (iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Banking and other financial services (excluding insurance)

- (v) Acceptance of deposits and other repayable funds from the public;
- (vi) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction;
- (vii) Financial leasing;
- (viii) All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts;
- (ix) Guarantees and commitments;
- (x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:
 - (A) money market instruments (including cheques, bills, certificates of deposits);
 - (B) foreign exchange;
 - (C) derivative products including, but not limited to, futures and options;
 - (D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
 - (E) transferable securities;
 - (F) other negotiable instruments and financial assets, including bullion.

- (xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;
- (xii) Money broking;
- (xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;
- (xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;
- (xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;
- (xvi) Advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

**ANNEX 7: Proposed Model Schedule for future Insurance Commitments
by WTO Members****Introduction**

This Proposed Model Schedule is a proposed text for the use of WTO Members in scheduling commitments under the framework of the GATS.

It does not require a new framework of GATS, nor does it require a new annex or a new method of scheduling commitments under the GATS.

It is suggested as a desirable text to be used not only when Members schedule new commitments, but also for Members who have already made commitments as described in each item of the text.

The attached document represents two separate contributions which WTO Members would add to their commitments in insurance. The first represents commitments to market access and national treatment. It builds on existing commitments already in the schedules of many countries, but incorporates certain specific obligations so as to remove any ambiguity as to whether they are built into the more general obligations assumed in the schedule. For instance, some countries already have inserted “none” in their insurance commitments for certain modes of supply, such as that of commercial presence. The purpose of the attached text is to give greater specificity and predictability to those commitments that are important to the industry. In addition, it sets forth obligations clearly not addressed in current schedules, such as the obligation to fully stage a commitment within a specified timeframe, as well as a standstill to protect acquired rights.

The second part of the contribution could be entitled “Best Practices in Insurance”, which take the form of “additional commitments” under GATS Article XVIII. It addresses those aspects of domestic regulation that are not addressed by the market access or national treatment provisions. They reflect regulatory obligations that exist for both foreign¹⁶⁷ and indigenous suppliers of services. Unlike the first part of the text, however, the best practices would be uniformly adopted by a critical mass of countries. Conceptually, the two parts serve the same objective, in that they are addressing effective market access for insurance providers. However, they are separated because of the way in which the GATS is structured.

In order to make clear the intended effect of this text, the following comments are felt necessary to ensure completeness in the obligations to be assumed in the area of insurance.

¹⁶⁷ “Foreign” means “from another WTO member” throughout the Model Schedule and the “Best Practices” annex.

I. PROPOSED MODEL SCHEDULE FOR INSURANCE SERVICES

The following would be an integral part of the specific commitments in the insurance sector pursuant to Article XVI and XVII of the GATS, entered into in accordance with the wider obligations in Parts I and II of the GATS relating to Sub-Federal entities. The obligations to be assumed by a Member must be read with commitments expressed in the columns of market access and national treatment in its schedule, in order to reflect the full extent of the Member's undertakings. In some instances, the obligations assumed in the market access and national treatment columns in a Member's schedule may capture some of the undertakings listed in this text. It nonetheless is suggested that those obligations should be described or supplemented by the wordings used in this proposed model schedule with the objective of providing greater clarity and specificity to certain aspects of the Member's insurance obligations.

It is recognized that some obligations cannot be assumed at the conclusion of the current negotiation. However, some appropriate time frame for the staging of obligations is to be established, in general leading to full obligations in a maximum two years time from entry into force of the results of this negotiation.

The proposed text does not suggest a different method of scheduling commitments. It recognizes the right of Members to schedule commitments according to the Financial Services Understanding, which is annexed to the GATS; or according to standard scheduling techniques as provided in Article XX of GATS.

Unless otherwise indicated, the terms "insurance services" and "insurance supplier" incorporate all forms of insurance and reinsurance underwriting; insurance intermediation (brokerage and agency services, including reinsurance brokerage); surety; consultancy, actuarial, risk management, risk assessment, and claims settlement services.

Market Access and National Treatment

A. Acquired Rights

With respect to all insurance services, future measures and schedules of commitments adopted by Members will, at a minimum, not reduce or impair the current level of market access and national treatment available to foreign insurance services and services suppliers.

B. Market Access - Cross Border delivery in respect of Reinsurance, MAT Insurance

1. Reinsurance, MAT insurance and insurance services related to these types of insurance are to be bound under the cross border mode of supply without restrictions to market access. Members will assume identical undertakings with respect to access to MAT and insurance intermediation (brokerage and agency) services related to these types

of insurance by clients located abroad, without regard to whether the foreign insurance supplier is registered in the consumer country.

2. For life and non-life reinsurance¹⁶⁸ the following additional specific commitments are to be included in the schedule:
 - (a) Elimination of mandatory cessions imposed on insurance suppliers to cede all or a portion of their risks to specified insurance or reinsurance suppliers;
 - (b) Elimination of any requirements that impose greater restrictions on the percentage of cessions to foreign reinsurance suppliers than to domestic reinsurance suppliers;
 - (c) Elimination of right-of-first refusal privileges for domestic reinsurance suppliers;
 - (d) Elimination of discriminatory requirements imposed on foreign reinsurance suppliers as they relate to collateralisation and localization of assets;
 - (e) The abolition of reinsurance monopolies; and
 - (f) The guarantee of freedom of form of reinsurance and freedom of reinsurance contract terms.

C. Market Access - Commercial Presence

1. Form of establishment

- (a) A foreign insurance supplier may establish a commercial presence by setting up a subsidiary (either wholly or partly (majority) owned), or by forming a new company, or through acquisition of an insurance supplier already established in the host country or as a branch;
- (b) In their regulatory approach to a foreign insurance supplier, Members shall have full regard for the relationship between such a supplier and its parent company when the supplier enters into the market;
- (c) Consistent with international intellectual property, business name registration and trademark law, a licensed foreign insurance supplier may provide its services using its home company name in the host country market, provided it does not infringe an already established trademark in that country;
- (d) Foreign insurance suppliers should not be denied a commercial presence in the form of a branch or a subsidiary on the basis of their form of legal organization in the home market.

¹⁶⁸ The commitment should allow for differentiation on a least trade restrictive basis for life and non-life reinsurance market segments, consistent with the nature of risks assumed.

2. Equity shares

- (a) Where commercial presence is in the form of a joint venture with a partner located in the host country, the decision to operate through a joint venture, and the percentage of equity shares assumed by the foreign partner, should be determined solely by the joint venture partners themselves;
- (b) Foreign equity share restrictions will be eliminated. Where necessary, this will be achieved over a transition period terminating by a fixed date, not to exceed two years from the entry into force of this schedule of commitments;
- (c) During the above transition period, any such limitations should permit the foreign partner to hold at least 51% of the equity in the company, with staged increases.

3. Compulsory Lines

Members will assume full commitments to market access and national treatment that cover compulsory risks, to ensure that foreign insurance suppliers can compete for insurance lines and insurance services that are required of persons and businesses that reside in Member countries.

4. Monopolies

Members should endeavour to eliminate the provision of insurance services by designated monopolies or exclusive services suppliers.

5. Private participation in Pensions and Funds Management¹⁶⁹

Upon the adoption of measures that allow for private participation in the pension systems of WTO Members whose current regime prohibits this, or for Members whose current system authorized private participation in such pension systems, such Members will commit in their schedules to give other WTO Members the benefits of market access and national treatment. Foreign suppliers providing pensions and funds management services¹⁷⁰ will have access, on a non-discriminatory basis, to offer their services to private and/or public pension systems provided by host country Members. Where pension fund services are provided through the commercial presence mode, foreign suppliers will be afforded the choice of opportunities as provided in C.1 (a) and C.2 above. Foreign suppliers providing public and private pension funds and services may offer the range of product and investment options they find necessary to meet benefit needs consistent with national treatment requirements.

¹⁶⁹ Reservation by the Italian market.

¹⁷⁰ Pension fund services would include the design of public and private pensions systems; the marketing of such pensions to individuals, employers, and governmental entities; the investment of pension funds on behalf of pension plan participants and retirees; and the administration of public and private pension plans including, but not limited to, administrative services and record keeping, compliance and enrolment services.

D. Market Access - Temporary Entry of Natural Persons

1. In general, nationality and residency requirements on personnel should be avoided.
2. Where a foreign insurance supplier operates through a commercial presence, it may select, as its representative in the host country, any person who physically resides in the host country, irrespective of nationality; provided that the representative meets regulatory standards that identify competency to perform services in such a role, and any other provisions relating to the fitness of that individual to perform the obligations of a company representative.
3. In addition to the commitments undertaken in the general headnote to the GATS schedule pertaining to the temporary entry of natural persons, the following additional obligation is assumed with respect to insurance: host country Members shall provide temporary visa and associated work permits, where required, to professional level personnel employed by the foreign insurance services supplier's home and third country offices in a timely manner for the purpose of entering the country and providing short and mid-term assistance to its host country insurance services operations.¹⁷¹

E. National Treatment

1. In addition to the right to compete for all lines of insurance in a host country, foreign insurance suppliers, who are licensed or established in the host country, shall have the same opportunities to compete for domestic insurance business as indigenous insurance services suppliers with respect to insurance for state-owned or state affiliated enterprises, or any enterprise where the state holds an equity share.
2. Foreign insurance suppliers will be treated no less favourably than domestic services suppliers with respect to capital, solvency, reserve, tax and other financial requirements, subject to the provisions of Paragraph 2 (a) of the Annex on Financial Services. Where less favourable treatment is imposed on the basis of Paragraph 2 (a) of the Annex, Members will explain the basis for the different treatment accorded and, in particular, why such treatment is necessary for the protection of policyholders.
3. In the case of insurance intermediation, Members will limit any conditions or limitations with respect to monetary transfers by insurance intermediaries to what is necessary to assume their legal responsibilities in the country where the service is delivered.

¹⁷¹ These obligations under the fourth mode of supply must be read with undertakings in the headnotes to services schedules addressing this category. For Members who have scheduled according to the Understanding on Financial Services, any specific obligations assumed under the Understanding must be read with these obligations.

II. Best Practices in Insurance

The following obligations are assumed under Article XVIII of the General Agreement on Trade in Services, which allows for additional commitments to be entered into schedules other than those covered by market access and national treatment, as defined in Articles XVI and XVII, respectively.

A. Transparency

1. New and existing regulations, as well as revisions to existing regulations, will be made publicly available at all times, preferably in a public journal or register, in order to insure their availability to all interested parties.¹⁷²
2. New or revised regulations will be submitted for public comment prior to their enactment. A reasonable period of time, ordinarily no less than one month, will be provided to interested parties to submit comments on all proposed regulations.
3. New or revised regulations will not be made effective until market participants have had a reasonable period of time to become familiar with their contents and take necessary steps to implement them. Except for regulations which must be implemented immediately, due to emergency or other exigency, they will, at a minimum, enter into legal force two weeks following their publication.
4. As part of the procedures for implementing new or revised regulations, Members will provide, in writing, their explanation as to the reasons for rejecting or accepting proposals made by interested parties.
5. An insurance supplier applying for a license will be provided with a written statement, setting out fully and precisely the documents and other information necessary for obtaining authorization. This statement should aim to simplify and accelerate, as appropriate, the specific procedures to be followed.
6. Members will ensure that there are established procedures that enable consumers to assess the creditworthiness of insurance companies. In addition, they will insure that insurance suppliers are free to provide information on their creditworthiness to the public, including information from independent rating organizations that provide such assessments.¹⁷³
7. Subject to the exception under Article XIV(c)(ii), Members will ensure that there will be no restrictions on the availability of financial services information from domestic or foreign sources to registered insurance suppliers.
8. Members will ensure that there are publicly available, non-discriminatory rules and procedures established that govern the identification and handling (including disclosure) of financially troubled institutions.

¹⁷² This obligation forms part of a general obligation assumed by all Members under GATS Article III.

¹⁷³ This obligation is subject to Article 2 (b) of the Annex on Financial Services.

9. Measures adopted with respect to taxation (national and sub-national) that affect all insurance products will not enter into force until they have been notified to the WTO through a semi-annual notification process established under the Services Council.

B. Solvency and Prudential Focus

1. Members will provide for insurance market stability and consumer protection through solvency and prudential regulations, allowing the market to determine which products and services are offered and rates applied.
2. Members will adopt and implement procedures that encourage and expedite the offering of insurance products and services.
 - (a) With the exception of products sold and rates applied to individual persons and compulsory lines, insurance regulation will not require new products, rates, and services to be filed or approved;
 - (b) Where filing and approval of an insurance product or service is required, the Member regulatory authority will make publicly available the policy reasons for such requirements and explain how the requirements are the least burdensome means of accomplishing those objectives;
 - (c) Where filing and approval is required, insurance suppliers will be permitted to introduce a new product, which will be deemed to be approved after sixty days time if the insurance supervisor has not taken action to disapprove it;
 - (d) No limits will be placed on the number and frequency of new product and service introductions by an insurance supplier.
3. Members will not restrict the payment of dividends by foreign insurance suppliers provided solvency margins are met.
4. Standardised Reporting, Actuarial, Training Practices/Requirements.

Members should encourage adoption of accounting and auditing standards based on recognized international “best practices” standards. International Actuarial Association standards should be adopted to harmonize standards, and to facilitate the evaluation and comparison of insurance suppliers’ financial strength, and their incorporation of new skills.

C. Insurance Monopolies

For remaining insurance monopolies, the following obligations are to be assumed:

1. As a general rule, designated insurance monopolies are to be prohibited from offering insurance products outside the area of their monopoly designation. Where monopolies are permitted to engage in the sale or underwriting of insurance products outside the area of their monopoly

rights, appropriate supervisory and oversight steps will be taken to ensure that monopolies do not abuse their monopoly position when competing in product areas that are open to competition.¹⁷⁴

2. Insurance suppliers with designated monopoly rights will maintain separate accounts for monopoly and non-monopoly activities, to insure that revenues from the monopoly do not subsidize competitive insurance activities.

D. Independent Regulatory Authority

The insurance regulatory body will be an independent government entity, to ensure that decisions regarding procedures adopted by the regulator are impartial with respect to all participants, and will encourage a competitive insurance market.

¹⁷⁴ This obligation is addressed in Article VIII (2) of GATS.

ANNEX 8: OECD Framework for insurance market liberalisation

FRAMEWORK FOR INSURANCE MARKET LIBERALISATION

- Considering that the liberalisation of the insurance markets (including reinsurance) is beneficial to the consumers, the economy and the insurance industry, and the consequent need to promote it;
- Considering that liberalisation requires genuine access to national markets as well as to local markets of federal states;
- Considering that a successful liberalisation calls for an adequate regulatory and supervisory framework;
- Conscious that the liberalisation process may need to be achieved progressively and may need to take account of differences in classes and modes of delivery;
- Having regard to the OECD Codes of liberalisation, the work of the OECD related to the revision of these Codes and to liberalisation issues in general, the Twenty Insurance Guidelines for economies in transition, and taking account of the non-binding nature of this "framework for insurance market liberalisation";

The OECD Insurance Committee:

- *agrees on the following basic principles for the liberalisation of the insurance markets:*

Principle No.1: Liberalisation requires genuine market access.

Principle No. 2: Liberalisation requires adherence to the concept of national and non-discriminatory treatments.

Principle No. 3: Liberalisation requires a suitable regulatory framework and adequate prudential rules.

Principle No. 4: Liberalisation requires open and ongoing dialogue among regulators and all market participants, transparent markets, and a transparent regulatory and supervisory process.

Principle No. 5: Liberalisation requires fair competition and de-monopolisation.

- *invites non-member countries to adopt these principles;*

- agrees to develop, in the framework of the 2001-2002 programme of work of the OECD Insurance Committee, further analytical work on the implementation of these principles, the identification of the obstacles for such implementation and to consider the best policy recommendations and guidelines that the Committee could consider in this respect and possibly report to the OECD Council.

ANNEX 9: Selected statistics on the BCIMR countries

		BRAZIL	CHINA	INDIA	MEXICO	RUSSIA	
	units						
Area	'000 sq km	8,512	9,597	3,290	1,973	17,075	
GDP per capita	USD in 05	8,400	7,926	3,400	10,000	11,100	
GDP in	Agriculture	% in 05	8	13	19	4	5
	Industry	% in 05	40	47	28	26	37
	Services	% in 05	52	40	54	70	58
Unemployment rate	% in 05	10	20	9	4	8	
Gini index of income distribution		64	44	33	55	40	

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International Association for the Study of Insurance Economics

"The Geneva Association"

Route de Malagnou 53
CH-1208 Geneva
<http://www.genevaassociation.org>

Tel. +41-22-707 66 00
Fax. +41-22-736 75 36
E-mail: secretariat@genevaassociation.org

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The Activities of The Geneva Association

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The International Association for the Study of Insurance Economics, or by its short name "The Geneva Association", is a unique world organisation comprised of a maximum of 80 chief executive officers from the most important insurance companies in the world (Europe, North and South America, Asia, Africa and Australia). It is a non-profit organisation. Its main goal is to research the growing importance of worldwide insurance activities in all sectors of the economy. It tries to identify fundamental trends and strategic issues where insurance plays a substantial role or which influence the insurance sector. In parallel, it develops and encourages various initiatives concerning the evolution - in economic and cultural terms - of risk management and the notion of uncertainty in the modern economy.

The Geneva Association also acts as a forum for its members, providing a worldwide unique platform for the top insurance CEOs. It provides a framework for its members to exchange ideas and discuss key strategic research issues, especially at the General Assembly where once per year over 50 of the top insurance CEOs gather. The Geneva Association serves as a catalyst for progress in this unprecedented period of fundamental change in the insurance industry. It seeks to clarify the key role that insurance plays in the development of the modern economy.

The Historic Development of The Geneva Association

Former Presidents of the Geneva Association: Mr Raymond BARRE, Paris (1973-1976); Mr Fabio PADOA, Trieste (1976-1983); Mr Julius NEAVE, London (1983-1986); Prof. Dr Dr e.h. Reimer SCHMIDT, Aachen (1986-1990); Sir Brian CORBY, London (1990-1993); Drs. Jan H. HOLSBOER, Amsterdam (1993-1999); Mr Walter KIELHOLZ, Zurich (1999-2003).

The Constitutive Assembly of the Geneva Association took place in Paris on February 27, 1973, at the headquarters of La Paternelle (today part of the AXA Group). The following companies were represented by their President or Chief Executive Officer: Allianz, Münchener Rück, Aachener & Münchener, and Victoria for Germany; Commercial Union, Royal and Mercantile & General for the United Kingdom; Erste Allgemeine for Austria; Royale Belge for Belgium; UAP, AGF, Paternelle, Préservatrice and SAFR for France; Generali, RAS, Reale Mutua, INA and Fondiaria for Italy; Nationale Nederlanden for the Netherlands, and the Swiss Re for Switzerland.