Albanian Insurance Market

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Part I: Risk in Insurance Company and risk category

- **Some history:**

- Around of 1900s Lloyd`s had branches in some cities: Shengjin, Durrres and V lora, all naval cities (in a book written by an Englishman at 1904).
- English, French and Italian companies operated in Albania before 1944.
- At 1948: first Albanian insurance company was created: Insurance State Institute
- At 1998 was licensed the first private Insurance company
Role of Albanian Financial Supervisory Authority

• To ensure that insurers are financially sound and in a position to discharge all their obligations to policyholders and claimants;

• To identify, evaluate and analyze risks, documenting the results, and to develop recommendations how the analysis can be applied to the ongoing monitoring of the insurer

• To have in place adequate risk management policies and practices to appropriately mitigate significant risks associated with its business, to identify areas of higher risk in institutions operations and then, where necessary, to work with their management to reduce risks to acceptable levels
Insurance company

- Insurance Company means a legal entity with its seat within the territory of the Republic of Albania, licensed in order to carry out insurance activity by the Financial Supervisory Authority in accordance with Insurance Law;
- The role of insurance industry is basically the transfer of a risk, pool of risks or redistribution risks from insured to the insurer.

- Till now, insurance market operate by four categories:
  - Non life insurance company (7 companies)
  - Life insurance company (3 companies)
  - Mix of life and non life insurance company (1 company)
  - Reinsurance company (1 company)

- Insurance markets are characterized by diverse distribution systems:
  - Direct writing
  - Exclusive agent
  - Independent agent
  - Broker

- To have a control at insurance market, Financial Supervisory Authority approved some regulations for ratification of the agents and brokers that operate at insurance companies.
Risks at insurance company

By Financial Supervisor Authority point of view, whatever business risk may be identified in any insurance company, it can be included in one of the selected categories:

1. **Credit risk:**
   Exposure to this risk results from financial transactions with a counterparty including issuer, debtor, borrower, broker, policyholder, reinsurer or guarantor. **Common activities:**
   - Premium collection
   - Agent receivables
   - Reinsurance recoveries
   - Investments
   - Other receivables such as commissions and refunds

2. **Market risk:**
   Exposure to this risk can result from market-making, dealing and position-taking activities in markets such as interest rate, foreign exchange, equity, commodity and real estate. **Common activities:**
   - Investments
   - Asset valuation
   - Real estate
3. **Insurance risk:**

   It is related by:

   - **Product design and pricing risk:** exposure to financial loss from transacting insurance and/or annuity business.
   - **Underwriting and liability risk:** exposure to financial loss from the selection and approval of risks to be insured, the reduction, retention and transfer risk

   **Common activities:**
   - Policy per premium considerations
   - Selection of risks to be insured
   - Marketing and sales mark-up
   - Underwriting performance of agents, brokers and sales personnel (direct writing)

4. **Operational risk:**

   Exposure to this risk can result from deficiencies or breakdowns in internal controls or processes, technology failures, human errors or dishonesty and natural catastrophes.

   **Common activities:**
   - Management oversight
   - Financial statement presentation
   - Disaster recovery
   - Information systems
   - Claim processing procedures
   - Reserves methods and assumptions
   - Loss adjustment expenses
   - Customer service
5. **Liquidity risk:**
It arises from a company’s inability to purchase or otherwise obtain the necessary funds, either by increasing liabilities or converting assets, to meet its on- and off-balance sheet obligations as they come due, without incurring unacceptable losses. **Common activities:**
- Assessment of impaired securities (bonds, stocks etc.)
- Investments in joint ventures, partnerships and limited liability companies
- Investments in real estate

6. **Legal and regulatory risk:**
It arises from a company’s non-conformance with laws, rules, regulations, prescribed practices or ethical standards in the jurisdiction in which the company operates. **Common activities:**
- Compliance with statutory accounting principles and with AFSA
- Tax liability
- Guarantee fund maintenance
- Market conduct compliance

7. **Strategic risk:**
It arises from a company’s inability to implement appropriate business plans, strategies, decision-making, resource allocation and its inability to adapt to changes in its business environment. **Common activities:**
- Management oversight
- Company consideration of risks
- Inaccurate benchmarking
- Financial projections and economic forecasts
Part II: Risk management

1. Risk management

Risk management means the totality of the methods and rules used by the insurance, or Reinsurance Company for determining, assessing and analyzing all the eventual risks, in order to avoid the financial losses.

It is not a program, but a process for which senior management and Board of Directors are increasingly called upon to ensure and this process is necessary to be changed by the time, because the market conditions change too.

In April 2009s, the Internal Monetary Fund projected total loss from the financial crisis of around US $ 4,1 trillion, of which about one-thirds suffered by insurance companies, pension funds and other financial institutions.

All insurance firms have suffered an erosion in the value of their assets and life insurers have suffered more than non-life insurance company.
Point of view from Albanian Financial Supervisory Authority:

The supervisory process is a cycle:

- Gathering and analyzing financial filings, reports from auditors and actuaries, information from the marketplace and other data on an on-going basis
- Refining the risk profiles of insurance companies with the results of this analysis
- Planning and executing on-site inspections using the risk profiles as then known to us, and
- Further refining the risk profile of the institutions using information obtained in the on-site inspections

Auditor`s reports should be reviewed as part of the supervisor`s assessment of risk. The primary objectives that will be reviewed at auditor`s reports are:

- To identify material which have been identified by the auditors in the course of their work
- To use the working papers as a source of additional information in formulating the risk profile of the company
- To obtain the auditor`s observation on matters such as the strength and weaknesses of the internal control environment, systems and general management and the effectiveness of the internal audit department.

The basic activities one might expect to find in an insurance company are:

- Underwriting
- Reinsurance negotiation and placement
- Claims management and valuation
- Investing.
Part III: Ratio Analysis in Albania (for non-life insurance company)

- Insufficient historical experience under modern accounting standards in the Albanian insurance sector to produce single indicative scores or a profile based on these ratios.
- However as time passes these can be introduced. In the interim the ratios, and those relating to solvency in particular, can be used to determine which insurers need closer supervisory attention.

The following 9 ratios have been identified as the initial IRIS set for non life insurance in Albania:

a) **Premium Growth Rate**
   
   **Formula:**
   \[
   \text{Premium Growth Rate} = \frac{(\text{Gross Premium Written for current year} - \text{Gross Premium Written for previous year})}{\text{Net Premium Written of previous year}}
   \]
   
   - The accepted value for this ratio is ± 40% (By Early Warning Test it must be ± 33%)
   - Rapid growth or decline in premium volume may be indicative of major changes in corporate strategy or other important factors: entry into new lines of business, an attempt to increase cash flows to meet claims payments, loss of business, exit from certain classes of business

b) **Retention Ratio**
   
   **Formula:**
   \[
   \text{Retention Ratio} = \frac{\text{Net premiums written}}{\text{Gross premiums written}}
   \]
   
   - The normal range for this ratio is 40% to 80% (Early Warning Test has the same range)
   - This ratio defines how much of its business written a company has retained for its own account.
   - A retention ratio of less than 20% often indicates that the insurer is closer to being a broker than a real underwriter, but may find exchange commission more remunerative than brokerage
c) **Capital Ratio**

Capital Ratio = Capital and surplus (shareholders funds)/Gross written premium

- The normal range for this ratio is 20% to 50%
- The capital and surplus used for the purposes of this ratio should be after deducting non approved (or admitted) assets and after adequate provisions have been set up.
  This ratio measures how much premium can be written for a unit of shareholders’ funds

d) **Claims Ratio**

Net Claims Ratio = Net claims incurred / Net premiums earned

- The normal range for this ratio is 50% to 80% (By Early Warning Test it must be 25% to 30%)
- Sudden changes in claims ratios are a red flag and can point to such things as inadequate or poor reinsurance, changes in business strategy or changes in the approach to provisioning.

e) **Expenses Ratio**

Expenses Ratio = Net expenses / Net written premium

- The normal range for this ratio is 25% to 50% (By Early Warning Test it must be 65% to 70%)
- Net expenses are equal to gross expenses less exchange commission paid by reinsurers under proportional treaties. The net expense ratio is a measure of how efficient an insurer is. Premium received must be sufficient to pay expenses and claims, as investment income is normally required to provide an adequate profit. If the expense rate is too high the insurer will eventually find that it cannot compete for market share against more efficient operators.
f) **Combined Ratio**

Combined Ratio = Expense ratio + Claims (or loss) ratio

- The normal range for this ratio is 85% to 105%
- The combined ratio represents the result of the company's technical account. Where the combined ratio exceeds 100%, the company must have investment and/or other income sufficient to offset the excess of 100% to remain profitable. There is a danger that, when investment income is high, companies will knowingly write to a loss in the technical account, relying on the investment income to produce a profit. The usual reason is to increase market share by reducing premium rates. If investment markets suffer a downturn, companies that have attempted this strategy may find themselves in financial difficulty.

g) **Investment Income**

Investment income ratio = Investment Income / Net earned premium

- The normal range for this ratio is 4% to 8%
- The investment income ratio is a measure of how effective the insurance company management is in collecting premiums and investing them effectively until claims are paid. In a modern competitive market place the typical investment income ratio should be between 4% and 8%. A ratio of 5% is normally enough to provide an adequate return to capital if the combined ratio is 100%. Fluctuations in the investment ratio are red flag and should be investigated by the supervisor.
h) **Technical Provisions Ratio**

Technical Provisions Ratio = Capital and surplus (shareholders funds)/Technical provisions

- The normal range for this ratio is 10% to 30%

- Technical provisions are the sum of claims provisions, unearned premium provisions and any unexpired risk provision. They should be on a net of reinsurance basis. This ratio shows how much scope there is for error in the technical provisions. The ratio should typically be at least 20% (in other words there is a 20% margin for error in the technical provisions before the insurer becomes bankrupt). Changes in this ratio can point to changes in provisioning standards or simply to an improving or deteriorating solvency position.

i) **Solvency**

Solvency ratio = Capital and surplus (shareholders funds)/Required minimum solvency under then law

- The normal range for this ratio is 150% to 300%

- The actual solvency margin for a well run non life insurer is typically at least 200% of the minimum required. When the ratio falls below this the supervisor will typically begin to monitor the insurer more closely in an industrial country environment. Actions required may have included ceasing writing certain classes of business, changing certain management personnel and producing a business plan to retrieve the situation.
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<th>2006</th>
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<th>2008</th>
<th>2009</th>
<th>MIN</th>
<th>MAX</th>
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<tbody>
<tr>
<td>Premium Growth Rate</td>
<td>12.37%</td>
<td>30.63%</td>
<td>18.84%</td>
<td>9.07%</td>
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<td>Net Retention Ratio</td>
<td>89.72%</td>
<td>85.42%</td>
<td>79.50%</td>
<td>82.16%</td>
<td>40.00%</td>
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<td>Net Claims Ratio</td>
<td>36.97%</td>
<td>25.87%</td>
<td>25.70%</td>
<td>36.24%</td>
<td>50.00%</td>
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<tr>
<td>Expense Ratio</td>
<td>5.69%</td>
<td>5.94%</td>
<td>6.71%</td>
<td>7.02%</td>
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<td>Combined Ratio</td>
<td>92.66%</td>
<td>81.81%</td>
<td>92.82%</td>
<td>106.53%</td>
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</tr>
<tr>
<td>Investment Income</td>
<td>7.02%</td>
<td>4.07%</td>
<td>5.82%</td>
<td>7.14%</td>
<td>4.00%</td>
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<tr>
<td>Capital Ratio</td>
<td>6.740%</td>
<td>6.299%</td>
<td>6.242%</td>
<td>51.92%</td>
<td>20.00%</td>
<td>5.00%</td>
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<tr>
<td>Technical Provision Ratio</td>
<td>6.985%</td>
<td>7.733%</td>
<td>88.89%</td>
<td>73.52%</td>
<td>10.00%</td>
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<tr>
<td>Solvency</td>
<td>40.277%</td>
<td>460.81%</td>
<td>315.98%</td>
<td>374.43%</td>
<td>15.00%</td>
<td>300.00%</td>
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PART IV: Checklist of actuaries at Life and Non-life Insurance Company

Checklist of actuaries is a combination between:

1. Control of documents (off-site)
2. Inspection to insurance company (on-site)

1) Control of documents:

- **Technical/Mathematical Provisions, include:**
  - Review the database of technical provisions, if it is completed with data and built according to requirements of the FSA Regulation
  - Calculation of Technical/Mathematical provision based on FSA regulation
  - Liability and Adequacy Test (LAT)
  - Run off Test.

- **Risk management contracted by the insurance company, include:**

  Review the reinsurance program, specifically:

  - Composition of reinsurance participating in reinsurance coverage: based at the requirements of FSA Regulation
  - Limits of reinsurance coverage
  - Ceded premiums in reinsurance and claims paid from reinsurers should be correctly accounted by the insurance company, and the actuaries will include them in the calculation of mathematical and technical provisions
Review of insurance risks, include:

- Summary of the risks insured from the reinsurance company in each insurance portfolio.
- Based at directive no 10, insurance company will report continuously the list of risks exceeding 30 million leke and claims exceeding 10 million leke the copy of that contracts too.
- Check if company had take risks over 10% of it Solvency Margin.
- Check of coinsurance contract

Ratio analysis, we have seen them above.

2) Inspection to insurance company include:

- Verification of reinsurance contracts with those deposited in the Authority
- Verification if there are facultative reinsurance contracts and if they are reported in FSA.
- Performance of the risk allocation
- Verification of the claims register
- Actuarial opinion for risk management by the company
THANK YOU