

Insurance Market Reform in Serbia

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Abstract

The financial system of a country is defined by the structure and the character of property relationships, the degree of economic and social development of the country, and by the political relations themselves. The financial system is an integral part of national economy's economic and industrial system that enables its functioning through transferring financial resources between various groups and economic subjects. The basic role of the financial system is to link the saving and investment units through financial markets and financial institutions. The reform of Serbian financial system influenced all the components of such a system, as well as the sector of insurance. The insurance market reform started at the end of 2004, with the enactment of the Law on insurance¹ and other relevant statutory documents.

Key words: *insurance market, the reform of Serbia's financial system*

JEL Classification: *G22*

Introduction

The financial system is the integral part of economic and trade system of national economy that enables their functioning so that it performs the transfer of financial assets between various groups and economic subjects.

The main goal of this paper is to show the economic effects of the insurance market in Serbia. This is accomplished through the attainment of several defined aims:

- Establish the location, role and importance of insurance companies in the financial system;
- Emphasize the legal and organizational form of the insurance companies which is the most adequate one regarding the existing socio-economic environment;
- Emphasize the necessity and importance of the insurance market reform in Serbia;
- Draw concrete conclusions regarding economic effects of the insurance in Serbia.

In order to accomplish the defined aims and concrete tasks, we start from the following *working hypotheses* that will be confirmed or denied:

¹ "Official paper of the Republic of Serbia", no. 55/2004, 70/2004 – correction, 61/2005, 61/2005 – another law, 85/2005 – another law and 101/2007.

1. If the insurance market is developed, there will be more visible positive economic effects on the functioning of the overall economy.
2. If in Serbia the reform of insurance market is consecutively conducted, there will be more developed insurance products, improvement of the quality of placement channels, quality of service and maintenance of health competition, which will further contribute to the better information of insurance beneficiaries and strengthening of trust.

Research Methodology

In accordance with the defined subject, goal and concrete working tasks, adequate research methods are applied in this paper:

- general scientific method, whose application enables auditing, explanation and valorization of the effects of the reform of insurance market in Serbia. Among the numerous analytical and structural methods derived from the former we distinguish:
- hypothesis testing method that proves or documents initial statements and hypotheses;
- analysis and synthesis method, which is used for generalization of the phenomena that are relevant for the explanation and assessment of the implications that the insurance market reform has over the functioning of the economy in Serbia;
- quantitative and qualitative methods in explanation and predicting effects of the reform of insurance market in Serbia.
- comparative analysis method, which is used for comparative analysis of various insurance systems, aiming to identify their advantages and disadvantages and provide relevant conclusions.

The Role of Insurance Companies in the Financial System

The financial system is the reflection of the wider institutional framework – the economy system. It consists of financial markets and financial institutions, financial flows and financial instruments. The financial system's components enable the financial savings to be sent from economic units (subjects) that constitute them, towards economic units (subjects) that in certain conditions can make the best use of them. Therefore, the financial markets link economic units that in a certain period possess the surpluses of financial resources with those that suffer a shortage of these resources.²

The financial market has an important role in directioning the saving to the end users, that is to the investors, as well as in providing credibility of the data on economic units that participate in them. The financial market institutionalizes the risk in a rational manner in the sense that every participant's all possible losses can be covered from his or her own wealth. Efficient financial system means the presence of various financial institutions that, in their areas, own various financial instruments regarding liquidity, due dates and income. We can distinguish between the following financial institutions:

- deposit financial institutions;
- contractual and savings financial institutions;
- investment financial institutions and

² Kedwell, D. S. et al., *Financial institutions, Markets and Money*, John Wiley and Sons, New York, 2003.

- other financial institutions.³

Deposit financial institutions are the most present in every day practice because most of the economic units, starting from the citizens, through companies and state use their products and services every day.

Contractual and savings financial institutions are insurance companies and retirement funds. They require the money through contracts and periodically.

Insurance companies are involved in the life insurance and gather their funds through selling insurance policy and thus they protect beneficiaries from losses in income due to premature death or early retirement.⁴ Beyond these risks many insurance companies for the life insurance also provide good saving conditions in their policy.

In developed countries life insurance is the most developed type of insurance, so that 2/3 of the insurance premium goes to the life insurance premium, so that life insurance in the world of market economy, as insurance activity, has the dominant position. Life insurance consists of all types of insurance where the insured case is related to the certain event in the life of the insured person. The basic types of life insurance are: insurance in case of death and insurance in case of reaching the certain age.

The basic source of the law in this area in Serbia is 'The law on obligatory relations' and 'The law on property and personal insurance'⁵, whose articles are predominately of imperative character. Beside these, as an important legislative source, there are numerous general conditions for the operations that represent also the conditions for this contract to have the character of adhesive contract.

In European countries, life insurance is the most developed type of insurance. Many people think that obligatory social insurance does not provide satisfactory economic protection, so they sign a contract on voluntary life insurance. In case of death of the insured person, or in case that the insured person lives up to the certain age, insurance beneficiary is also entitled to the insured amount regarding life insurance and the incomes regarding social insurance. Except from the financial protection in case of a tragic event, owning a life insurance policy has many other advantages. Life insurance is a kind of saving. Before the insured case occurs the insurance contractor has some rights that do not exist in other kinds of insurance, like the right to sell out the insured amount, the right on the advance and the right to pledge the policy. The policy is a valuable sheet of paper and in this shape it is used as the tool for providing easier access to the credit in banks.

In Serbia life insurance is not developed, because the standard of living is such that the citizens can not pay the premium for the voluntary life insurance. Today when someone wants to get the loan to buy the apartment, the insurance for it is provided through mortgage or by insuring the user in case of the loan beneficiary's death. The funds for providing the loans are created by the bank from the life insurance resources that life insurance organisations deposited in the bank.

Insurance companies that perform property insurance and responsibility insurance are financial institutions that perform insurance for the case of financial losses created due to theft, fire, emergency.

³ Mishkin, F. S., *The Economic of Money, Banking and Financial Markets*, Addison Wesley, New York, pp. 7-30, 2004.

⁴ Mishkin, F. S., Eakings, S. G., *Financial Markets and Institutions*, Addison Wesley, New York, pp. 369-567, 2003, 2004.

⁵ *Official paper of FRY*, No. 30/96, 57/98 – correction, 53/99, 55/99 – correction and *Official paper of the Republic of Serbia*, No. 55/2004 – another law and 70/2004 – correction of another law.

They acquire their incomes from policy selling and premium charging. They have higher possibility of losses, that is an outflow of money because of the payment of insurance contributions.

The role of financial institutions in financial system operations is very high, especially the role of institutional investors represented by insurance companies.

For a long time there has been no demand for non-bank financial institutions' services in Serbia, caused by the following reasons: low quality of services, poor investment on the market, lack of trust among citizens, political instability during the 90's etc. In the last several years insurance market growth in Serbia has approached the growth rate of the banking sector.

Organization Forms of Insurance Companies in Serbia

According to the existing legislation⁶, insurance activities in Serbia can be performed by the insurance company in the form of stock company and mutual insurance company.

The insurance company is the legal entity that performs the activities of insuring the property and persons. With the insurance organisation as the founder, interested persons make agreements on insurance. According to those agreements, insurance contractors pay to the insurance organisation premium of insurance. From the collected premium and other resources that he/she possesses, the insurer pays insurance compensations that is a sum for insurance (depending on the type of insurance) to the persons affected by the insured case. The insurance organisation can participate in financing the measures in order to remove or diminish negative effects of the causes that can produce damage (prevention measures).

Performing insurance activity could not be possible in many cases if there is no reinsurance as an economic necessity in those cases when the certain risk that is covered by the insurance occurs and provokes such large damage that the insurer could not compensate from the funds that he possesses. The insurer transfers a part of the premium to the reinsurer, and the reinsurer takes the obligation to participate in the damages that the insurer is obliged to compensate for the insured person.

Stock company for insurance operates with the fixed premium that can not be changed after the contract on insurance is closed. Stock company can perform all kinds of insurance, or only some of them (like obligatory insurance for operating motor vehicles or reinsurance).

Stock company for insurance is established by the contract signed by at least two legal entities or persons. Foreign legal entities and persons can establish reciprocity terms with the stock company for insurance or invest the money into the stock company for insurance.

The founders invest the money into the initial fund for the company safety. Minimal amount of the initial safety fund is defined by the law, depending on the types of insurance provided by the company. Basic capital of the stock company for insurance could not be less than the following amounts in RSD calculated by the middle exchange rate of the National Bank of Serbia on the payment day:

1. life insurances

- life insurance except for the voluntary pension insurance
€2.000.000
- voluntary pension insurance
€3.000.000

⁶ Law on insurance, "Official paper of the Republic of Serbia", no. 55/04.

○	all kinds of life insurance	
	€4.000.000	
2. <i>non-life insurances</i>		
○	insurance for the cases of emergency and voluntary health insurance	
	€1.000.000	
○	casco insurance for motor vehicles and liability insurance in transportation	€2.500.000
○	other property insurances, other liability insurances	
	€2.000.000	
○	all kinds of property insurances	€4.500.000
3. <i>reinsurance</i>		€4.500.000

The licence of the National Bank of Serbia is issued for the performing of one or several types of insurance that stock company for insurance would perform. National Bank of Serbia decides on the licence within 60 days since the request is submitted and after judging whether the legal prerequisites are fulfilled as well as the conditions that prove the need for the existence of stock company for insurance.

The provision quotes the types of insurances for which the licence is issued. If the decision is given for all kinds of insurance within one type of insurance, the provision will mention only that type of insurance. Founders of the stock company for insurance are obliged to submit the application form to be on the register of the authorized body within 30 days since the day the licence for insurance activity was given to them. Together with the application form for registering, the licence for performing insurance activities is submitted. Stock company for insurance has the obligation to send the decision on entering the register to the National Bank of Serbia within a certain period since the decision is given to them.

In order to perform a certain type of insurance that is not listed in the licence or to stop the performance of a certain type of insurance activity listed in the licence, the Stock company for insurance submits to the National Bank of Serbia the request for altering the licence regarding performing insurance operations. National Bank of Serbia will turn down the request for issuing the licence for performing the insurance operations, quoting the reasons listed in the law for that and it will issue the decision on ending the validation of the licence for performing insurance activities. The company does not submit the application form to register within 30 days from issuing the licence, if the company does not start with insurance operations within 6 months from the date of entering into register, if the company does not perform insurance operation for over one year constantly, with the transfer of insurance portfolio to another insurance company, starting the liquidation procedure or with the initiation of bankruptcy procedure. On the issuing permit for reinsurance operations are accordingly applied paragraphs of this law that are related to the issuing of the licence for performing insurance operations. After the licence is issued the founders would gather the assembly for establishing the company.

Organisers of the stock company for insurance are represented by an assembly of stockholders, administrative committee, supervisory board and director. For the election of the member of the administration or supervisory board it is necessary to provide the accord of the National bank of Serbia, in the opposite case this election is treated as invalid. National bank of Serbia will deny the request for accord with performing the operations as the administration member, or the member of the supervisory board of stock company for insurance, if the person does not comply with the requests defined by the law or if due to the operations and activities can jeopardize the functioning of the stock company for insurance. It is defined the possibility of withdrawing the agreement given by the National bank of Serbia in the cases specified by the law.

The administrative committee of the company defines in the general decision the conditions for insurance and premium tariff, maximum of selfsupport per one risk taken. The premiums paid by the insurance contractors are part of the insurer's total income. Insurance contractor is due to pay gross premium that consists of technical premium and addition for management expenses. Funds in technical premium are used for covering the expenses of the insurer per concluded insurances, for paying reinsurance premium and so called technical reserves (transferring premiums and reserved damages). Technical reserves are used for covering the future obligations of the insurer for the occurred insurance cases. Addition for management expenses is used for covering management costs of insurance company. Initial safety fund and operation reserves in the stock company for insurance make the so-called guarantee reserve. The purpose of the legal request regarding guarantee reserve is to limit the company in taking over the insurance obligations.

The obligations and responsibility of management of the stock company for insurance are providing operations according to the rules of risk management, monitoring the risk and taking over appropriate measures for removing it, providing that the business record is kept and creating accounting reports, creating the reports for National Bank of Serbia, performing internal audit.

Management in the stock company for insurance is obliged to inform the supervisory board of the company in case the liquidity of the company is jeopardized, if the reasons for validity stopping or taking over of the licence occur or if the guarantee reserves decrease under the solvent margin. Also, the member of the management is entitled to inform the supervisory board of the stock company for insurance and National Bank of Serbia on the end of functioning in another legal entity or if the member of the management and members of his/her immediate family gather the stocks in another stock company.

The supervisory board of the stock company for insurance has the function of monitoring the internal audit operations, examining the findings of the National Bank of Serbia in the controlling procedure, examining financial reports and yearly reports on the company operations, as well as the reports on application of the insuring and reinsuring policy.

The company for mutual insurance is a legal entity that performs insurance activity in the interest of its members on principles of reciprocity and solidarity. It can perform all the insurance operations, but not the reinsurance activities. Legal entities and persons can establish it. The company for mutual insurance gathers contributions from its members. The amount of contribution can be changed after the contract is signed, depending on the ratio between gathered contributions and created obligations by the company.

A company for mutual insurance can be established as:

- company with unlimited contribution (premium);
- company with limited contribution.

The company with unlimited contribution can demand that each member should pay the additional contribution necessary for covering non-covered damages and other expenses without limitations.

The company with limited contribution can demand that each member should pay the additional contribution that is not bigger than his previously paid contribution in total from the same operational year if the damages and other expenses are bigger than previously paid contributions and other incomes of the company.

The financial part of the basic company for mutual insurance capital can not be less than the amount defined for stock company for insurance. Like in the case of stock company for insurance, for the company for mutual insurance as well, the request to the National Bank of Serbia for issuing licence for conducting insurance business is given by the founders or

authorized person. With the request for issuing permit the necessary documentation prescribed by the law is submitted.

The legislation is the same both for the company for mutual insurance and stock company for insurance in case of establishment, request for issuing permit, management bodies, special limitations of the management and supervisory board, and the authorities of the management and supervisory board.

Reform of the Insurance Market in Serbia

Insurance market in Serbia in the beginning of the reform pictured the effects of socio economical status in Serbia in the 90's. The reasons for the insufficient development of insurance market were numerous: low standards of living of the citizens, totally negative economic situation, clients' insufficient knowledge on the insurance products, the insurer's and the insured's lack of awareness of the market principles.

In the last three years, the reform of the insurance market in Serbia has been successfully accomplished. The creation of the adequate legislation made the Serbian market interesting also for the foreign insurance companies. National Bank of Serbia was the reform leader with the role of severe surveillance and control over establishment and operations of the insurance companies and through the increasing of the limits for founders investments and enabled today's claims to be recovered in over 90% cases.

The insurance market is dynamically developing. The presence of the global insurance companies affects the new insurance products development, improving the quality of the distribution channels, the quality of service and establishment of healthy competition, better information for the insurance beneficiaries and strengthening of trust. The activities of National Bank of Serbia regarding bringing back the trust in insurance sector gave the visible results. The insurance sector is stabilized and the quality of selling network improved. They all contributed to the growth of insurance market for the first time approaching the growth rates in the banking sector. The total amount of the insurance premia of all 20 insurance companies operating in Serbia reached the sum of approximately 630 million EUR, which represents an increase of 16% as compared to 2007.⁷

It is expected that in the following 4 years, the potential of Serbian insurance market should be doubled, which is confirmed by massive coming in of the big insurance companies, representatives of the big world companies in the insurance area. In the last 4 years since the transition started in this financial sector, on the Serbian market there have come Italian company «Generali», Austrian «Uniqua», «Wiener» and «Grave», French «Credy agricole life», «Basler» from Switzerland and «Triglav» from Slovenia. The Italian insurance company «Fondiarria» entered the market with the purchase of DDOR Novi Sad. DDOR covered 22% of the insurance market in Serbia. Above it is, for now, the only insurance company owned by the state «Dunav osiguranje». Dunav osiguranje is going to be privatized, but we yet do not know which privatization model will be applied. We assume that it will be applied a combined model that would enable the state to remain the dominant owner.

According to the data of the National Bank of Serbia, foreign insurance companies in the last year recorded a growth of 33%. Foreign insurance companies focus mostly on life insurance, while the domestic insurance companies have the precedence in non-life insurances.⁸ It is expected that foreign insurers that operate according to the market principles in their home lands and other European countries should establish the same principles in Serbia.

⁷ www.nbs.co.yu

⁸ www.bestjobs.com

The National Bank of Serbia continued with initiated activities on the stabilisation of the insurance markets and protection of the client's interests through surveillance organisation, insisting on the strengthening of corporative management and transparency of the company's operations, through the estimation of the risk management, as well as through taking of the licence from the insurance companies that jeopardize or could jeopardize insurance funds with their non-adequate insurance.

Conclusion

After the Insurance law and other relevant statutory documents had been adopted, it was created in Serbia a legal framework for insurance companies operations, based on international practice. Solutions in the legislation were created having in mind the solutions in the legislation of developed European countries, and taking into account the certain demands prescribed in the EU directives regarding insurance. The reform of the insurance market in Serbia led by the National Bank of Serbia was successfully conducted. The National Bank of Serbia introduced strict surveillance, increased founders investments for receiving licences and made sure that today's injured persons are paid in over 90% of the cases. Newly created business climate on the reformed Serbian insurance market brought large insurance companies and the representatives of serious world companies in the sector. The presence of the global insurance companies affects the development of insurance products, improvement of the distributive channels' quality, service quality and the establishment of healthy competition, and further contributed to the better information of the insurance beneficiaries and strengthening of trust. Thus, the more developed the insurance market, the more visible the positive economic impacts on the functioning of the economy in general.

The activities of the National Bank of Serbia regarding the resetting of trust in the insurance sector gave visible results. The insurance sector is stabilized and the quality of selling network is improved. They all contributed to the fact that the growth of insurance market approached the growth rates of the banking sector. It is expected that in the next four years the potential of Serbian insurance market is doubled, which confirms massive incoming of the big insurance companies, representatives of great global companies in the insurance area.

Foreign insurance companies are centered on life insurance, while domestic insurance companies still have the primacy in non-life insurances. The foreign insurance companies that operate according to the market principles in their home countries and other European countries, are expected to establish the same principles in Serbia as well. The National Bank of Serbia continued with the initiated activities on stabilization of insurance market and protection of the client's interest by surveillance organisation, by insisting on the strengthening of corporative management and transparency of the operations of the company, by estimating risk management, and also by withdrawing the licenses from the insurance companies that jeopardize or could jeopardize insurance assets due to their inadequate insurance.

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Reforma pieței de asigurări din Serbia

Rezumat

Sistemul financiar al unei țări este definit de structura și caracterul relațiilor de proprietate, de gradul de dezvoltare economică și socială a țării și de relațiile politice. Sistemul financiar reprezintă o parte integrantă a sistemului economic și industrial al economiei naționale, care permite funcționarea sistemului prin transferul resurselor financiare între diferite grupuri și subiecți economici. Rolul de bază al sistemului financiar este de a conecta unitățile de economisire și investiție prin instituțiile și piețele financiare. Reforma sistemului financiar din Serbia a influențat toate componentele acestui sistem, precum și sectorul de asigurări. Reforma pieței de asigurări a început la sfârșitul anului 2004, odată cu intrarea în vigoare a Legii privind asigurările și a altor norme relevante.