

**PROJECT**

TO THE

**ALBANIAN SUPERVISORY AUTHORITY**

FOR

**INSURANCE MARKET REFORM**

**PROJECT KICK OFF: July 2014**

## ABBREVIATIONS AND ACRONYMS

AFSA	Albanian Financial Supervisory Authority
ALL	Albanian Currency - Lek
FIRST	Financial Sector Reform and Strengthening Initiative
FSAP	Financial Sector Appraisal Program
GDP	Gross Domestic Products
GWP	Gross Written Premium
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principles
MTPL	Motor Third Party Liability
TA	Technical Assistance
WB	The International Bank for Reconstruction and Development, the World Bank

The Project *Albania: Insurance Market Reform* seeks to assist AFSA with implementation of legal and regulatory reforms to strengthen the supervision and regulation of the insurance sector and to support the development of sound catastrophe insurance in Albania. The project kicked off in July 2014 and is *expected to be implemented in a period of 24 months*.

- Albanian Financial Supervisory Authority, is the beneficiary agency;
- The World Bank (WB) initiated the project and supports its implementation;
- Financial Sector Reform & Strengthening Initiative (FIRST) is financing the project.

## **A. Sectorial Context**

The insurance sector in Albania remains small and underdeveloped with gross written premium of about 0.79 percent of GDP as of the end of 2014. With insurance consumption of €29 per capita in 2014, Albania lags behind all countries of Southeastern and Central Europe. During 2011-2014, the market experienced little growth in real terms mainly due to weak economic growth, lack of public awareness, low insurance education and fierce price competition among 11 insurers<sup>1</sup> who shared the market of only €83 million in gross written premiums (GWP). The real growth of insurance premiums from 2009 to 2014 was only 9 percent, falling even below the cumulative GDP growth (10.8 percent) over the same period. As a result, insurance penetration measured as a ratio of GWP to GDP increased somewhat from 0.69 percent to 0.79 percent from 2009 to 2014. The development of the sector has been hindered by the lax insurance regulation, low disposable incomes, poor industry record of claims performance, the lack of trust in insurance among the public. The market claims ratio was only 36% as of the end of 2014, due to extremely high expenses. As a result, if the assessment of solvency were to be carried out based on adequate technical provisions, the solvency ratio for some insurers would drop below that allowed under the current solvency regulation.

## **B. Rationale for the Project**

The IAIS assessment conducted as part of the recent 2013 FSAP found that Albania's legal and regulatory framework for the insurance industry is only partially compliant with most IAIS requirements. Albania's rule-based insurance laws were out of date and not in compliance with the risk-based insurance supervisory requirements underpinning IAIS ICPs. The main rationale for this project is to assist the AFSA with the implementation of several important FSAP recommendations in support of the financial sector reform.

Until 2014 the institutional setup of insurance supervision and supporting legislation has proven to be largely ineffective due to the lack of real independence, severely constrained financial resources, absent representation in the law-making process and the acute shortage of qualified

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<sup>1</sup> The number of insurers during the last quarter of 2014 dropped to 10, as in October 2014 two insurers merged.

personnel. The existing legal framework for insurance supervision has been eroded over time by enactment of conflicting with other laws and regulations.

To address these issues, a new draft insurance law and a manual on risk-focused supervision of non-life insurance were prepared with the WB's assistance, as well as a legal package for AFSA independence, which consisted of draft amendments of several laws, including AFSA law. Such legislation was approved in 2014. However, (i) a comprehensive set of secondary regulations, (ii) guidelines and methodologies required for effective thematic on-site inspections on claims and reserving and (iii) a risk based framework for the supervision of the life insurance market have yet to be developed and implemented in support of the new insurance law and the main risk-focused manual.

Albania is also highly vulnerable to natural disasters and climate change. Yet, very few homeowners have earthquake insurance. Nevertheless, there is significant earthquake risk accumulations in insurers' balance-sheets, a major part of which comes from insurance of properties used as loan collateral by local banks. Such risk accumulations require proper risk management to ensure that claims are paid in full and insurer remains solvent after the earthquake, which currently is often not the case.

### **C. Issues to be addressed**

The main gaps to be addressed under the proposed TA comprise three areas: (a) limited technical capacity of AFSA in regulating MTPL reserving; (b) inadequate general insurance supervision, including that of life-insurance; (c) the absence of a national earthquake insurance scheme.

### **D. Project Components & Outputs**

This project will cover three specific components:

***Component 1: MPTL Insurance Regulation.*** The component aims to enable AFSA to properly set and supervise MTPL reserving requirements. Under this area the following technical activities will be covered:

- (i) Update of the actuarial analysis of historic market claims development patterns performed by the previous WB funded MTPL project for all market players and the Albanian Insurance Bureau to determine experience-based IBNR requirements to be used by the AFSA to carry out off-site supervision of reserving practices of individual insurers.
- (ii) Update of (a) minimum regulatory data reporting requirements to the local market for all MTPL policies issued and claims received and paid based on the most recently

documented cases of reporting abuses and violations; (b) recommendations on additions/modifications to the structure and output of the existing MTPL insurance policy due to the recently introduced statutory requirement for coverage of uninsured claims; (c) a review and recommendations on improving specific data reporting requirements with regard to claims arising from uninsured vehicles, and (d) a review and recommendations for the minimum regulatory requirements for MTPL supervisory data filing and administration.

- (iii) Update of reserve setting methodologies and guidelines developed under the previous MTPL project in light of new claims data, changes in statutory requirements for uninsured claims and considerable changes in the overall structure and dynamics of the MTPL market (e.g. different composition of vehicle park, increased frequency of accidents, increased repair costs, etc.) that local companies should adhere to in setting the IBNR reserves and premium rates.
- (iv) Development of an automated regulatory risk-based reserving tool for the AFSA to enable to carry out more efficient on-site inspection of insurers' reserving adequacy.
- (v) A workshop for the AFSA staff to facilitate the transfer of updated reserving tools, methodologies and know-how.

***Component 2: General Insurance Supervision.*** The component aims to assist AFSA with improving the quality of its current regulatory supervisory capabilities. Under this area the following technical activities will be covered:

- (i) Assist AFSA with developing an internal insurance companies' rating/ranking mechanism that can help to track their compliance with regulatory requirements and better allocate scarce supervisory resources relative to the risk.
- (ii) Update the existing and develop new thematic (claims and reserving) supervisory on-site inspection manuals that can be used by AFSA staff to conduct highly focused short-term inspections of insurers' main areas of operations.
- (iii) Training of on-site supervisors in conducting thematic (claims and reserving) inspections of insurance companies.
- (iv) Review and revise the existing insurance regulations in support of the new insurance law and in line with the most recent IAIS requirements, as per the recent FSAP recommendations.
- (v) Review and revise the current regulations on life-insurance and develop a risk-based manual for the supervision of life insurance, in light of best international experience and the Albanian market requirements, including the provisions of the new insurance law.

***Component 3: National Earthquake Insurance Program.*** The component aims to facilitate the development of the Albanian insurance market by helping the AFSA to develop a draft National Earthquake Insurance Law. Under this area the following technical activities will be covered:

- (i) Technical discussions/ workshops with all key stakeholders in the country, including the government, the AFSA, and the private insurance market to determine the respective roles for each stakeholder in the national compulsory insurance program.
- (ii) Preparation of a framework technical paper in support of the draft earthquake insurance law.
- (iii) Assistance in the first technical draft of the National Mandatory Catastrophe Insurance Law, which will lay out the respective roles of the public and private sector in the operation of the scheme, the law enforcement mechanisms, and the type of insurance coverage to be offered to the public, the regulatory requirements to the national program and the role of the government in ensuring its ultimate solvency.