

INSURANCE SECTOR IN SERBIA

Second Quarter Report 2011

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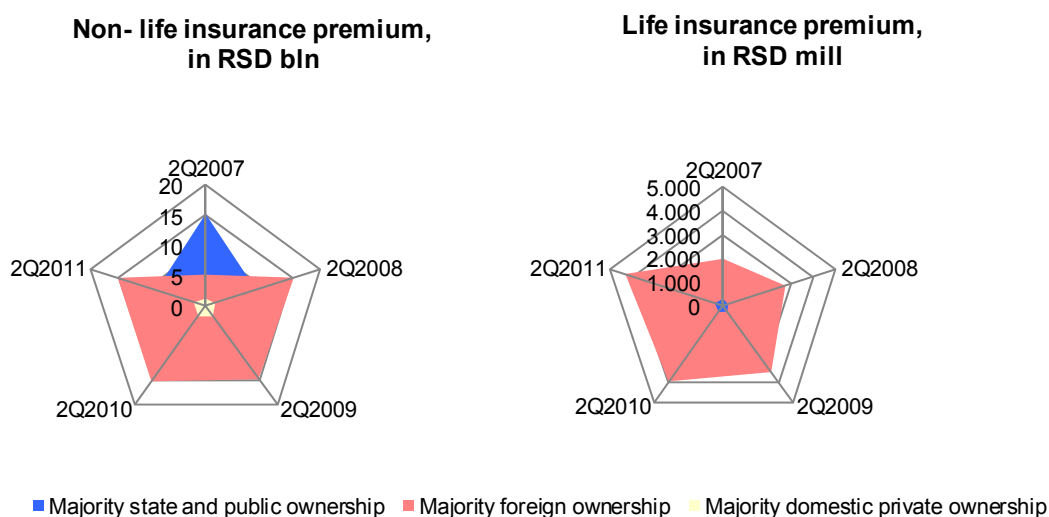
Insurance market

Market participants

Insurance companies

In the second quarter of 2011 the insurance market involved 27 insurance companies, with one addition since the same period a year earlier – a newly founded company engaged in non-life insurance business. 23 companies engaged in insurance activities only and four are specialist reinsurance companies. Of companies engaged in insurance business, seven engaged in life insurance, ten in non-life insurance, and six companies in both life and non-life insurance.

Breakdown by ownership shows that of 27 insurance companies, 20 were in majority foreign and seven in majority domestic ownership.



Foreign-owned greenfield insurance companies (twelve since 2005) again recorded a dominant share in life insurance premium of 92.1%, non-life insurance premium of 59%, total assets of 66.6% and employment of 64.9%.

Other market participants

In addition to insurance companies, the market also comprised 17 banks, 77 legal entities and 112 entrepreneurs, as well as 11,660 natural persons licensed to engage in insurance agency/brokerage.

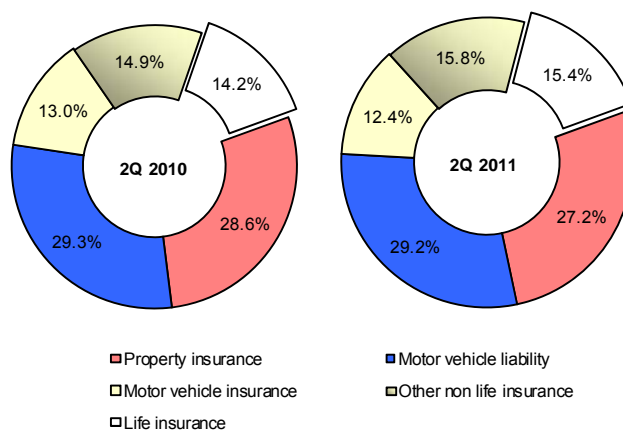
Insurance portfolio structure

Due to a decline in household spending and lower demand for insurance products, non-compulsory non-life insurance products in particular, total premium generated from insurance business in Q2 2011 came at RSD 30.6 billion (EUR 298 million or USD 433 million)¹ which is a modest increase of 2.1% on a year earlier.

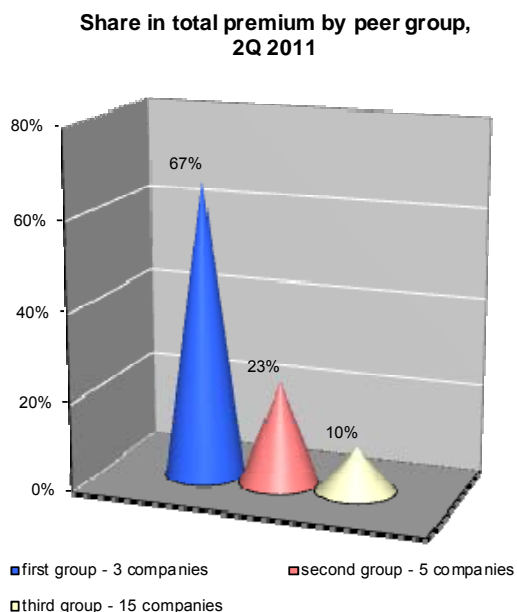
The share of non-life insurance in total premium was 84.6%, and the share of life insurance premium 15.4%. The increase in the share of life insurance premium from 14.2% a year earlier resulted from the increase in this type of insurance by 11%.

The insurance premium structure in Q2 2011 resembled that from the same quarter last year, with motor third party liability insurance (MTPL) accounting for the largest share (29.2%), followed by property insurance against fire and other hazards and other property insurance (27.2%) and full coverage motor vehicle insurance (12.4%).

**Total premium according to the types of insurances
in 2Q 2010 and 2Q 2011**



¹ At the middle exchange rate of the National Bank of Serbia as of 30.06.11.



Following a short-lived recovery in 2010, the sale of non-life insurance policies relapsed in Q2 2011 as a result of a decline in non-compulsory insurance premium, primarily property insurance (2.9%) and full coverage motor vehicle insurance (2.8%). On the other hand, MTPL insurance premium recorded a reverse trend, recovering from decline in Q1 2011 to a modest growth of 1.6 %.

In terms of their respective shares in total premium, insurance companies are classified into three groups. The first comprises three companies accounting for over 15% of total premium, the second includes five companies accounting for under 15% and the third comprises 15 companies accounting for under 3% of total premium. This indicates almost the same portfolio concentration relative to the same period a year earlier when the first group of three companies covered 67.2% of the market, the second, comprising the same five companies – 21.5% and the third, comprising 14 companies – 11.2%.

The Herfindahl Hirschman index, calculated by summing up the squares of the respective market shares or, in this case, balance sheet totals of all insurance companies, points to moderate market concentration which is likely to decrease further. The HHI declined from 1198 in Q2 2010 to 1135 in Q2 2011.

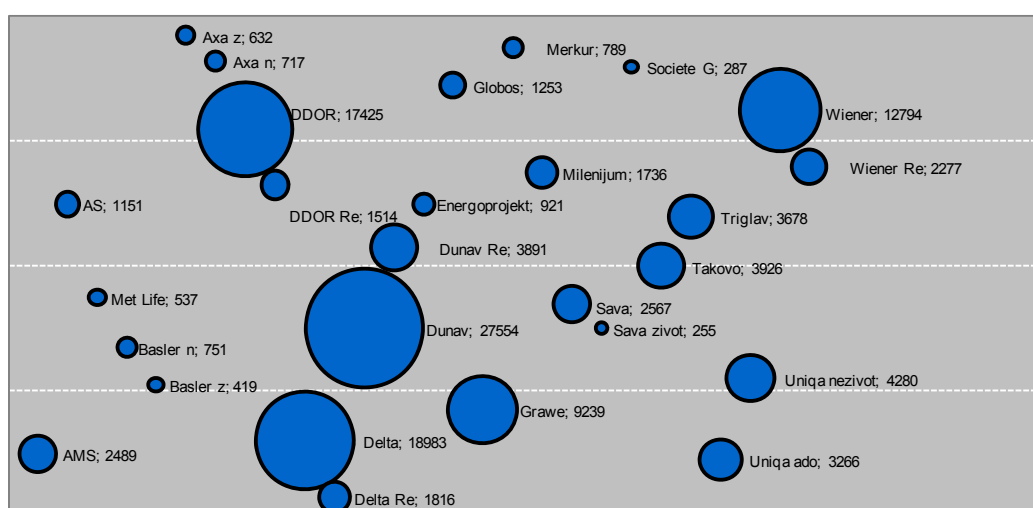
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Balance sheet total and balance sheet structure

Balance sheet total

The balance sheet total of insurance companies increased to RSD 125.1 bln in Q2 2011, up by 8.7% on Q2 2010.

**Balance sheet total of insurance companies in million RSD
as at 30/06/2011**

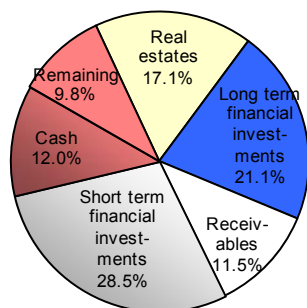


Composition of assets

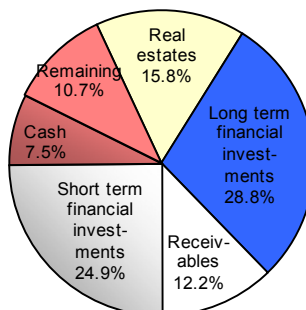
At end-H1 2011, current assets continued to account for a major part of total assets of insurance companies – 54.1% (of which 24.9% referred to short-term financial investments and 12.2% to premium receivables). Fixed assets accounted for 45.9% of total assets (of which 28.8% referred to long-term financial investments and 15.8% to property and equipment).

Compared to Q2 2010 when current assets made up 60.8% (of which 28.5% were short-term financial investments and 11.5% premium receivables) and fixed assets 39.2% (of which 21.1% were long-term financial investments and 17.1% property), we may conclude that the composition of assets somewhat changed. Relative to Q2 2010, long-term financial investments recorded the strongest growth (48.6%), on back of 15-year government bonds, continuing an upward trend from Q1 2011. Property share within fixed assets declined, while receivables share within current assets slightly upped (from 11.5% to 12.2%).

Structure of assets as at 30/06/2010



Structure of assets as at 30/06/2011

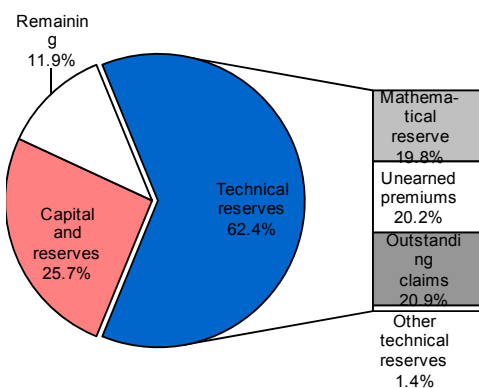


Composition of liabilities

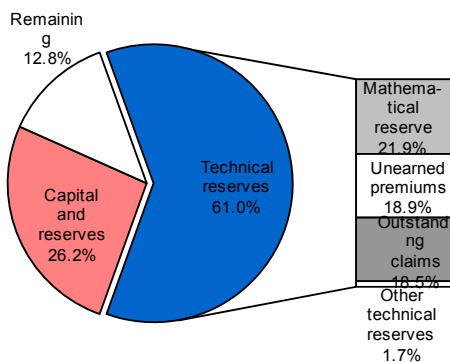
As at 30.06.11, technical reserves accounted for 61% and capital and reserves for 26.2% of total liabilities.

A y-o-y comparison of the composition of liabilities reveals that technical reserves kept their dominant share. In the period under review, technical reserves grew by 6.7%, from RSD 71 billion to RSD 75.8 billion, with mathematical reserves growing at a fastest rate of 20.4%.

Structure of liabilities as at 30/06/2010



Structure of liabilities as at 30/06/2011



Performance indicators

Solvency

The solvency of an insurance company depends on the size and composition of their liquidity, the ratio of their technical reserves to the volume of undertaken obligations as well as on the sufficiency of guarantee reserves to protect policyholders in the event of unforeseen losses, by acting as a buffer for losses not covered by technical reserves.

On 30.06.11, the solvency margin amounted to RSD 14.5 billion and the guarantee reserve came at RSD 27.8 billion. The ratio of guarantee reserve to solvency margin stood at 201.28% for non-life insurance companies and at 181.23% for life insurance companies.

Quality of assets

The share of intangible investments, property, investment in non-tradable securities and receivables (as types of assets difficult to collect) in the total assets of companies engaged primarily in non-life insurance stood at 37.03% and 39.20% in 2010 and Q2 2011, respectively, indicating that, despite the rising share of such assets, companies remain able to settle their obligations.

Declining from 8.87% in 2010 to 8.17% in Q2 2011, the share of the above types of assets for companies engaged primarily in life insurance remained at an acceptable level. The change in the value of this indicator was occasioned by the nominal decline in the above types of assets.

Coverage of technical reserves

In order to protect the interests of the insured and third damaged parties and ensure timely payment of damage claims, insurance companies need not only allocate adequate technical reserves but also invest their assets, depending on the type of insurance they provide, taking care of the maturity of obligations, profitability and investment dispersion.

The trend of better coverage of technical reserves in companies engaged primarily in non-life insurance dating back to Q3 2010 continued through Q2 2011. Namely, data submitted by companies evidence that the coverage of technical reserves with prescribed types of assets went up from 100.29% in 2010 to 101.67% in Q2 2011.

In companies engaged primarily in life insurance the coverage of technical reserves by prescribed types of assets stood at 102.39% in Q2 2011, and at 101.74% in 2010.

Overall, technical reserves in non-life insurance business in Q2 2011 were for the most part covered by deposits with banks (29%), government securities

(24%), insurance premium receivables (14%) and cash holdings (11%). Technical reserves in life-insurance were dominated by government securities (84%), for the most part RS bonds, followed by bank deposits (11%).

Liquidity

To be able to settle its liabilities, an insurance company must meet asset-liability maturity matching requirements as well as follow marketability standards and maintain the quality of its assets. Given the unpredictability of the size and timing of individual damage claims, a company must carefully plan the structure of its assets for the purpose of meeting not only obligations under damage claims, but other obligations as well.

The ratio of short-term assets (current assets less inventories) to short-term liabilities for companies engaged primarily in non-life insurance was 104.58%, in Q2 2011 and 110.28% in 2010, indicating sound liquidity.

The ratio of short-term assets (current assets less inventories) to short-term liabilities for companies engaged primarily in life insurance was 130.84% in Q2 2011 and 316.82% in 2010. Movement in this indicator points to adequacy of liquid assets for the settlement of short-term liabilities. Sound liquidity is due primarily to life insurance companies' investment in long-term securities issued by the government.

Motor third party liability

In Q2 2011, twelve companies engaged in compulsory motor third party liability insurance.

Total MTPL premium went up by 1.6% relative to Q2 2010.

Portfolio concentration increased moderately in this segment since in Q2 2011 three insurance companies accounted for 58.3% of the market, as opposed to 56.1% in the same period last year.

Conclusion

The y-o-y comparison points to further, albeit slower development of the Serbian insurance market:

- Insurance industry balance sheet total rose by 8.7%, to RSD 125.1 bln.
- Total capital rose by 11.1%, to RSD 32.6 bln.
- Technical reserves gained 6.7% – both life and non-life insurance technical reserves fully covered. Investment into long-term securities gained ground, from 64% to 84% in life insurance and from 17% to 24% in non-life insurance, owing to investment into 15-year RS bonds.
- Up by 2.1% from Q2 last year, total premium came at RSD 30.6 billion;

- The share of non-life insurance in total premium remained dominant (84.6%). MTPL insurance premium ramped up, while non-compulsory insurance, such as property and full coverage insurance, has been on the downside, reflecting insurance industry vulnerability to the global financial crisis.
- The share of life insurance in total premium upped from 14.2% to 15.4%.
- The Herfindahl Hirschman index points to moderate market concentration.
- The number of insurance companies rose from 26 to 27, while total insurance sector employment increased by 3.3% to 11,289.

Insurance companies should focus on the following key areas: corporate governance (implying, inter alia, a well-developed system of internal controls), improvement of risk management procedures and investment valuation techniques, promoting transparency, good business practices and fair dealing with clients, as well as education of prospective clients. This will contribute to the strengthening of client confidence and the creation of conditions conducive to further development of this segment of the financial system.

It is important to ensure consistent compliance with compulsory traffic insurance regulations, particularly with regard to timely payment of claims and application of the bonus-malus system.