FINANCIAL SECTOR ASSESSMENT PROGRAM

LEBANON

THE INSURANCE SECTOR: A MARKET & RISK BASED REVIEW

TECHNICAL NOTE

DECEMBER 2013

This Technical Note was prepared in the context of a Financial Sector Assessment Program Development Module mission in Lebanon during May, 2013 led by Gabriel Sensenbrenner, World Bank and overseen by Finance and Private Sector Development Vice Presidency, World Bank. The note contains technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at www.worldbank.org/fsap.

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Abbreviations

ACAL	*Association des Compagnies d'Assurances au Liban*
AFIRC	Arab Forum of Insurance Regulatory Commissions
FSAP	Financial Sector Assessment Program
IAIS	International Association of Insurance Supervisors
ICC	Insurance Control Commission

Currency at time of report preparation: 1 USD = 1480 LBP

INTRODUCTION AND SUMMARY

1. **This note summarizes the conclusions of the review of the insurance sector in the Lebanon as part of the Financial Sector Assessment Program (FSAP)[1].** The main objectives of the assessment are to review the performance and structure of the insurance sector with respect to:

- **The potential exposure of the sector to vulnerabilities,** either generated from the sector or in response to other circumstances outside the sector that could either be magnified or dampened by the sector;

- **The potential for the sector to grow and develop**, in its own context and also to contribute to the overall long term growth and development of the economy and the well-being of the Argentine people; and

- **The relationship between the oversight and regulatory arrangements for the sector against international norms and best practices**.

2. **The note focusses, primarily, on the "developmental" objective.** The note is prepared in varying levels of detail selectively identifying then developing issues and based firmly in an analysis of the existing market situation and performance.

3. **The insurance sector is material compared to other markets in the region but small by worldwide standards**. The sector has grown in nominal and real terms supported by growth in motor and medical insurance. Life insurance growth has been supported by the development of a bancassurance model, including the introduction of single premium credit life products.

4. **However, the sector has developed largely by an evolutionary process than through significant innovation**. Insurers tend to have business models focused on organic growth of successful operations and approaches. In more limited cases, innovations have been experimental, tactical, and not always successful. Future development will, in the absence of external initiatives, tend to be focused on continuing to refine and grow current practices organically. This suggests that the sector is better placed to react to change than to initiate it, and looks to external initiatives for change to a greater extent. Being cautious about change, and conservative in experimenting, has the advantage of minimizing the risk of loss through unsuccessful initiatives. However, reacting to rather than anticipating adverse developments can and has meant that foreseeable losses could have been reduced.

5. **Industry participants consider that the number of insurers constrains the sector however, the response to competition and efficiency settings needs to be more nuanced**. The introduction of proportionate approaches to regulation through a new insurance law would be a more effective solution for the sector to resolve the current inefficiencies.

6. **Insurers, generally, have sufficient expertise to operate current business models but some weaknesses should be addressed.** Understanding prudent provisioning has improved but

[1] The note has been prepared by Craig Thorburn, Lead Insurance Specialist, of the World Bank.

challenges remain. The auditing profession is capable but small insurers have difficulty justifying services beyond minimum levels. Actuarial capacity in Lebanon is limited in supply but is available and capable. Weaknesses include concerns about underpriced products and inadequate pricing capacity, insufficient understanding of catastrophic exposures, and underdeveloped organization wide approaches to risk management, including integrated capital, asset, liability and operational risk management.

7. **Sector initiatives directed at improvement should be integrated with supervisory functions**. Supervisory initiatives that start with assessment and dissemination of current good practices should give stakeholders the opportunity to discuss and develop their own technical capacity. Analytical studies of priority would include those directed at a better understanding of risk exposure and management, economic capital, and key risk management approaches. Priority should be given to assessing risk parameters that would support further refinement of the internal risk rating systems at the ICC as well as inform insurer management. These would include approaches to asset risks as well as technical risks in priority business lines, natural catastrophic exposures, and reinsurance management.

8. **The insurance law is very outdated. A modernization of the insurance law is long overdue.** There is no solid basis for proportionate approaches in many areas of regulation, solvency and capital regulation is antiquated, and intervention powers are insufficient to allow a more graduated approach. Opportunities to develop supervisory cooperation in the region are not sufficiently supported by legal powers. Corporate governance, internal control and risk management considerations do not reflect modern thinking.

9. **Despite the limitations in the insurance law, the Insurance Control Commission (ICC) has grown in stature and respect**, supervisory practices have been developed, and improvements instituted as the ICC has taken advantage of areas where improvements can be advanced. The ICC has shown an admirable capacity to develop approaches for review and analysis, follow-up, market conduct, intermediary registration, and fraud investigation.

10. **Consumer protection initiatives have helped to enhance the sector standing and can be leveraged further**. The ICC has initiated a welcome market conduct effort including a consumer complaint handling service and a reconstituted distribution licensing system. In the absence of insurance law reform, distribution requirements could be refined progressively to ensure consumer protection services are maintained, in particular, to facilitate the range of products and distribution channels in use. Currently, the distribution decree offers one of the best opportunities for proportionate, modern requirements.

11. **Supervisory capacity should to continue to develop**. Both the analytical efforts and the supervisory initiatives could be further developed with increased resources and technical support. As noted, enhancing the risk rating system, including continuing refinement of risk sensitive financial capacity, and adding additional risk features to more fully reflect the range of sources of risk in insurance operations would be useful.

12. **There is an opportunity to increase market penetration**. Longer term insurance faces an adverse fiscal environment compared to alternatives, but a new pension product initiative would need to be accompanied with a modernized insurance law to ensure sound operation. Efforts to make the insurance market more inclusive could be explored although the principle of

proportionality can only be introduced at the distribution level until the insurance law is reformed to allow consideration of the same principle for insurers.

MARKET SIZE, COMPOSITION AND DYNAMICS

Penetration, Growth and Comparisons

13. **The insurance market in Lebanon is material compared to other markets in the region but small by worldwide standards**. It is small relative to GDP by developed standards and heavily oriented to the non-life sector where growth has been stronger in more recent years. Insurance penetration stood at 2.84 percent in 2012 and insurance density was $US301. Empirical studies of the development of insurance markets indicate that the sector transitions from a nascent stage to a developing stage then a mature stage and Lebanon is at a level consistent with the developing stage[2].

14. **Growth in nominal terms has been particularly strong in the non-life sector in particular and the rate of growth has been increasing.** [3] The trend in insurance penetration illustrates that growth has been healthy. The sector has grown in nominal and real terms supported by growth in motor and medical insurance. Life insurance growth has been supported by the development of a bancassurance model, including the introduction of single premium credit life products. Over the longer term, this growth has followed weakness during periods of security disruptions in Lebanon or the broader region, highlighting the importance of peace to the economy and the insurance sector in particular.

Table 1: Trends in Insurance Penetration and Density

						Rates of Growth (percent per annum)		
	2001	2006	2010	2011	2012	1 year	6 years	11 years
Insurance Premium (in millions local currency)								
- Life insurance	146,679.75	263,719.44	491,862.52	533,938.80	568,052.18	6.39%	13.64%	13.10%
- Non life insurance	470,490.75	512,093.61	864,296.55	940,221.69	1,384,017.17	47.20%	18.02%	10.31%
Total	617,170.50	775,813.05	1,356,159.07	1,474,160.49	1,952,069.35	32.42%	16.62%	11.04%
Insurance Penetration (premium to GDP)								
- Life insurance	0.55	0.78	0.88	0.88	0.83	-6.65%	0.97%	3.74%
- Non life insurance	1.77	1.51	1.54	1.56	2.01	29.17%	4.86%	1.18%
Total	2.32	2.29	2.42	2.44	2.84	16.19%	3.62%	1.85%
Insurance Density (premium per capita) in local currency								
- Life insurance	38,599.93	64,321.81	116,279.56	125,337.75	132,105.16	5.40%	12.74%	11.83%
- Non life insurance	123,813.36	124,900.88	204,325.43	220,709.32	321,864.46	45.83%	17.09%	9.07%
Total	162,413.29	189,222.70	320,604.98	346,047.06	453,969.62	31.19%	15.70%	9.79%
Insurance Density (premium per capita) in USD								
- Life insurance	25.61	42.67	77.13	83.14	87.63	5.40%	12.74%	11.83%
- Non life insurance	82.13	82.85	135.54	146.41	213.51	45.83%	17.09%	9.07%
Total	107.74	125.52	212.67	229.55	301.14	31.19%	15.70%	9.79%

Source: AXCO figures and categories used for comparative purposes, Staff Analysis

15. **Comparing market statistics with other countries in the region highlights a relative strength of the insurance sector in Lebanon compared to other countries in the region but the gap between this and fully developed markets.** Although comparisons between countries

[2] For a discussion on the phases of insurance market development see Enz (2000) or Beck and Webb (2003) as examples. Along with comparative figures against other countries, the "S-curve" reinforces the view that the Lebanese sector can and should be expected to grow considerably.

[3] For international comparisons, the primary source is figures reported annually by Swiss Re and by AXCO.

need to be interpreted broadly due to differences in market circumstances and conditions, it is notable that Lebanon compared well in terms of size and growth rates when considering other countries and the region composed of the Arab Forum of Insurance Regulatory Commissions (AFIRC) (refer to Table 2).

Table 2: Some Comparative Statistics

	Selected Jurisdictions									
	Lebanon		Egypt		Jordan		Morocco		Cyprus	
year to ...	2012		2012		2012		2012		2012	
	Level	Growth pa	Level	Growth pa	Level	Growth pa	Level	Growth pa	Level	Growth p
Premium in local currency										
Life insurance	568,052.18	7.07%	4,633.60	9.48%	44.50	8.81%	8,776.34	8.40%	429.31	18.00
Non life insurance	1,384,017.17	21.34%	6,088.90	13.21%	419.80	9.85%	17,063.70	7.65%	389.75	12.69
Total	1,952,069.35	15.99%	10,722.50	11.51%	464.30	9.75%	25,840.04	7.90%	819.06	15.29
Premium in USD										
Life insurance	376.82	7.07%	764.62	7.92%	62.68	8.81%	1,016.96	7.27%	550.40	4.75
Non life insurance	918.09	21.34%	1,004.77	11.60%	591.27	9.85%	1,977.25	6.52%	499.68	0.04
Total	1,294.91	15.99%	1,769.39	9.92%	653.94	9.75%	2,994.21	6.77%	1,050.08	2.35
Insurance Penetration										
Life insurance	0.83	-5.02%	0.30	-5.35%	0.20	-3.43%	1.07	2.32%	2.40	3.15
Non life insurance	2.01	7.64%	0.39	-2.13%	1.91	-2.50%	2.08	1.61%	2.18	-1.50
Total	2.84	2.89%	0.70	-3.60%	2.11	-2.59%	3.14	1.85%	4.58	0.78
Insurance Density (in local currency)										
Life insurance	132,105.16	6.21%	55.09	7.55%	6.85	5.87%	269.21	7.32%	536.64	24.84
Non life insurance	321,864.46	20.37%	72.39	11.21%	64.58	6.89%	523.43	6.57%	487.19	19.22
Total	453,969.62	15.06%	127.48	9.54%	71.43	6.79%	792.64	6.82%	1,023.83	21.97
Insurance Density (in USD)										
Life insurance	87.63	6.21%	9.09	6.01%	9.64	5.87%	31.20	6.20%	688.00	10.82
Non life insurance	213.51	20.37%	11.95	9.63%	90.96	6.89%	60.65	5.46%	624.60	5.83
Total	301.14	15.06%	21.04	7.98%	100.61	6.79%	91.85	5.71%	1,312.60	8.27

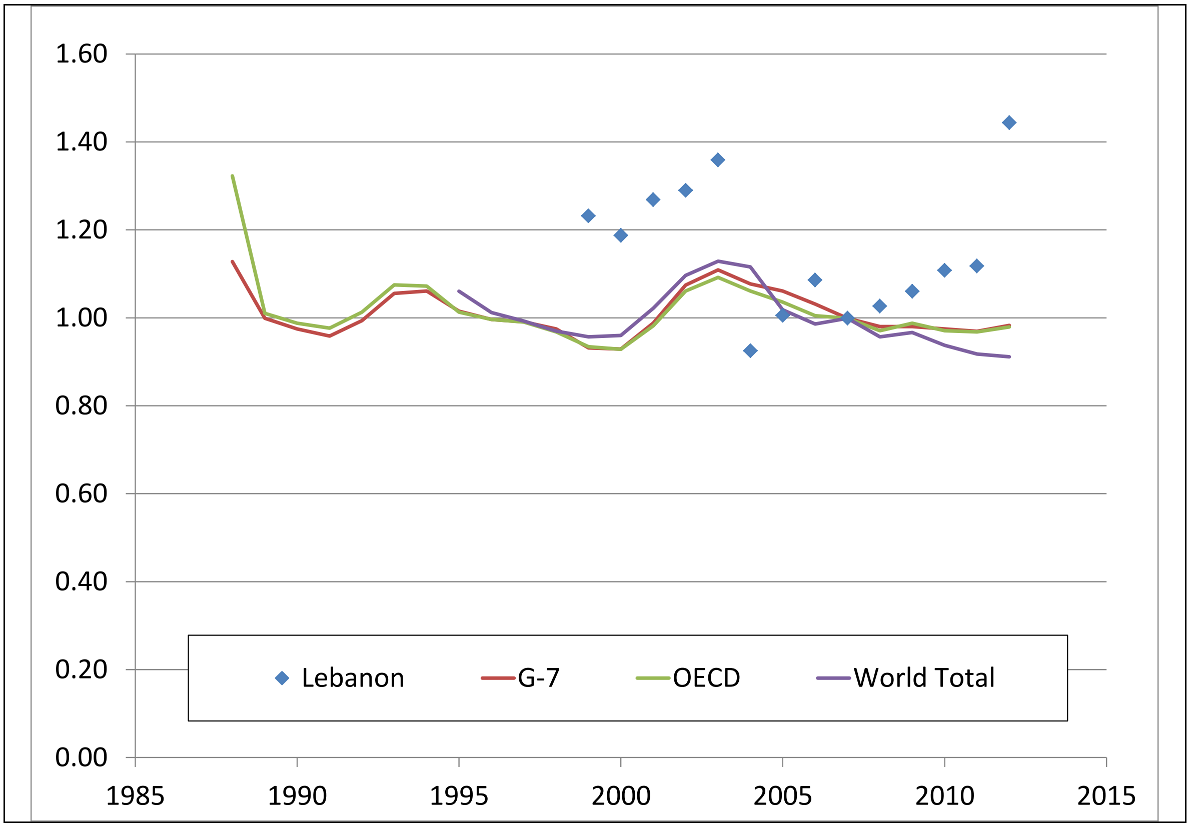
Source: AXCO, Staff Analysis

Sector Size, Trends and Products

16. **The trend in the non-life insurance sector penetration measure shows solid growth.** Gross premiums of 1,384 billion LBP were reported by the ICC in the year to June 2012, up from 512 billion LBP in 2006; a rate of increase just over 18 percent per annum. Insurance penetration for non-life insurance has grown from 1.5 percent to 2.0 percent over the same six year period indicating solid growth in real terms.

17. **Unlike many markets, the non-life sector in Lebanon has maintained a trajectory of growth independent of global pricing cycle trends.** Figure 1 shows the insurance penetration in the non-life sector compared to several large aggregate averages that would be independent of individual jurisdiction market peculiarities, standardized to 1 in 2007. The persistent global pricing cycle is not evident in Lebanon, despite the fact that the sector has a material reliance on reinsurance to provide capacity.

Figure 1: Comparison of Non-Life Penetration against the Pricing Cycle



Source: AXCO and Staff Analysis

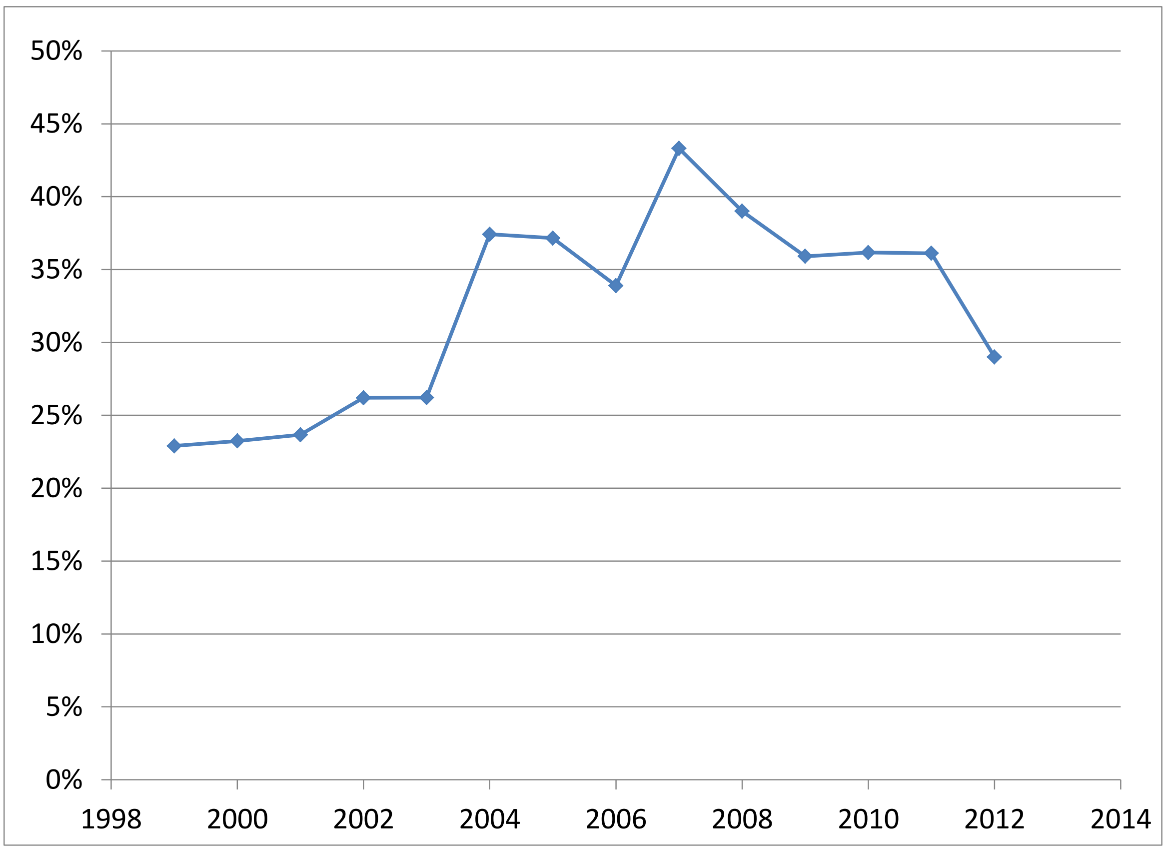
18. **Stakeholders attribute growth to a range of different impacts but all agree that the influences are diverse and partial.** Per unit price increases have been reported. These increases have arisen from a range of factors. High levels of claims inflation has been indicated by some insurers, pushing up unit premiums particularly for medical coverage. Improved provisioning and a move away from undesirable cash flow underwriting have also been noted. Reduced fraud in the compulsory motor insurance area is also having an impact on formalizing informal insurance operations. All of this has contributed to an improved understanding of risk and pricing than would have been the case five or ten years ago. At the same time, the cost of risk, provisioning and pricing are still not universally and completely understood, only better than they were in the past.

19. **Increases in motor and medical insurance products also reflect greater use of insurance**. Motor insurance formalization is only one feature of growth. Additionally, some insurers have promoted new motor products that provide more comprehensive protection and are sold as multiyear single premium products on cars purchased with loans, with the effect of bringing forward premium pushing up growth rates compared to regular premium equivalent coverage. Medical insurance has also seen increased utilization. Both these products have been able to be advanced by insurers particularly because of the lower need for reinsurance support, and although tending to be simpler in risk profile, they are not all absent of complexities in risk management.

20. **Opinion varies about the extent that insurance awareness might have increased**. Insurance awareness is seen as a key challenge that is limiting sector development. However, there is some evidence that increased insurance utilization has occurred and that this has been facilitated by a small increase in insurance awareness. Bancassurance distribution has facilitated reach into areas that were historically less well served outside the capital, and increased insurance awareness.

21. **The non-life sector would like to see further expansion in compulsory insurances but maturity in the sector will require successful voluntary demand and supply**. Motor and worker's compensation insurance for foreign workers are obligatory. Interest in adding new classes has been expressed. There is also a significant but less recognized opportunity to adjust current compulsory insurance coverage, extending coverage to include third party property damage in the case of motor insurance for example, and continue to improve compliance. However, the longer term sustainable and mature sector needs to be based on a capacity to develop products that are voluntarily purchased, needed, and valued by customers; something that could be undermined by too heavy a reliance on compulsion for sector development.

Figure 2: Proportion of Total Premium that is Life Insurance



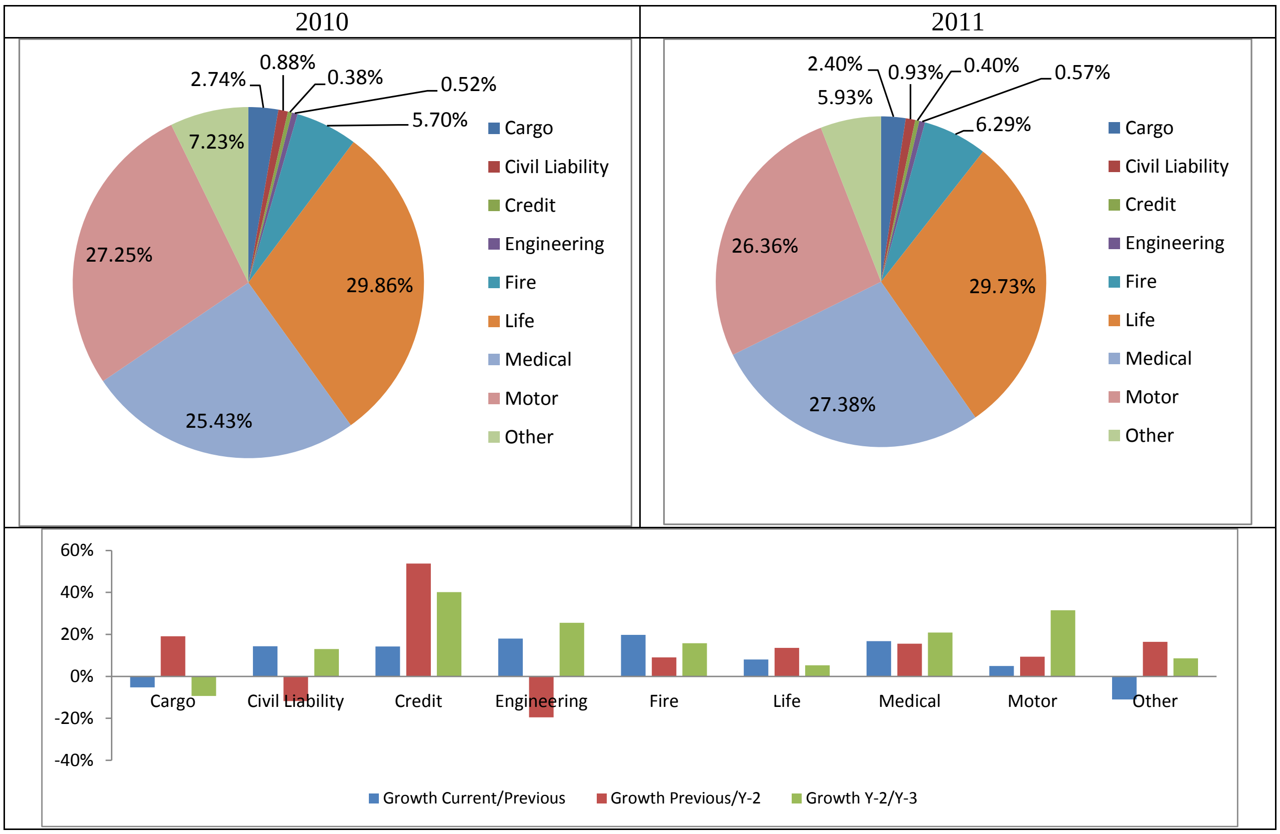
Source: AXCO, Staff Calculations

22. **The life insurance sector represents around thirty percent of the total premium income and has been less dynamic.** The sector is small relative to the non-life sector and growth has been less substantive. Shorter term risk products are more popular than longer term savings reflecting uncertainty in the broader environment. Lower levels of life insurance premium in Lebanon also show trends that reflect the regional security challenges. Retirement

and long term saving products are not emphasized by the market, where technical limitations, capital constraints, and taxation all play a part in a reduced appetite to develop these products.

23. **Product trends in recent years highlight the focus on relatively simpler risk products** in medical motor and short term life insurances (refer Figure 3). This profile ensures that the sector, albeit long standing, is focused on the less technically demanding product lines and is more reactive than innovative, responding to client needs more so than innovating to create fresh demand. This conservative approach has had benefits for insurers and allowed steady growth and stability, but has limited capacity for creativity and innovation.

Figure 3: Product Shares by Class of Insurance (percent of gross premium)



Source: ACAL, Staff Analysis

24. **Taxes act as a break on sector development.** Premium based taxes provide an incentive for some business leaking outside the market, particularly marine insurances. Life insurance savings and investment products are not treated evenly between those provided by insurers and those provided through other types of entities that are exempt. Retirement products are particularly nascent despite the absence of a significant provision by the state.

Insurers, Distribution, Linkages and Competition

25. **There are 55 insurers in Lebanon in 2012.** Insurers are licensed separately for life, or non-life insurances or as composites. Of the total, there are only five dedicated life insurers. The number of insurers has remained fairly constant.

26. **Measures indicate intense levels of competition.** Research suggests that a wholly competitive insurance market tends toward international norms and that, taking into account the level of development of the insurance market and the absolute size, a neutral level for the herfindahl index can be estimated to inform the assessment of actual market measures. The argument, supported by cross country observations, is that markets with lower concentration are characterized by low profitability, insurers launching price and distribution poaching wars in an effort to grow and achieve economies of scale, both of which can undermine the financial stability of the sector, and of eventual merger activity to resolve the lack of economies secured through organic market growth[4]. This hypothesis is supported by industry observers and market participants in Lebanon (refer Table 3).

Table 3: Trends in Competition Measures in Lebanon

Competition Measures	2000	2006	2007	2008	2009	2010	2011
Herfindahl Index							
- Life insurance	4,121	1,652	1,468	1,338	1,126	1,038	1,092
- Non Life insurance	461	572	585	559	553	535	529
Market Share of Largest 5 Insurers (percent)							
- Life insurance	82.32	75.07	76.76	73.18	66.22	62.79	68.21
- Non Life insurance	39.10	43.22	43.83	42.91	42.02	41.72	41.50

Source: AXCO, Staff Calculations

27. **The larger number of insurers, and low herfindahl measures, persists due to the nature of insurer operations and ownership**. Small insurers, family owned and operated, might well be more like family brokerage firms in other jurisdictions, with limited risk retention and a focus on simplest low risk products. A number of these smaller insurers have been described as not really "active" in the market. In such an environment, with limited profitability and constrained resources, the capacity of the sector to innovate on the basis of new and more advanced technical skills is limited. In Lebanon, consistent with this situation, companies have to concentrate on developing their business in an organic and careful manner rather than seek significant investment in innovation that might not succeed. As such, the development of the sector has been constrained by the large number of insurers. Table 4 shows some comparative values for the competition measures showing that the figures for concentration are particularly low for Lebanon compared to AFIRC and even when compared to large and developed markets in the G-20.

Table 4: Comparing Competition Measures in the Region and Beyond

	Selected Jurisdictions					Country Group Averages	
	Lebanon	Egypt	Jordan	Morocco	Cyprus	AFIRC	G-20
Measures of competition							
Herfindahl index							
Life insurance	1092	2358	1767	2232	1874	3321	1192
Non life insurance	529	3096	613	1184	645	1964	764
Market share of largest 5 insurers							
Life insurance	68.21	90.44	81.03	91.19	83.02	88.39	57.67
Non life insurance	41.50	73.98	41.92	70.53	45.87	72.02	49.71

Source: AXCO, Staff Calculations

28. **Opinion varies as to the "right" number of insurers.** Sector participants advocate a reduction in the number of insurers but the "right" number varies considerably. During the

[4] Refer Thorburn (2008)

mission, various views were expressed from as many as 35 to as few as 10 insurers. There is consensus that consolidation is to be expected but that it has not occurred for cultural reasons and motivations at smaller firms that are not purely economic. World Bank research suggests that the herfindahl measures are better indicators to draw upon cross country guidance given the different definitions and thresholds of insurer operations. In the case of Lebanon, unless there is significant market growth, the life insurance herfindahl can be expected to grow gradually to double its current level and the non-life measure could be closer to three times the current level.

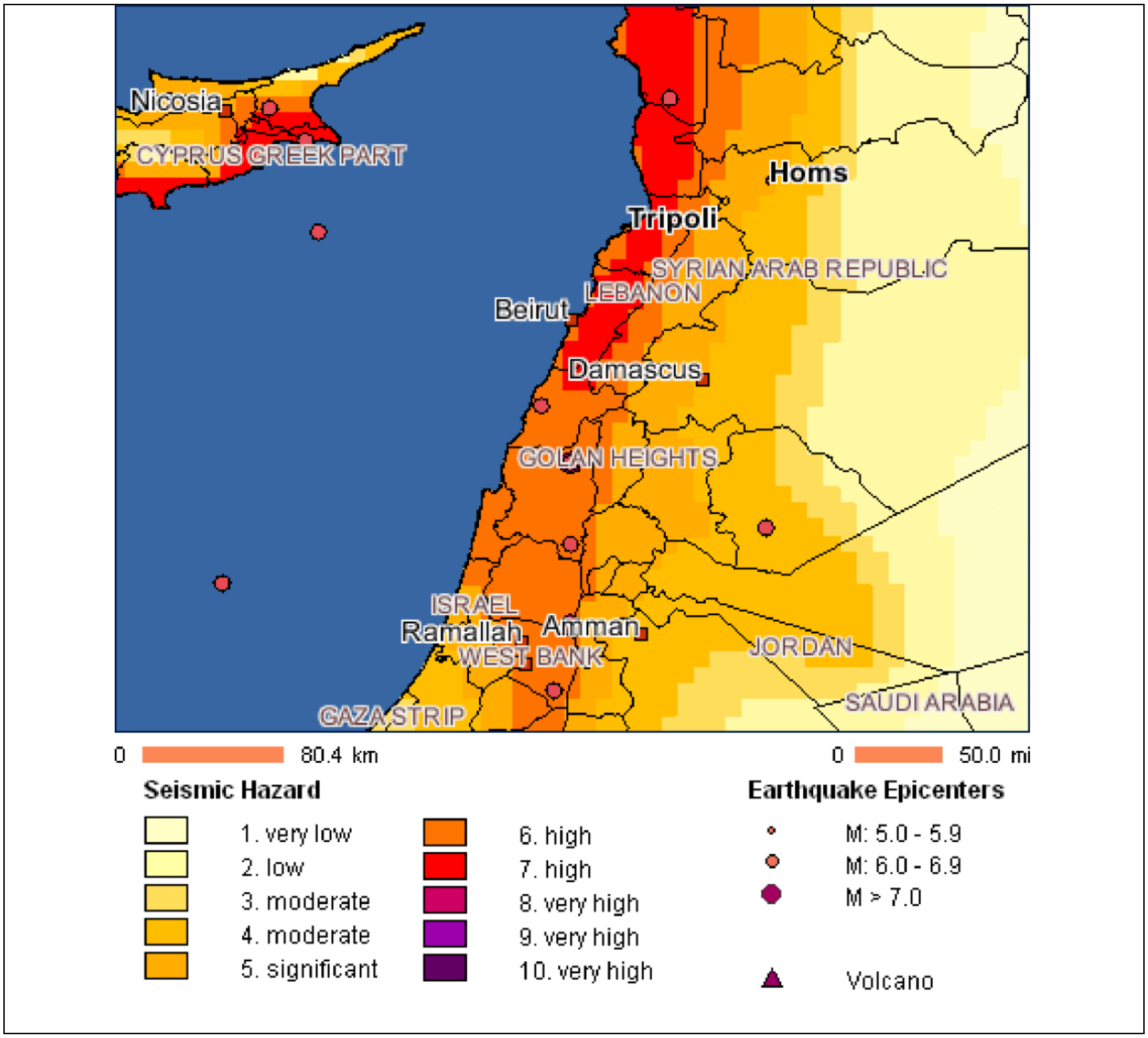
29. **However, it is not necessary to reduce the number of insurers to unleash further development**. Proportionality in regulation and supervision is possibly a preferable approach that could be used in Lebanon to find a way forward. It is likely to be more effective in a shorter time frame than waiting for market pressures to take effect. However, the insurance law would need to be amended to provide the basis for such an approach. An updated insurance law modernizing toward a more risk based approach and providing a more structured rule making power would also be consistent with international norms and practices. This should be a high priority given the potential benefit to the sector and the wider economy.

30. **The market uses a range of distribution channels including agents, brokers, direct sales and, more recently, bancassurance.** Most distribution is focused on the capital and surrounding Mount Lebanon but bancassurance and other alternative channels such as Lebanon Post are offering opportunities to expand reach to other parts of the country. Companies with associations with banks are the more active users of the bancassurance channel and tend to concentrate on short term risk type life insurance through that linkage. Agents and broker licensing is required under the insurance law but, for resource reasons, compliance is not able to be followed up and there are limited sanctions available. A new broker decree is under development but is limited in how far it can go due to the constraints in the current law.

Reinsurance and Catastrophic Risk

31. **Much of Lebanon has some exposure to natural catastrophes, principally earthquake.** There is a moderate exposure to earthquakes throughout the country although events are uncommon but can be significant. Seismic mapping is incomplete and the risk is not fully understood, and reports are that insurers may not all be well protected by reinsurance. Other natural perils are not considered material for the insurance sector particularly given the low levels of insurability.

Figure 4: CatNet Earthquake Exposure Map



Source: AXCO and Swiss Re CatNet ™.

32. **Reinsurance retentions and cessions are important to provide capacity in the market.** Most commercial classes of insurance are heavily reinsured (70 to 90 percent of premium ceded) whilst smaller retail products (life, motor and medical) are reinsured only to a more limited extent. Motor cessions represent, for example, only 6 percent of premium[5].

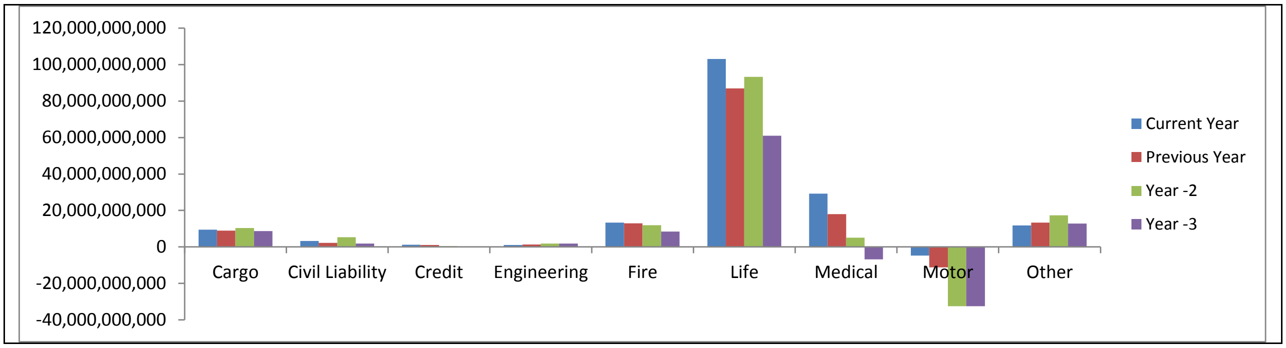
Financial Performance, Assets, Liabilities and Solvency

33. **The profitability of insurers has deteriorated and the large motor portfolio records underwriting losses.** Insurers have been able to secure profit over time through reliance on investment profits rather than underwriting profits. Conservative approaches and relatively simple product lines have made it possible to ensure low but positive profits. Competition, pricing technical skills that are less than fully developed by international standards, and motor

[5] Source: ACAL

risks that are becoming more complex with changes to product design, all make the motor portfolio losses more persistent than would otherwise be the case.

Figure 5: Trends in Profit by Class



Source: ACAL, Staff Analysis

34. **Expenses make up around 33 percent of premiums divided between sales and administrative costs.** Claims ratios just over 60 percent are consistent with many comparable markets pointing to the need to improve performance by targeting costs. In the longer term, claims ratios can be expected to increase as the market develops; adding value to clients, but this requires improved efficiency (refer Table 5). It should be noted that the combined ratios in 2010 and 2011 at levels around 85% are generally comparable with the average for all countries of 87 percent[6] and consistent with the general level of the global pricing cycle in the non-life segment.

[6] Source: Axco data average for all jurisdictions reporting combined ratios for all non-life insurance business. Individual classes of business within the non-life segment would not be as comparable given differences in definitions of classes between jurisdictions.

Table 5: Financial Performance Ratios

Line of Business	Loss Ratio		Expense Ratio		Commission Ratio		Reinsurance Ratio		Net Accounting Loss Ratio		Combined Ratio		Financial Income Ratio	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
Life	30.5%	24.0%	10.0%	9.9%	11.3%	11.1%	4.3%	4.8%	34.8%	28.7%	56.1%	49.8%	19.6%	21.6%
Life Total	**30.5%**	**24.0%**	**10.0%**	**9.9%**	**11.3%**	**11.1%**	**4.3%**	**4.8%**	**34.8%**	**28.7%**	**56.1%**	**49.8%**	**19.6%**	**21.6%**
Cargo	34.4%	83.1%	16.0%	16.0%	17.8%	17.9%	13.3%	33.6%	47.7%	49.5%	81.5%	83.4%	3.9%	4.5%
Civil Liability	56.2%	30.6%	15.4%	17.3%	17.2%	19.3%	11.0%	19.4%	45.2%	50.0%	77.7%	86.6%	6.2%	4.0%
Credit	39.0%	28.3%	30.0%	30.8%	16.0%	16.8%	9.7%	7.0%	48.7%	35.3%	94.8%	82.9%	3.0%	3.7%
Engineering	35.5%	24.4%	14.8%	14.1%	15.6%	14.2%	23.4%	38.4%	58.9%	62.8%	89.3%	91.1%	5.1%	5.3%
Fire	69.3%	33.5%	15.0%	15.2%	18.6%	18.5%	14.0%	22.0%	55.3%	55.5%	88.9%	89.2%	5.0%	4.4%
Medical	73.5%	75.0%	12.7%	12.7%	10.1%	9.9%	0.3%	0.0%	73.8%	75.1%	96.7%	97.7%	2.8%	3.1%
Motor	58.2%	61.1%	15.2%	16.7%	28.4%	26.9%	2.3%	2.5%	60.4%	63.5%	104.0%	107.1%	4.8%	5.8%
Other	44.1%	39.5%	14.8%	16.2%	21.6%	25.5%	11.2%	9.9%	55.2%	49.5%	91.6%	91.2%	4.3%	5.3%
Non Life Total	**62.8%**	**61.8%**	**14.3%**	**15.0%**	**18.9%**	**18.8%**	**1.3%**	**3.0%**	**64.1%**	**64.9%**	**97.3%**	**98.7%**	**4.0%**	**4.5%**
Grand Total	**53.1%**	**50.3%**	**13.0%**	**13.5%**	**16.6%**	**16.5%**	**2.2%**	**3.6%**	**55.3%**	**53.8%**	**84.9%**	**83.8%**	**8.6%**	**9.7%**

Source: ACAL, Staff Analysis

35. **Total assets in the insurance sector have grown to 3.37 billion USD**. Investment options are limited and are concentrated in liquid assets such as cash and short term deposits, fixed interest securities and property. Just under one third of assets are non-investment type assets such as reinsurance related items, fixed assets for operations, and various receivables.

36. **Insurance company investments are subject to a rule based regulatory system**. ICC requires insurers to have investments that cover technical provisions and the insurance law incorporates an accepted list of assets including government bonds, approved property and land, approved stocks, corporate bonds, and reinsurance related assets. There are no regulations covering assets covering shareholders' funds.

37. **Non-life insurers have to hold unearned premium provisions subject to regulated minima and claims provisions that include allowance for both reported and unreported claims**. In 2004 two decrees were issued covering enhanced unearned premium and claims reserving as well as new definitions of admissible assets. This was subject to a court dispute and was revised and reissued in June 2009 in the form of Decree No 2441 and Decree No 2442. The decrees also cover 'incurred but not reported' claims and premium deficiency reserves.

38. **Solvency margin requirements are out of date and low by international standards.** Local and foreign insurers and reinsurers (if any) are subject to the same minimum capital requirements. At LBP 2.25 billion (USD 1.5 million), the absolute minimum is not out of line with international norms or a barrier to entry. An out of date solvency margin requirement at 10

percent of premium is required. As part of the future development of the sector, a more risk based regime should be explored. Initially, this could be developed as a risk assessment tool for the sector and the ICC before it is implemented as a solvency regime under a revised insurance law with appropriate transitional arrangements.

Aspects of regulation and supervision

39. **The regulation of the insurance sector is established under the Law on Insurance Organisations,** Decree No 9812 of 1968. Subsequent amendments have been limited and there has been no material update since 1999. The legislation has very limited flexibility to allow modernization of the insurance oversight system to better reflect modern thinking and is in need of a comprehensive review. Compulsory motor insurance is provided for under the road safety code. A range of other insurance issues tend to be incorporated in the laws or decrees of various ministries complicating the opportunity for the oversight of insurer soundness to be more coordinated and consistent across product lines and adding cost to insurer business operations[7].

40. **Supervision of the insurance sector lies with the Minister for the Economy and its Insurance Control Commission.** The ICC has been enhancing its operations over the last decade and has been effective in the areas that it has been targeting. Some other areas that would be obvious are constrained by the out-of-date regulation. Although not fully independent, the growing stature of the ICC is welcome. The ICC is organized into two main teams (Financial Supervision and Market Conduct) and both have been developing their methods and skills adding value to the sector and the protection of policyholder's interests. Staffing numbers have been growing in line with increased activity and now stand at 20, and should be further increased progressively. The ICC should also be able to take advantage of technical assistance to supplement current staff efforts particularly for project related work.

41. **Mutuals are overseen by the ministry of agriculture and are subject to tax exemptions.** Consideration could be given as part of the review to how mutual insurers could be incorporated under modern insurance regulation and a level playing field on policyholder taxation impacts introduced.

42. **Despite the limitations in the insurance law, the Insurance Control Commission (ICC) has grown in stature and respect**, supervisory practices have been developed, and improvements instituted as the ICC has taken advantage of areas where improvements can be advanced. The ICC has shown an admirable capacity to develop approaches for review and analysis, follow-up, market conduct, intermediary registration, and fraud investigation.

43. **Consumer protection initiatives have helped to enhance the sector standing and can be leveraged further**. The ICC has initiated a welcome market conduct effort including a consumer complaint handling service and a reconstituted distribution licensing system. In the absence of insurance law reform, distribution requirements could be refined progressively to ensure consumer protection services are maintained, in particular, to facilitate the range of products and distribution channels in use. Currently, the distribution decree offers one of the best opportunities for proportionate, modern requirements.

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[7] This situation has arisen for a number of reasons including political challenges in amending laws and an opportunistic approach taken by the sector in advocating for reforms rather than a more strategic approach that is more comprehensive.

44. **Supervisory capacity should to continue to develop**. Both the analytical efforts and the supervisory initiatives could be further developed with increased resources and technical support. As noted, enhancing the risk rating system, including continuing refinement of risk sensitive financial capacity, and adding additional risk features to more fully reflect the range of sources of risk in insurance operations would be useful.

KEYS TO SUCCESS

45. **The successful way forward for the sector lies in a collaborative development of a sector strategy**. To date, the sector has developed largely by an evolutionary process than through significant innovation. Insurers are unlikely to be able to marshal such innovation on their own but need to work together, and in partnership with policymakers. Key elements for discussion will have to include:

A. **New products,** including the potential to develop appropriate fiscal regimes consistent with a level playing field for savings and investment products, and those relating to retirement saving.

B. **New markets,** including the careful management of regional engagement.

C. **New regulations,** particularly so that the ICC has the capacity to develop proportionate rules and supervisory practices that can reflect differences between large and small insurers facilitating appropriate risk management and risk sensitive capital, investment and operational risk rules consistent with the nature, scale and complexity of insurers. This proportionate approach will be critical so that insurers with a currently simpler business model who wish to continue on that basis can be properly distinguished from those wishing to take advantage of more complex risk and business opportunities.

D. **New skills,** enhancing technical skills, studying and understanding pricing related data that can better support current and proposed products, including a fresh understanding of catastrophe exposure and its effective management.

46. **It is critical that this effort be advanced in partnership with the government and ICC. Sector initiatives directed at improvement should be integrated with supervisory functions**. Supervisory initiatives that start with assessment and dissemination of current good practices should give stakeholders the opportunity to discuss and develop their own technical capacity. Analytical studies of priority would include those directed at a better understanding of risk exposure and management, economic capital, and key risk management approaches. Priority should be given to assessing risk parameters that would support further refinement of the internal risk rating systems at the ICC as well as inform insurer management.

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