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# Insurance In Ex-Yugoslavia 25 Years After Dissolution: Is The Gap Closing?

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# Insurance In Ex-Yugoslavia 25 Years After Dissolution: Is The Gap Closing?

Looking back 25 years to the time of the break-up of Yugoslavia, market researchers argued that in many respects the country had the most sophisticated insurance system among the centrally planned economies in Central And Eastern Europe. Despite the challenges in the Yugoslav insurance market--losses because of unpaid or inadequate premiums as well as poor investment results--the insurance system allowed companies and private individuals to protect themselves against various risks.

Since then, and with the exception of Slovenia and to some extent Croatia, most insurance markets in ex-Yugoslav countries have fallen well behind. This is mostly due to weaker economic development and higher political risks for these countries, lower household incomes and a lack of demand for insurance protection, as well as weaker institutional frameworks in these insurance markets, spanning from regulation and supervision to corporate governance and risk management capabilities. Today this part of ex-Yugoslavia has some of the least developed insurance markets in Europe, with the lowest insurance penetration and very high reliance on a few, mostly mandatory, lines of business (chart 1).

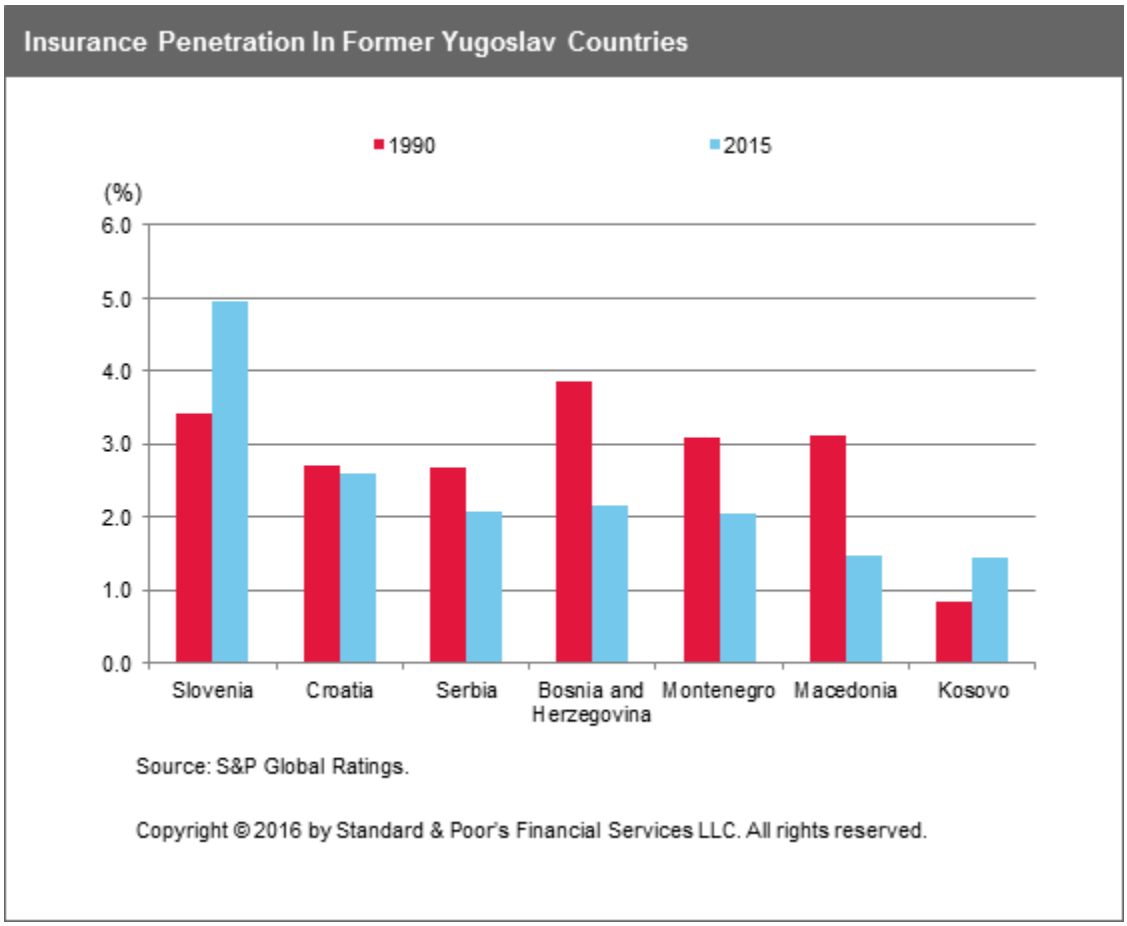
The exceptions are Slovenia and, to some extent, Croatia, where over the past 25 years markets have been able to overcome these issues and approach Western European levels of insurance protection with a more diverse mix of insurance coverage.

In our view, insurance markets will grow only moderately particularly relative to currently low penetration levels in parts of the region, at best at high-single-digits in the next few years. Additionally, some of the markets will face considerable challenges from unfinished market liberalization, which may further harm already fragile insurance markets in the region, in our view.

## Overview

- We believe that, in the medium term, insurance markets of former Yugoslav countries will remain at two speeds, with Slovenia and Croatia considerably better off.
- Slovenian and Croatian insurance markets have evolved to reach penetration on a par with some other EU members.
- In most other former Yugoslav countries, insurance penetration has declined over the past 25 years, with markets that are fragmented and focused on mandatory products.
- Health and life insurance have the best prospects, but growth is likely to be gradual.

**Chart 1**




## The Yugoslav Insurance Market Was The Most Developed Among Centrally Planned Economies

The reasons for Yugoslavia's historically well-developed insurance market 25–30 years back were twofold. The first was a relatively long tradition of insurance in the area, mainly due to proximity to more developed neighboring markets of Austria and Italy. Secondly, the more open and trade-oriented Yugoslav economy, in comparison with other centrally planned economies, and slightly higher income and wealth level as in some other centrally planned economies dictated some need for further development of insurance. As a result, at the end of the 1980s, each republic and autonomous province had its own insurance company, which had a monopoly in its republic, meaning eight insurance companies were active in Yugoslavia. In addition, five domestic reinsurance companies were present, and could underwrite business across republics' borders. Foreign insurers were not allowed to operate in the market, and only a small proportion of reinsurance premium was retroceded abroad.

The collapse of Yugoslavia posed huge challenges to local insurance companies. The former republics were differently affected. Therefore, changes in the insurance sector didn't occur in the same way in each of the six new countries. In our view, macroeconomic development in the successor countries has played a very important role. Insurance markets

of countries with less competitive economies, which were additionally affected by war destruction, the crippling effect of international sanctions, and hyperinflation were considerably worse off. However, in our view, perhaps even greater and longer-lasting was the impact of the countries' approaches to prudential regulation, supervision, and frameworks for competition.

## A Fragmented Market Is Fueling Intense Competition

Competition was established differently in different countries after the break-up of Yugoslavia. Some countries such as Slovenia split their state monopolies into different insurance providers to increase domestic competition, while simultaneously imposing strict entrance barriers to protect the local insurance industry. On the other hand, other countries such as Bosnia and Herzegovina (BiH) and Kosovo considerably lowered their entry barriers. During the initial transition period, the emergence of the private sector in financial services, combined with a poor legal framework for insurance, led to a mushrooming market with tens of newly created insurance providers. Although the number of insurers declined over time, due to market consolidation and some insolvencies, these markets remain relatively fragmented. Triglav (A/Stable) and Sava Re (A-/Stable) emerged as the regional leaders, with regional market share of around 20% and 9%, respectively. Other former state monopolies retained comparably sizable scale despite competition, such as Croatia Osiguranje (not rated) in Croatia and Dunav Osiguranje (not rated) in Serbia.

High competition is common among the market participants aiming to gain scale. This is mainly a result of smaller market size--the combined insurance markets was worth €4.4 billion in 2015, of which Slovenia and Croatia together represented around 70%. The rest of premiums were split between 94 active insurance companies. Moreover, insurers are mostly focused on mandatory products only, like motor third-party liability (see chart 2). In countries where mandatory lines dominate, development of new lines is slow due to relatively low cultural awareness of insurance and a relatively unstable legal environment.

## Lack Of Actuarial Data Makes Appropriate Pricing Difficult

Underwriting practices in Yugoslavia were not based on sound actuarial analysis, as insurance was a service provided by the state with no need for profit. As a result, most of the former Yugoslav republics do not have their own databases with historical data that could be used for proper actuarial calculations. Moreover, due to very small market sizes, even new databases might not be highly reliable for effective actuarial calculations. Actuarial data from Austria, Germany, and other EU countries are available to market participants. But the relevance of these data is limited as it would have to be adapted to the domestic market. That said, calculation of appropriate tariffs is challenging and may lead to inadequate tariffs for some types of insurance. Moreover, the existence of a large number of small insurers makes it difficult for the supervisory authority to control tariffs.

Additionally, we have observed on some markets that overly competitive behavior remains relatively widespread in many forms, such as pricing products below the required premium, the concealment of unfavorable terms and exclusions in insurance contracts, and the awarding of extraordinary bonuses to retain loyalty. In addition, cooperation with specific brokers may not always have a sound economic rationale. However, we note that, with improved

supervision, market underwriting discipline has been improving in recent years.

## Unresolved Legal Issues, Unfinished Privatization, And Overall Economic Instability Are Also Stalling Development

In our view, lack of transparency with respect to property rights remains an issue in several countries in the region. War-damaged or destroyed property registry archives have further decayed in the past 25 years, so documentation of ownership rights is often inadequate or not up to date. Moreover, many houses in Serbia, Kosovo, BiH, and Macedonia were built without official registration, sometimes on areas exposed to natural catastrophes. Even if legalized, insurance coverage for these houses may be difficult to obtain. Moreover, countries in the region that are outside the EU are disadvantaged by a lack of modeling sophistication for large perils by international model providers and large reinsurers, which we do not expect to improve materially any time soon.

Although the governments of all of the countries declare that they are supportive of insurance development, in general the property of critical public infrastructure is insured only in Croatia and Slovenia. In the rest of the countries, some critical infrastructure remains almost unprotected from pure risks. We note that this slightly improved after floods in 2014 when some critical infrastructure in Serbia and BiH was severely hit and caused considerable losses for state-owned enterprises. However, we do not expect major improvement in penetration in the medium term. Very low disposable household income in some of these countries also limits development of other insurance lines. Therefore we expect insurance penetration and a more diverse business mix for insurers to evolve only modestly.

## EU Accession Is A Catalyst For Improving Insurance Supervision

After the collapse of Yugoslavia, the new supervisory authorities had to build up resources, and were challenged to efficiently supervise a rapidly growing number of insurers in markets affected by many problems. Some countries eventually overcame supervisory challenges after staff were trained and retained. Moreover, we think that supervisory sophistication has substantially improved in countries that have become members of the EU and adopted Solvency II--Slovenia and Croatia. However, supervision remains a burning issue in non-EU countries, mainly due to smaller resources and structures in a buildup phase. We nevertheless recognize that the capacity of the supervisory authorities is improving. In non-EU countries, implementation of Western European best practices is mostly limited to international cooperation between insurance supervisory authorities and external technical assistance provided by the International Monetary Fund, the World Bank, and by foreign experts sent from various foreign central banks. However, such assistance may only be provided after problems have already emerged on the local market. This may hinder supervisors from taking early actions before a liquidation procedure is triggered, as seen in case of the Serbian insurance company Takovo, which was liquidated in 2014. Such insolvencies cause considerable negative press coverage for the local insurance sectors, which leads to further loss of confidence in insurance in these markets.

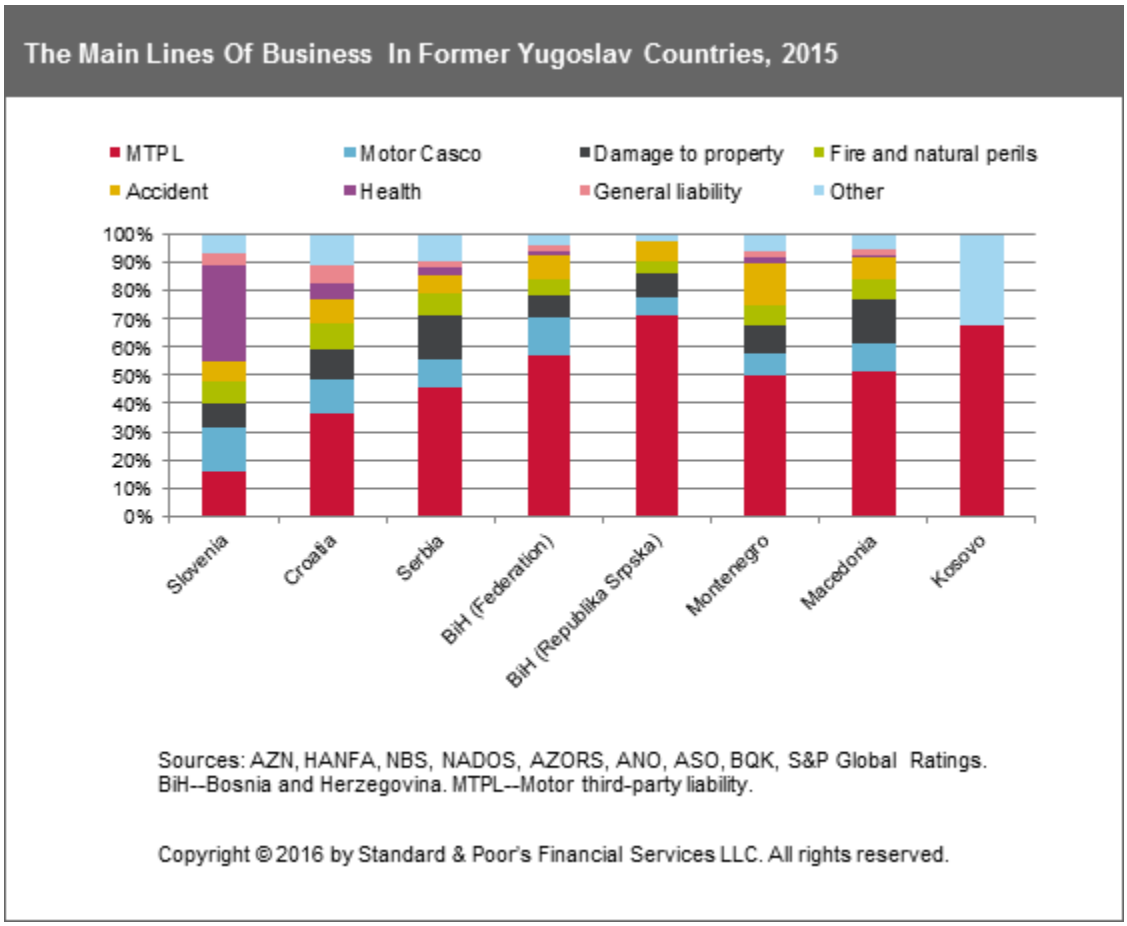
## Life And Health Are The Most Promising Lines

Problems with inefficiency and irregularities of the existing state health insurance already point to a need to develop a private health insurance system. Currently, health insurance has had the highest penetration in Slovenia. In other countries, this line is still relatively small, though its growth is among the fastest. Nevertheless, considerable legal and institutional barriers will need to be removed to support voluntary health insurance and private providers of health services.

Levels of pensions provided by the existing systems are falling, which is forcing people to save additional funds for their retirement. In the 1980s, life insurance business in Yugoslavia was developed and represented around one quarter of the insurance market premiums. However, afterwards life business was heavily depressed by high inflation. As a result, life premiums only recently climbed again toward the levels seen in the 1980s. With inflation that now seems to be under control across the region, and slowly rising wealth levels, we expect further development of this line.

In terms of property and casualty (P/C) insurance, we expect some growth in motor casualty and collision (casco) and motor third-party liability, given that car ownership in most of the countries in the region, except Slovenia and Croatia, is still below the European average. However, Serbia, BiH, Macedonia, Montenegro, and Kosovo do not yet have liberalized markets for mandatory motor insurance. Some growth in mandatory motor insurance may be partially offset by a temporary market contraction after liberalization.

**Chart 2**




## Gradual Improvements And Moderate Growth At Best In The Next Few Years

Overall, we expect that less developed countries in the region will continue to suffer from the problems we have mentioned, since improvements in these areas are likely to be achieved only gradually. In our view, a poor past insurance regulatory environment in conjunction with inadequate supervision and poor corporate governance with low legal protection may have long-lasting consequences. Therefore, we believe that in the medium term, insurance markets of former Yugoslav countries will remain at two speeds, with Slovenia and Croatia considerably better off. We think that insurers that we rate are well prepared, compared with the rest of the market. They have been able to build scale and have good diversification of premiums coming from their P/C, health and life insurance lines, which allows them to retain healthy profitability.

## Related Criteria And Research

### Related research

- The Former Yugoslav Republics 25 Years After The Fall Of Yugoslavia. Where Are They Now? Nov. 14, 2016
- Insurance Industry And Country Risk Assessment: Slovenia Property/Casualty, Sept. 5, 2016

- Insurance Industry And Country Risk Assessment: Slovenia Life, Sept. 5, 2016
- Triglav Group, Sept. 9, 2016
- Pozavarovalnica Sava d.d., Sept. 9, 2016

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