Still not a free Russian insurance market

White & Case's Victor Khvesenya – the end result is that the domestic Russian insurance market is deprived of not only much needed capital, but also of Western know-how, expertise and management.

VICTOR KHVESENYA, an associate at White & Case, shows how far the Russian insurance industry is divorced from the development of a free market economy.

Russia's anticipated entry into the World Trade Organisation (WTO) will require it to review existing restrictions on foreign capital in the insurance sector. Recently, Russian officials have been giving mixed signals as to how far the country may go to eliminate such restrictions. The minister of finance, Alexey Kudrin, has stated that Russia is prepared to reduce the effect of these restrictions and even eliminate some of them, including increasing the foreign participation quota from 15% to 25%.

Maxim Medvedkov, deputy economy and trade minister and Russia's chief WTO negotiator, has suggested that the Russian authorities are prepared to open around 50% of the insurance market to foreign participation.

While the insurance market in Russia continues to grow, foreign investment in the Russian insurance industry is still limited by the Russian government. Of the more than 1,400 insurance companies registered in Russia as of 1 January 2003, only about 40 are companies with foreign investors. The same law which standardised the insurance industry in Russia, and gave stability-seeking foreign investors the assurance they needed to begin investing in 1992, still restricts foreign direct investment by limiting foreign ownership in Russian insurance companies.

MARKET OVERVIEW. Russian insurance companies are usually licenced to underwrite both life and general lines of insurance. The major general lines in Russia are property insurance, third party liability insurance, and accident and medical insurance. Russian insurance companies are licenced for each particular line. Insurance brokers are permitted to operate without a licence, but must be registered with the Ministry of Finance.

Despite the development of the industry over the past 10 years, enormous volumes of industrial property and liabilities in Russia are either under-insured or not insured at all. Accident and property insurance coverage are not yet popular among Russians in relation to the latter, due to the limited size of the Russian middle class who are the only people to be able to afford to purchase both valuable items and the insurance to cover them. Currently, industry experts in the market estimate that only 15% of all potential risks in Russia are covered.

Foreign insurers are permitted to operate only through Russian registered subsidiaries, which so far have captured only a 4.1% share of the Russian insurance market.

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MARKET HISTORY. Upon the dissolution of the Soviet Union in 1991 the Russian authorities sought to attract foreign investment into Russia. Such investment, however, was not warmly welcomed in the area of insurance. In post-Soviet Russia the 1992 Insurance Law became the first specialised law regulating insurance. While the Insurance Law was considered a major step forward for foreign insurance companies looking to enter the Russian market, it also restricted foreign direct investment by limiting the percentage of foreign ownership in any Russian insurance company to 49%.

In 1996 Russia ratified a 1994 agreement on *Partnership and Cooperation between the Russian Federation and the Participating States in the European Union.* This agreement, in part a necessary preliminary step toward Russia's entry into the WTO, required Russia to eliminate the 49% limitation on foreign participation by June 1999. The Russian Federation lived up to its commitment and set aside this limitation by amending the Insurance Law in November 1999.

RESTRICTIONS

However, the amended Insurance Law also introduced new restrictions (outlined below) on insurance companies with foreign participation, including a quota on foreign participation. As a result, there is currently no insurance company in Russia directly and wholly owned by a foreign entity.

A QUOTA ON FOREIGN PARTICIPATION. The 1999 Insurance Law established a 15% quota for foreign investment in the Russian insurance market. This quota is the maximum allowable combined capital contribution by foreign investors or their subsidiaries in the charter capital of all Russian insurance companies. Each capital contribution made by a foreign investor must be approved by the Ministry of Finance, the Russian insurance regulatory agency.

Once total foreign participation in the capital of Russian insurance companies meets the 15% quota, the Russian insurance regulatory agency will no longer issue new insurance licences to companies with foreign capital, will not permit the acquisition of shares in insurance companies by foreign investors, and will not permit foreign residents or their subsidiaries to open branches in Russia.

Presently, the available quota for foreign investment in the market is 2.918 billion roubles (approximately US$96 million) or 10.9% of the market. Since 2001 the available quota has increased by 0.7% because the capitalisation of Russian insurance companies has substantially increased (see table). Although the available quota may appear large relative to the total capitalisation of Russian insurance companies, it is small relative to the size of a potential investment by a major multinational insurance company.

OTHER RESTRICTIONS. Even with the abolition of the 49% limitation on foreign ownership, insurance companies which are subsidiaries of foreign investors, or in which foreign investors directly own more than 49%, are subject to a number of additional restrictions.

Companies with foreign capital are prohibited from writing life assurance, mandatory insurance (i.e. insurance required by law, such as insurance for auditors or operators of hazardous productions), mandatory state insurance to be provided at the expense of a state budget (such as insurance of military personnel) and insurance of the property interests of state or municipal enterprises. This restriction does not apply to foreign owned insurance companies registered and licenced to write a particular line of insurance before 23 November 1999.

A very Russian look for religion – just as there is a very Russian look for insurance.

"Foreign owned insurance companies in Russia must receive prior permission to open branches or to acquire insurance subsidiaries."

By law, insurance companies are required to obtain prior permission from the Ministry of Finance, which, as already mentioned, currently regulates the Russian insurance industry, for all increases in statutory capital by funds of foreign parties or their subsidiaries, as well as for sales of shares to any foreign party. Thus no existing capitalisation or newly issued shares can be freely sold to a foreign buyer or a foreign owned subsidiary. Furthermore, Russian shareholders in insurance companies must obtain prior permission to transfer their shares to foreign parties or their subsidiaries.

Subsidiaries of foreign insurance companies are allowed to operate in Russia only if the foreign investor has a 15 year history in the insurance business in its own country and has participated in insurance companies established in Russia for a period of not less than two years. This restriction does not

Capitalisation of the Russian Insurance Market

Parameters	*2001**	*2002***
1. Total amount of charter capital of Russian insurance companies	$526m	$906m
2. Total amount of foreign participation in Russian insurance companies	$25m	$37m
3. Percentage of used quota	4.8%	4.1%
4. Available quota for foreign participation	10.2%	10.9%
5. Available amount of foreign investment in Russian insurance companies	$53m	$96m

(*)Order of the Ministry of Finance of the Russian Federation No. 223 dated 9 August 2001.

(**)Order of the Ministry of Finance of the Russian Federation No. 44 dated 6 March 2002.

The dollar amounts are calculated on the basis of the official exchange rates effective in Russia as of 1 January 2001 and 1 January 2002 respectively.

apply to foreign owned insurance companies registered before 23 November 1999.

Foreign owned insurance companies in Russia must receive prior permission to open branches or to acquire insurance subsidiaries. The minimum requirement for the charter capital of foreign owned companies is many times higher than that for Russian owned companies.

The minimum charter capital for Russian owned insurance companies engaged in any line of insurance other than life is approximately US$83,000; for those involved in life assurance it is approximately US$116,000; and for those exclusively engaged in reinsurance it's approximately US$165,000. The minimum charter capital for foreign owned companies exclusively engaged in reinsurance is approximately US$995,000 and approximately US$830,000 for all other lines of insurance.

REQUIREMENTS

In addition, there are a number of other requirements which are applicable to all insurance companies with any share of foreign participation. These requirements include:

- Foreign investments into the statutory capital of an insurance company must be paid only in Russian roubles, thus prohibiting foreign cash and in-kind payments by foreign parties.
- The chief executive officer and the chief accountant of an insurance company must be Russian nationals.

The Russian insurance regulatory agency is empowered to introduce specific requirements for insurance companies with foreign participation in respect of the formation and placement of insurance reserves and their ratios. Presently, no requirements exist that would specifically apply to insurance companies with foreign investments.

IMPLICATIONS FOR THE MARKET. Currently, restricting foreign participation in the Russian insurance market is economically unsound. The financial resources of all Russian insurance companies are not enough to cover all risks they insure. Thus the practice of placing excessive risks with foreign reinsurers is widespread, which results in an outflow of capital from Russia in the form of reinsurance premiums paid by Russian insurers to their foreign counterparties.

> *"...restricting foreign participation in the Russian insurance market is economically unsound."*

If Russia were to suffer from an over-abundance of foreign investment, restrictions on foreign investment in insurance might be understandable. However, foreign insurers in Russia have not come close to dominating the domestic insurance market. On the other hand, direct investment in the Russian insurance market would reduce the volume of much needed cash flowing out of the country in the form of reinsurance proceeds.

The existing restrictions on the insurance industry in Russia create unnecessary impediments for the development of Russian insurance companies with foreign participation, and provide additional hurdles for direct foreign investment in the Russian insurance market. The end result is that the domestic insurance market is deprived of not only much needed capital, but also of Western know-how, expertise and management. In turn, the market provides only a limited number of products and choices for the Russian consumer.

An empty hall in the World Trade Centre, Moscow – symbolising the lack of involvement by foreign insurers in the Russian insurance industry.

Foreign insurers could help to develop the insurance industry which would generate much needed capital, benefiting the Russian economy. It is anticipated that the willingness of the Russian government to increase the quota for foreign participation will represent the beginning of the liberalisation process of the Russian insurance market.