


Russia's transition to a free-market economy hasn't exactly been smooth, and its growing pains have taken a beating in the Western press. But according to this expert on the Russian insurance market, prospects for success there aren't as bleak as they've been cracked up to be.

By Mark D. Mariska

# Through The Looking Glass • *The Emerging*

*"Come, there's half my plan done now!  
How puzzling all these changes are!  
I'm never sure what I'm going to be,  
from one minute to another."*

—Lewis Carroll  
*Alice's Adventures in Wonderland*



Since the Berlin Wall came down in 1989, effectively signaling the end of the Cold War, the *Zeitgeist* in the West has been of a Soviet Union that was a failure and a Russia that is failing. But in reality, the Russian Federation has accomplished a great deal since the early 1990s, even if—to paraphrase Alice from the well-known children’s story—the changes have often been puzzling, caused some uncertainty, and generated a measure of doubt both for us and the Russian people.

While the West paid little attention to the insurance industry in the Russian Federation, Russian carriers survived the political, economic, and financial firestorms of the past decade. Even though the industry is young, insurance has managed quickly to become a major component of the new Russian market economy. The continuing siege of negative press, the zigzag of economic reform, and the besotted final years of Boris Yeltsin have served to camouflage fundamental progress. Democratic, free, and contested elections are the norm in Russia, the 1998 financial crisis is old news, and thanks to higher oil, gas, and commodity prices, the value of exports is soaring at this critical point in market reforms. Recent economic performance shows:

- ▶ Inflation is down to 15 percent from 2300 percent in 1992;
- ▶ Gross domestic product rose 7.3 percent by mid-2000;
- ▶ Industrial output is forecast to rise 7.5 percent in 2000;
- ▶ Central bank reserves at \$25 billion+ are double 1999;
- ▶ Trade surplus the could reach \$50 billion.

Occasional visitors and casual readers of Western media often leap to the conclusion that Russia is on the brink of collapse, consumer goods are in short supply, consumer queues are still prevalent, and most Russians are poor, poorly clothed, and hungry. It’s true that economic progress is uneven—Moscow and some regions do better than others—but a dangerous mind-set remains among many of us that what is “bad” for Russia is in some way “good” for us.

It just makes good business sense, however, to rethink our more dogmatic, Cold War attitudes toward Russia. First of all, we should be among that special group of cheerleader-supporters who look at stability in Russia as beneficial to world order and international trade. Second, we should recognize that Russia, as a large and potentially powerful economic force, could be a suitable incubator to grow the business of insurance. And third, Russia and its nascent insurance market represent a profitable, “European” alternative to the well-worn paths to South America, China, India, and the Pacific Rim.

More to the point, the Russian insurance sector is bursting with activity. Total collected premium exceeded \$4 billion in 1999, while insurance reserves reached \$1.2 billion for the top 150 companies. Russia could record more than \$5.25 billion in 2000 since premium production was well above 1999 levels. The insurance market “shakeout” in Russia is demonstrating a growing emphasis on personal lines, property, and liability. Life insurance, or “traditional insurance” as it’s called in Russia, is only now becoming available, and it’s certain to become a major category of insurance.

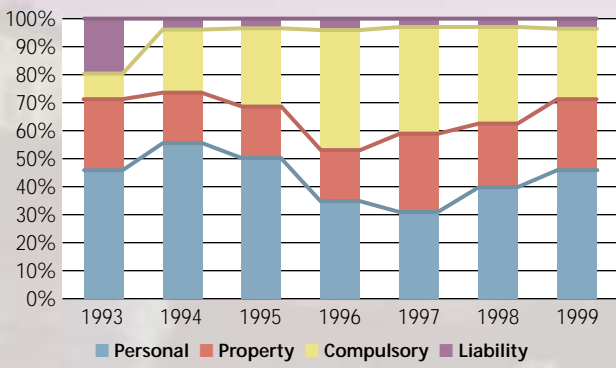
# Russian Insurance Industry

## Insurance Premium Categories

While various life insurance products existed in the Soviet Union and Eastern Europe during the planned-economy era, they were used to provide some basic protection as well as to reduce surplus purchasing power. Life insurance quickly became unimportant when nonindexed policies experienced devaluation during the hyperinflation brought about by economic reforms. That is changing.

Other trends are becoming clear in the Russian Federation amid a kaleidoscope of change. Insurance company mergers continue apace as the more adroit companies use acquisitions to obtain customers and to expand distribution. Traditional life insurance is on the verge of becoming a very popular product while mandatory third-party automobile liability is under active consideration by the DUMA (Russian Parliament) and could mean another \$2 billion in annual premium. This increase in activity in the industry comes from a number of factors that include:

## Insurance Premium Categories



- ▶ Economic recovery from the August 1998 financial crisis;
- ▶ Insurance companies emerging to be as important as banks;
- ▶ Increase in experience levels for insurance companies;
- ▶ Growing confidence in President Putin's administration;
- ▶ Increase in foreign currency reserves and financial liquidity.

During most of the 20th century the Soviet Union was a two-company country. The Ingosstrakh Insurance Company focused on international business while the Gosstrakh Insurance Company was the only domestic carrier. Even in Communist times Gosstrakh was a popular company known for life insurance endowment policies and personal property coverage. Ingosstrakh has been privatized while Gosstrakh, renamed as Rosgosstrakh, remains wholly owned by the Russian government and is operating at well below its potential.

The first insurance code was approved by the DUMA to be effective in 1993 and opened the market. By 1998 the number of Russian insurance companies had reached more than 2,300. In the past several years, however, a shakeout, along with mergers, capital inadequacy, and the 1998 financial crisis, has reduced the number of operating companies to about 1,200. Further consolidations can be expected.

### Number of Insurance Companies in Russia

One of the unusual innovations in the Russian insurance sector has been a product generally referred to as "salary scheme" insurance. The tax code of Russia's recent past encouraged a predictable response—artifice designed to circumvent what had become a confiscatory tax system. The government was slow to recognize that high tax rates didn't necessarily translate into higher revenue.

Insurance companies developed the "salary scheme," which can be described as something like a hybrid immediate annuity, with a tax-free payout, and a small life insurance and AD&D rider. The "salary scheme" system has worked approximately in the following manner:

- ▶ An insurance company "sells" a Russian organization or company;
- ▶ A "group enrollment" is conducted for organization employees;
- ▶ The employee then receives only a token cash salary on payday;
- ▶ The remaining salary is paid from an "annuity/insurance policy";
- ▶ Loans ("veksels:") are negotiated for the employee and the

organization;

- ▶ The loans are used to fund the annuity payment process;
- ▶ The annuity payment is without payroll and income tax;
- ▶ Both the employer and employee are "legitimately" served;
- ▶ A policy is usually renewed each month.

Many insurers have offered the small-margin "salary scheme" as an accommodation for large customers or to remain competitive in the market. Most Russian insurance professionals recognized that the "salary scheme" business had become an albatross and the industry couldn't advance without a focus on more traditional products.

In mid-2000, in what President Vladimir Putin hailed as "the most important event in the country's life," Russia enacted a tax overhaul that included a flat 13 percent income tax rate. The goal is to eliminate tax evasion, and this new tax code should just about render the "salary scheme" business unnecessary.

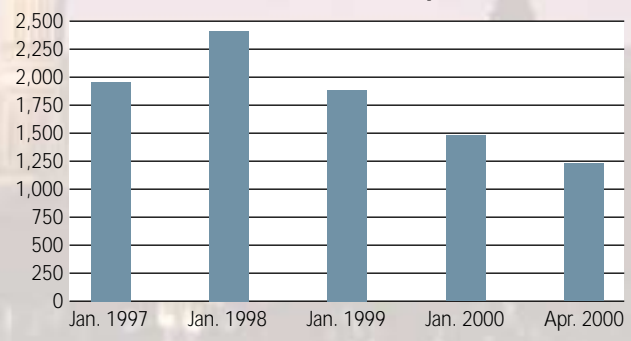
### Russian Insurance Stars

While a number of Russians have emerged as industry leaders, four of them stand out for particular notice. Dr. Igor B. Kotlovsky, an actuary, heads the Risk Management and Insurance Center and is a professor at Moscow State University. He has established an undergraduate and graduate insurance curriculum, and he organized an internship program providing on-the-job training with both Russian and foreign carriers. Kotlovsky has also been successful in organizing technical and financial support from the European Union.

Yevgeniy A. Kurgin is president of the ROSNO Insurance Group, ranked as the No. 4 company and the top multiline company in Russia. Kurgin organized the company in 1992 from scratch and weathered the "usual suspect" challenges to the point where ROSNO could achieve in excess of \$300 million in premium income next year. Kurgin's ROSNO has been rated the leading insurance company among Russian insurers by a magazine poll in 1999, which in 2000 also reported that ROSNO was the most stable insurance company in the country.

The All Russia Insurance Association, the principal trade association, is led by Igor Y. Yourgens. He has a diplomatic background with the United Nations, worked in the Soviet trade union movement, and gained experience as chief executive of an insurance company. Yourgens has energized the association, dramatically in-

## Number of Insurance Companies



creased membership, and is the key insurance industry liaison to the DUMA, the Russian government, and the European Union.

Alexandre E. Karpov, an attorney, started the VESTA Insurance Group in 1993, also from scratch, and has built his company into the ninth-ranked insurer in the Russian Federation. While VESTA is a multiline organization, Karpov, to his great credit, is convinced that personal lines is an important part of Russia's future. He also believes that traditional life insurance and personal auto, along with bancassurance marketing, will become a major focus for VESTA over the next several years.

### Overcoming Adversity

The insurance industry was hard hit by the August 1998 financial crisis, but the actions of industry leaders made certain that insurance was less affected than Russian banks. Many insurance companies were pursuing conservative strategies, carefully monitoring reserve compliance and limiting investments in government securities. Insurance companies were also less likely than banks to have hard-currency liabilities, and they weren't trapped in the ruble-dollar speculation that devastated many banks.

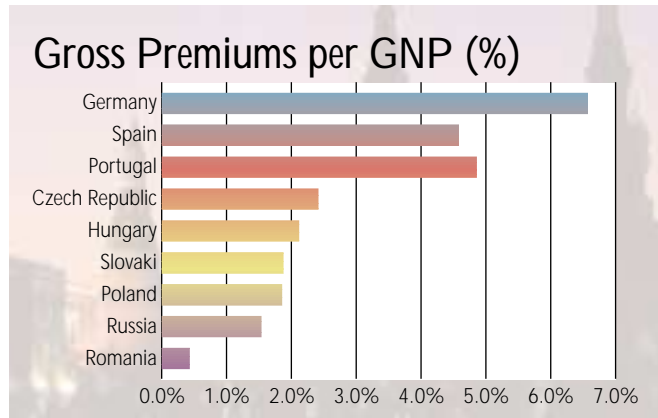
Since 1998 the "Top 50" companies have increased market share. They control a majority of the Russian insurance market representing a post-crisis redistribution of power in favor of the larger, better-managed companies. With Russia's 11 time zones and its vast territory, insurers have found that product distribution, effective communications, and good management controls drive their business. Regional marketing remains important for overall growth while European Russia—the part that's west of the Ural Mountains and 80 percent of the population—will be the priority market.

Distribution is the critical and most valuable asset, and not easy to duplicate in a "green field" startup. Russians sell through employed and independent agents and embryonic agency-like organizations. The next phase will include contemporary marketing methodologies, among them direct marketing (including the Internet), group and affinity marketing, and interactive customer service-oriented support systems. The Russians are fortunate in that these marketing extensions can be integrated without threatening an entrenched, in-place agent system simply because no traditions are in jeopardy.

Commercial lines insurance is becoming more important as well. The expansion in domestic Russian industry, the dramatic growth in retail trade, and the gradual increase in foreign direct investment require risk management and loss prevention programs along with appropriate insurance coverage to secure and protect assets.

Russia has never enjoyed a mercantile heritage or strong history of insurance. According to the Swiss Re SIGMA research, gross premiums were 1.6 percent of gross national product in 1998 and Russia is ranked close to the bottom among Western and Central European countries. While this tends to indicate an immature Russian insurance market, it also suggests there's substantial room for growth, if only to reach parity with the West.

The resilient Russian consumers had been running a stupe-



fyng gantlet caused by a combination of poor state planning, inferior quality goods, scarcity, and high inflation. Much of that is now behind them and life is improving as Russians have access to a wide range of consumer durables and nondurables. Only 10 years ago the typical "babushka on the street" used an abacus while shopping. Five years ago she had graduated to a solar-powered pocket calculator. Now, one would have to tap a shoulder to get her attention during the cell-phone conversation with her grandchild.

As a result, insurance "awareness" is growing in this long-suffering population. Insurance companies and consumers are beginning to find each other. With personal income rising by 9.0 percent in the first half of 2000, Russians are starting to consider asset protection, wealth accumulation and wealth trans-

1/4  
SC International  
Page 29

## Mid-Year-2000 Ranking Russian Insurance Companies

Rank	Company	Collected Premium
1	Industrial Insurance Co.*	\$408,061,557
2	Spasskaya Vorota Life.*	153,593,740
3	Yakor Insurance Co.*	95,619,564
4	ROSNO Insurance Co.	86,283,936
5	Ingosstrakh-Rossiya.*	76,396,923
6	LK-City.*	74,367,350
7	Ingosstrakh.	64,476,718
8	Interros-Soglasiey	64,011,650
9	VESTA Insurance Co.	60,109,735
10	National Insurance Group*	41,004,602

\*Indicates a company engaged primarily in "salary scheme" life insurance programs.

for planning, and programs directed toward retirement security. The market isn't saturated with competing product offerings, and carriers are looking for ways to respond to the consumer and increase profitability.

Following the 1998 financial crisis, insurance, principally life insurance and annuities, became one of the ways in which the Russian government can attract household savings to invest in the economy. Insurance is becoming an alternative to the banking system. Insurance companies, such as Karpov's VESTA Group, also see life and automobile insurance as the most promising, profitable areas for the longer term. The life segment of the market will require some additional state support so that premium paid by individuals for traditional life insurance and pension supplement policies will be tax advantaged.

Each licensed insurance company is required to file a series of detailed quarterly financial reports to the Russian State Insurance Inspectorate (Rosstrakhnadzor). These reports are compiled, and extracts are published and available periodically. The industry leaders are an eclectic group of companies including multiline carriers, companies primarily engaged in "salary scheme" business, and some relatively young companies.

We can expect this lineup to change dramatically as the industry morphs into a more recognizable Western model. The "salary scheme" companies will probably see a sharp reduction in revenue. Some companies will enter into partnerships with foreign strategic investors while others will combine with stronger Russian companies or financial groups. More than 60 foreign insurance companies already have subsidiaries in Russia, and in 1999 they accounted for 5.7 percent of the premium collected and 3.9 percent of the claims paid.

Legislation was passed in 1999 that allows foreign companies, with certain restrictions, to own up to 49 percent of a Russian life insurance company and 100 percent of a property-casualty company. Foreign insurers are subject to a minimum capital requirement, and they must have been involved in the insurance business for not less than 25 years, including not less than two years experience in the Russian market as minority shareholders in Russian companies. The new law also includes a temporary quota by which foreign capital will be limited to 15 percent of the authorized capital of all insurance companies operating in Russia. (There's a long way to go to reach this limit.)

Russians do many things well. Actuarial, marketing, and personal sales skills seem to be a natural component of their genetic code. A number of factors—let's call them "marketing multipliers" require executive focus and will help the Russian industry grow at an even faster rate. They're often taken for granted, but, in an emerging market, certain of these marketing multipliers, the "blocking and tackling" basics, are fundamental to success and include:

- ▶ Product development
- ▶ Product pricing
- ▶ Customer service
- ▶ Operating systems
- ▶ Distribution system expansion
- ▶ Control and communications
- ▶ Asset management
- ▶ A foreign partner affiliation

What can be expected in Russia over the next several years? With us or without us, the Russian Federation and the Russian insurance industry are going to be success stories. A solid dose of expansion capital, however, would help to improve the financial strength and competitive position of Russian insurance companies. Additional capital, along with contemporary insurance techniques and technology, would benefit both Russian insurance companies and the marketplace. We should look to this cross-pollination, consisting of capital and partnership affiliations, as the next logical step toward fuller cooperation. It would also open a new and important market that could sustain exponential growth over the coming decade.

Capital would provide for the development of a modern range of products and services to accommodate an increasingly sophisticated consumer population and business environment. Additional capital would also allow insurers to exploit opportunities within Russia as well as to capture market share, reduce operating expenses, and sell, cross-sell, and service a range of insurance and financial services products to a larger customer base.

Continuing economic progress in Russia has been very helpful for the country and the business of insurance. Although the Russian insurance market and its upside potential remain under-appreciated in the West, barriers to entry are more perception than reality. Foreign strategic investors, primarily from the European Union, are becoming more active, but portfolio investors haven't yet emerged as a factor because the better Russian companies are looking for "working partners" from whom they can learn more quickly.

While the Russian Federation integrates into the world insurance brotherhood and works to achieve its own version of "insurance Golconda," Russians are supercharged by a willingness to learn, an achievement ethic, and stress-testing that's hard to match. ●

**MARK D. MARISKA** IS A FORMER CHIEF DEPUTY INSURANCE COMMISSIONER FOR CALIFORNIA WITH 28 YEARS OF INSURANCE INDUSTRY EXPERIENCE. HE HAS BEEN ACTIVE IN INSURANCE DEVELOPMENT AND INSURANCE OPERATIONS IN THE RUSSIAN FEDERATION SINCE 1988. HE LIVES IN STAMFORD, CONN.