NATIONAL BANK OF SERBIA

INSURANCE SECTOR IN SERBIA

Report for 2016

Contents:

List of abbreviations

mln	million
bln	billion
Q3	three quarters in the year – from 1 January to 30 September

1. Introduction

According to law, the National Bank of Serbia (NBS) is entrusted with supervising the major part of the Serbian financial sector. In 2016, the financial sector under the NBS's supervision included 31 banks, 23 insurance undertakings, 16 financial lessors, seven voluntary pension funds, eight payment institutions and one electronic money institution.

2. NBS's activities in 2016

NBS's activities in 2016 were focused on safeguarding the insurance sector's stability and creating conditions for its further development, as well as on strengthening the supervisory function with a view to protecting the insured, insurance beneficiaries and injured parties.

On-site examinations

With a view to safeguarding the stability of the insurance sector, in 2016 the NBS conducted seven on-site examinations according to the plan – covering five insurance undertakings, one reinsurance undertaking and another supervised entity (a bank which obtained NBS's approval to carry on insurance agency activities). Apart from the planned examinations, in 2016 the NBS also conducted one extraordinary targeted examination in one insurance undertaking.

In three supervised entities the NBS carried out a full-scope examination, in two entities a partial examination covering risky activities and in one entity it conducted a follow-up examination. In all these procedures the examiners prepared examination reports and in five cases they also prepared official notes, upon receiving the objections to the examination report.

Full-scope examinations in two supervised entities identified minor illegalities and irregularities which had no major impact on the entities' operation, and/or omissions which could be removed by corrective measures, such as omissions in the governance system in terms of risk exposure, errors in accounting records etc.

Targeted examinations of risky activities in three supervised entities focused on business planning, market behaviour of these insurance undertakings – specifically, handling of complaints and pre-contract informing of policyholders, profitability of particular types of insurance, accounting records and insurance administration expenses.

Significant omissions were identified in recording of insurance administration expenses, which in turn led to the violation of regulations governing compulsory traffic insurance, unrealistic presentation of operating results by types of insurance and unreliable income sheets by types of insurance.

The examinations also identified irregularities in informing of policyholders and/or the insured on the rights stemming from a concluded insurance contract, unclear and inaccurate advertising of insurance products etc. The supervisor also focused on market behaviour of supervised entities in the following areas: distribution channels and promotional activities, settlement of claims for damages in MTPL insurance, handling of complaints and keeping records thereof, doing business with related persons etc.

In the course of a follow-up examination in one insurance undertaking it was found that the measures imposed by the NBS were partially implemented, which entailed the issuance of new supervisory measures. In 2016 the supervisor also examined on-site a report on a particular measure issued to a reinsurance undertaking and established that the measure was put into practice.

In one examined bank which has the NBS's approval to carry on insurance agency activities the examiners established omissions in informing of bank clients about the insurance products and/or in pre-contract informing of policyholders.

Following the completion of on-site procedures, the NBS issued supervisory measures to nine supervised entities – to five entities based on examinations conducted in late 2015 and to four entities based on examinations conducted during 2016. Three supervised entities were fined.

Apart from supervisory measures, the NBS also issued four decisions on termination of the examination procedure in cases where the identified irregularities were removed in the course of examination or within the deadline for objections, or following the implementation of supervisory measures. In one case the procedure was terminated because the entity ceased to be engaged in insurance activity.

Apart from conducting the planned on-site examinations, in 2016 the NBS supervisors also examined the reports on implementation of supervisory measures issued in 2015 in 13 supervised entities and prepared official notes thereof.

Off-site supervision and examinations

In parallel with conducting on-site examinations, the NBS also continuously analysed, monitored and examined the operation of all supervised entities in the area of insurance from economic, legal and actuarial aspects. It examined all reports which supervised entities submitted in hard copy or electronically, in accordance with their obligations under law or in response to the NBS's request. Based on these data the supervisor conducted a comprehensive analysis and assessment of riskiness of operations of insurance/reinsurance undertakings and prepared the examination plan for 2017.

In situations envisaged by the regulatory framework and based on the received documentation and data, two off-site examinations of insurance undertakings were conducted and documented by reports, and one was completed in 2016. The subject of both examinations was the credibility of reports which insurance undertakings compile and submit to the NBS, other regulatory authorities and the public. Given that in one case grave irregularities were identified, the NBS imposed on that insurance undertaking supervisory measures that are publicly disclosed[1] (dismissal of members of management). The measures were implemented, as duly verified by the appropriate act issued by the NBS.

Licenses, approvals and other supervisory activities

As part of its insurance supervision, the NBS also conducted a whole series of other, regular activities, such as processing of different types of applications for licenses and approvals, issuing of professional opinions and similar.

In 2016, special attention was paid to processing of requests for alignment with the Insurance Law. This was a complex activity spanning several months and including a thorough analysis of operations and acts of insurance/reinsurance undertakings and other supervised entities, as well as making sure that they comply with the new regulatory standards and criteria. In the process of alignment with the Law, insurance/reinsurance undertakings, among other, restructured their investment portfolios, met new capital adequacy requirements and set up reporting systems for these indicators. Decisions on alignment with the new regulatory framework included also operating licenses, by types of insurance, in the manner established by the current Insurance Law. The alignment procedure was successfully completed by six undertakings engaged in all types of life and non-life insurance, five undertakings engaged in all types of life insurance, eight undertakings engaged in all types of non-life insurance, as well as four undertakings engaged in reinsurance. In line with the regulations, undertakings engaged in both life and non-life insurance set up separate management of assets that serve or may serve for meeting liabilities arising from insurance, appertaining capital and liabilities.

The NSB redesigned its reporting system, in line with regulatory changes and user needs, so the data set on operation of insurance undertakings increased in scope and quality. New public registers of market participants were established, available to all interested parties that wish to access data on supervised entities. The new registers are available on the NBS website.

[1] For more detail, see chapter 5.

Development activities

NBS activities aimed at establishing conditions for the development of the insurance industry primarily included preparations for implementation of Solvency II in Serbia.

The Strategy for Implementation of Solvency II in Serbia was adopted in July 2016. In line with the EU integration process, it envisages phased implementation. The first stage was completed within the planned deadline, by implementing the following activities: the analysis of possibility of exemption of very small insurers from Solvency II implementation, the analysis of the capacity and readiness of undertakings to implement Solvency II and identification of legislative gaps and/or needs for amendment in order to achieve full compliance with Solvency II.

A significant activity of the NBS in creating conditions for the development of the insurance sector is alignment of the Serbian legislation with the *acquis* in the area of insurance. Serbia's negotiations about the EU membership pertain to conditions, dynamics and manner of transposition of the EU *acquis* which is divided into 35 chapters. The NBS is the leading institution in the Negotiating Group 9 for financial services. Insurance and occupational pension services are a separate subarea within the group. NBS representatives in this process continued to carry out the planned activities including, among other, preparation of the Negotiating Positions on: Solvency II, Motor Third Partly Liability Insurance (MTPL), distribution of insurance and financial reports of insurance undertakings.

As part of development of its supervisory function, in 2016 the NBS worked on: improvement of early warning indicators in line with the new regulations, by updating the existing and introducing new indicators, as well as expanding the range of entities covered by early warning indicators; professional education and training of employees in the NBS etc.

In 2016, the NBS for the first time successfully implemented the micro stress test of the insurance sector in Serbia in order to identify risk exposure of individual insurance undertakings and their ability to manage risks.

Professional exams

The NBS devotes special attention to education of certified insurance brokers and agents, as well as certified actuaries. According to the new regulations, the candidates, prior to taking the exam at the NBS, should pass the appropriate levels of training, in order to acquire all the necessary knowledge for the successful performance of their new tasks.

In order to raise the level of competences of candidates who were certified for insurance brokerage/agency activities and to finalise the list of active insurance brokers/agents, continuous education was introduced as a requirement for renewing the membership in the registry and staying in the business.

The Serbian Chamber of Commerce, engaged as a partner on this task, organised trainings for acquiring the title, as well as trainings aimed at continuous education of insurance brokers and agents in several Serbian cities, with participation of renowned insurance experts.

In 2016 the NBS organised two certification exams for insurance brokers/agents. Among the candidates who participated in the aforesaid trainings, 596 persons passed the certification exams.

3. Insurance market[2]

3.1. General indicators[3]

The growth of the world economy was positive in 2016, but assessed as moderate and the weakest annual growth post-crisis so far. After growing by 2.7% in 2015, real GDP is estimated to have grown by 2.3% in 2016.

A mild recovery is expected in 2017, with the growth forecast of 2.7%, driven mainly by growth in export-oriented economies.

The estimated real growth in *global non-life insurance premium* in 2016 was 2.4%, – 1.7% in advanced countries and 5.3% in developing ones, while Central and Eastern Europe, after two years of a decline, recorded a rise of almost 5.0%. Compared to 2016, the real growth forecast for 2017 is somewhat lower – 2.2% globally, 1.3% for advanced countries and 4.8% for Central and Eastern Europe, while developing countries are expected to record somewhat higher growth of 5.7%.

Rising by 5.4% in real terms in 2016, *global life insurance premium* is estimated to have grown much more than non-life insurance premium – 2.0% in advanced countries and 20.1% in developing countries, while falling fourth year in a row in Central and Eastern Europe. The projected global growth of life insurance premium for 2017 is 4.8% – of which 2.1% in advanced countries and 14.9% in developing countries. Central and Eastern European countries are expected to post growth as well.

Four countries with the largest share in global premium (the US, Japan, China and the UK) covered more than half of the global market (54.3%) in 2015. At the same time, Serbia ranked 86th in the world by the size of its insurance premium.

The Serbian insurance sector has remained underdeveloped and significantly below the average for EU member states. This is corroborated by the insurance market development indicators – the ratio of total premium to GDP and total premium per capita.

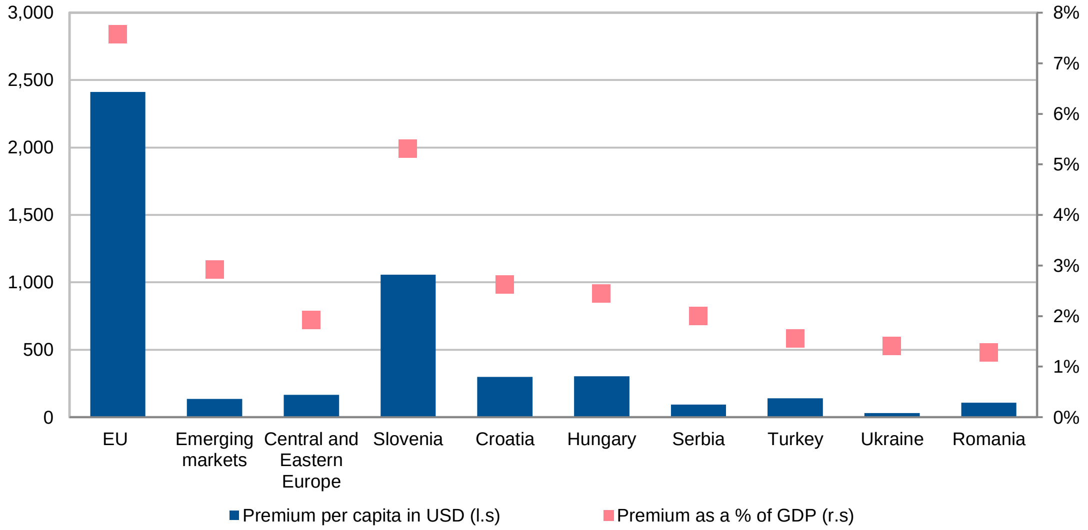
Judging by the 2015 premium to GDP ratio of 2.0%, Serbia ranked 61st in the world. The ratio for EU countries is as much as 7.6%. However, when compared with the 2.9% average for developing countries and 1.9% average for countries in Central and Eastern Europe, and given that countries such as Romania and Turkey are behind Serbia, it may be concluded that Serbia holds a satisfactory position.

---

[2] The Report is based on data that insurance undertakings are obliged to submit to the NBS, but their accuracy was not verified by the NBS in its on-site examinations. When analysing the insurance market, it should be borne in mind that changes presented in the Report are calculated relative to data for insurance undertakings which operated in 2015.

[3] Sources: Global Economic Prospects, World Bank, January 2017; Global insurance review 2016 and outlook 2017/18, Swiss Re, November 2016; World insurance in 2015, Swiss Re, Sigma No 3/2016, June 2016 and the National Bank of Serbia.

Chart 3.1.1 **Comparison of insurance sector development indicators**
(in 2015)



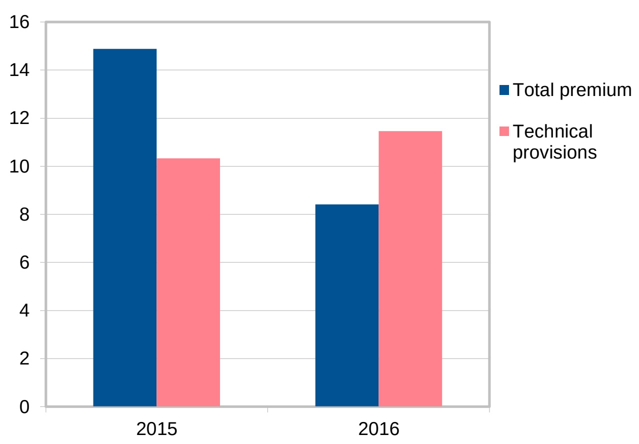
Source: Swiss Re, Sigma No 3/2016 and the NBS.

Measured by the 2015 premium per capita of USD 103 or EUR 94, Serbia was 67th in the world, while the same indicator for EU member states equalled USD 2,412, for the Central and Eastern European region USD 166, and for developing countries USD 135. The Cayman Islands ranked top in the world with USD 12,619, followed by Switzerland, while Slovenia and Croatia held 31st and 52nd place with USD 1,058 and USD 299, respectively.

In 2016, the premium to GDP ratio for Serbia was 2.1%, while premium per capita stood at USD 108 or EUR 102.

The development of the Serbian insurance market in terms of real premium growth indicates that positive trend was maintained.

Chart 3.1.2 **Real movement of total premium and technical provision**
(in %)



Source: NBS.

In the financial sector as a whole (banks, insurance, leasing and voluntary pension funds)[4] insurance ranked 2nd by its balance sheet amount, capital and employment levels. Of the total financial sector balance sheet worth RSD 3,556 bln in 2016, banks accounted for 91.2%, and insurance undertakings for 6.1%.

Table 3.1.1 **Share in total financial sector**
(in %)

	Banks		Leasing		Insurance		VPF	
	2015	2016	2015	2016	2015	2016	2015	2016
Balance sheet total	916	912	18	19	5.8	6.1	0.9	0.9
Capital	92.2	914	12	12	6.7	7.3		
Number of employees	68.0	67.5	12	11	30.5	310	0.3	0.3

Source: NBS.

3.2. Market participants

Insurance undertakings

In 2016 the insurance market in Serbia comprised 23 insurance undertakings, down by one[5] in year-on-year terms. Nineteen undertakings engaged in insurance activities only and four in reinsurance activities. Of the insurance undertakings, five were exclusive life insurers, eight exclusive non-life insurers, while six provided both life and non-life insurance.

The breakdown by ownership shows that of 23 insurance undertakings, 17 were in majority foreign ownership.

Foreign-owned insurance undertakings which entered the market via greenfield licences or privatisation arrived at a dominant share, which in 2016 stood at: 94.1% in life insurance premium, 62.5% in non-life insurance premium, 77.5% in total assets and 68.7% in total employment.

[4] Excluding payment institutions and electronic money institutions.
[5] In May 2016, one non-life insurer obtained the NBS's consent to initiate voluntary liquidation.

Chart 3.2.1 **Structure of insurance companies in Serbia by ownership** (in 2016)

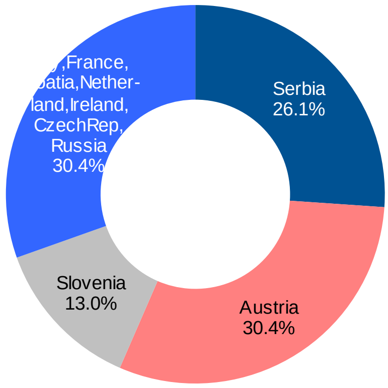
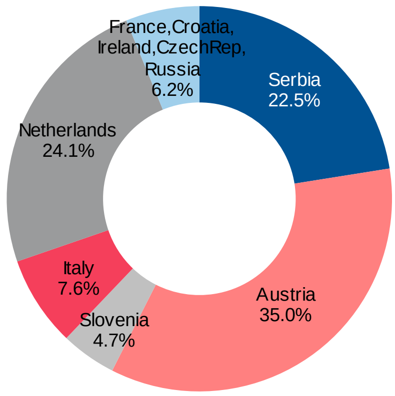


Chart 3.2.2 **Balance sheet total of insurance companies in Serbia by ownership** (in 2016)



Source: NBS.

Other market participants

In addition to insurance undertakings, the market consisted of 19 banks and five financial lessors licensed for insurance agency operations, 89 legal persons (insurance brokerage/agency undertakings) and 95 insurance agents (natural persons-entrepreneurs).

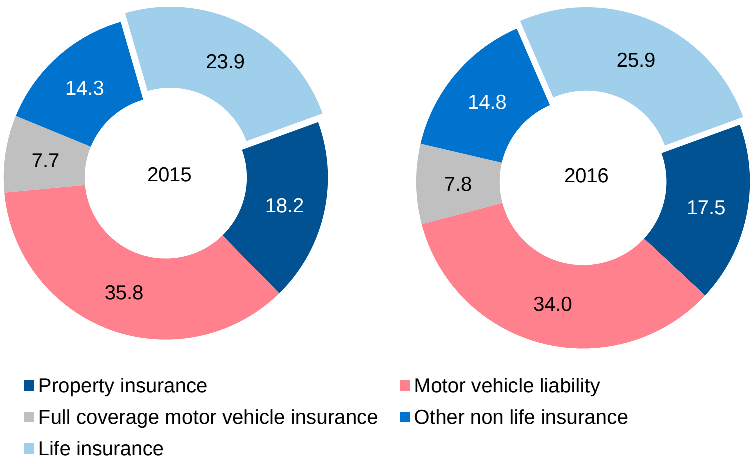
3.3. Insurance portfolio structure

Total premium generated from insurance business in 2016 came at RSD 89.1 bln (EUR 722 mln or USD 761 mln)[6], which is an increase of 10.1% in nominal and 8.4% in real terms.

In 2016, the share of non-life insurance in total premium was 74.1%. Life insurance increased its share from 23.9% in 2015 to 25.9% in 2016, owing to a 19.4% rise in life insurance premium relative to the year before.

[6] At the NBS middle exchange rate as at 31 December 2016.

Chart 3.3 **Total premium according to the types of insurance**
(in 2015 and 2016, in %)



Source: NBS.

The composition of the overall portfolio indicates that five types of non-life insurance alone – accident insurance, motor vehicle insurance, insurance of property against fire and other hazards, other property insurance and MTPL insurance – account for 64.1% of the total.

MTPL, as compulsory insurance, kept the leading share in total premium in 2016 (34.0%), followed by life insurance (25.9%) and property insurance (17.5%).

Accident insurance, including, inter alia, compulsory types of insurance such as passenger insurance in public transport and insurance of employees from injuries at work, professional and work-related illnesses, accounted for 4.9% of total premium in 2016.

MTPL insurance recorded growth in premium of 4.3% and property insurance of 5.8% relative to the year before. After the reversal of the downward trend in Q3 2015, the premium of full coverage motor vehicle insurance – "kasko" continued up in 2016, rising by 11.0% and slightly increasing its share in total premium to 7.8%.

The share of voluntary health insurance premium showed an increase from 2.0% in 2015 to 2.5% in 2016, owing to nominal growth in premium of 40.6%. Two insurance undertakings covered almost three quarters of the market.

Observing the ranking of top five insurers in terms of total premium and life insurance premium, there was a change in the fifth position, while in terms of the size of non-life insurance premium, there was a change in the fourth and fifth positions.

In terms of total premium, life-insurance premium and non-life insurance premium, the top five undertakings accounted for 74.9%, 82.0% and 78.9%, respectively.

Table 3.3.1 Ranking of five largest insurance undertakings

(in RSD mln, in %)

	2015			2016			Ranking change
	Amount	Share	Rank	Amount	Share	Rank	
by total premium							
Dunav	21461	26.5	1	22893	25.7	1	-
Generali	18633	23.0	2	19830	22.2	2	-
DDOR	9408	11.6	3	10330	11.6	3	-
Wiener	7872	9.7	4	9510	10.7	4	-
Triglav	3405	4.2	6	4229	4.7	5	increase
Uniqa nl	4190	5.2	5	3572	4.0	7	decrease
by non-life premium							
Dunav	20154	32.7	1	21537	32.6	1	-
Generali	12034	19.5	2	12858	19.5	2	-
DDOR	8629	14.0	3	9282	14.1	3	-
Wiener	4048	6.6	5	4422	6.7	4	increase
Triglav	3326	5.4	6	3963	6.0	5	increase
Uniqa nl	4190	6.8	4	3572	5.4	6	decrease
by life premium							
Generali	6598	34.1	1	6972	30.1	1	-
Wiener	3825	19.8	2	5089	22.0	2	-
Grawe	3215	16.6	3	3563	15.4	3	-
Uniqa l	1818	9.4	4	1831	7.9	4	-
Societe Gen	465	2.4	8	1506	6.5	5	increase
Dunav	1307	6.7	5	1355	5.9	6	decrease

Source: NBS.

Observed by distribution channels, the major portion of *total premium* in 2016 was generated via: insurance undertakings (61%), technical inspections (12%), banks (8%) and intermediaries (8%).

Speaking of *non-life insurance* premium, 64% of the total was collected by insurance undertakings, 17% via technical inspections and 10% via intermediaries. Banks collected as much as 74% of total loan insurance premium, and 36% of total MTPL insurance premium was collected via technical inspections of vehicles.

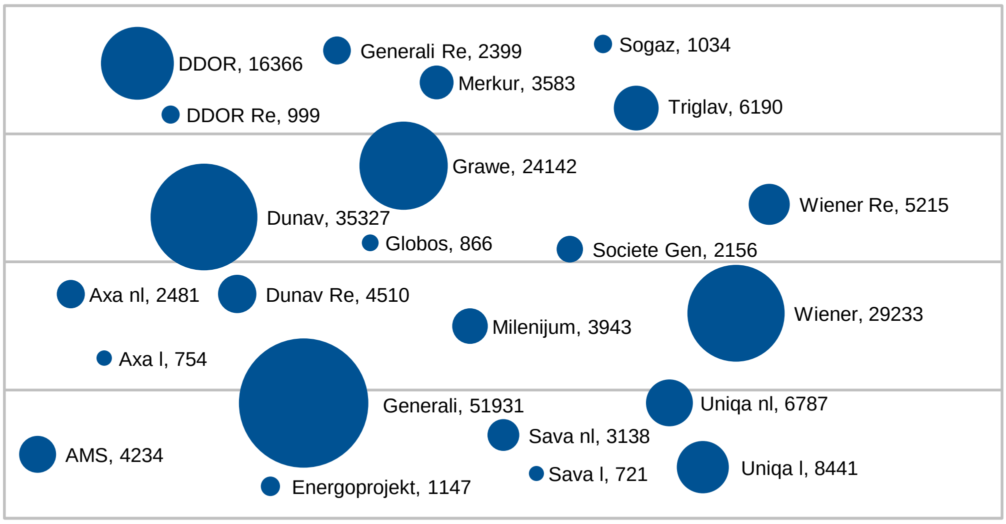
Life insurance premium is mostly generated via sale activities of insurance undertakings (54%), banks (23%) and natural persons – entrepreneurs (12%).

3.4. Balance sheet total and balance sheet structure

Balance sheet total

Balance sheet total of insurance and reinsurance undertakings increased by 12.4% in 2016 compared to 2015 and reached RSD 215.6 bln.

Chart 3.4.1 **Balance sheet total of insurance companies**
(as at 31/12/2016, in RSD mln)



Source: NBS.

In terms of the industry's balance sheet total, there was no change in the ranking of the top five insurance undertakings, which in 2016 accounted for 77.5% of the total.

Table 3.1.1 **Share in total financial sector**
(in %)

	Banks		Leasing		Insurance		VPF	
	2015	2016	2015	2016	2015	2016	2015	2016
Balance sheet total	916	912	18	19	5.8	6.1	0.9	0.9
Capital	92.2	914	12	12	6.7	7.3		
Number of employees	68.0	67.5	12	11	30.5	310	0.3	0.3

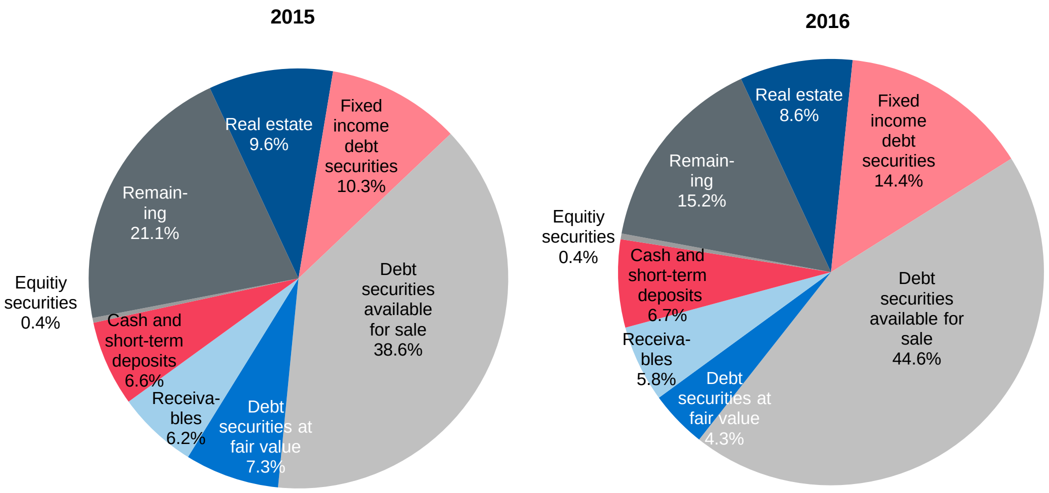
Source: NBS.

Structure of assets

As at 31 December 2016, assets of insurance undertakings comprised debt securities available for sale (44.6%), fixed income debt securities (14.4%) and debt securities recognised at fair value through income statement (4.3%), followed by: property, plant and equipment (8.6%), cash and short-term deposits (6.7%), receivables (5.8%), equity securities (0,4%) and other[7].

Compared to 2015, the share of debt securities available for sale increased owing to their robust growth of 29.6%, while those of property and receivables declined.

Chart 3.4.2 **Structure of assets**
(as at 31/12/2015 and 31/12/2016)



Source: NBS.

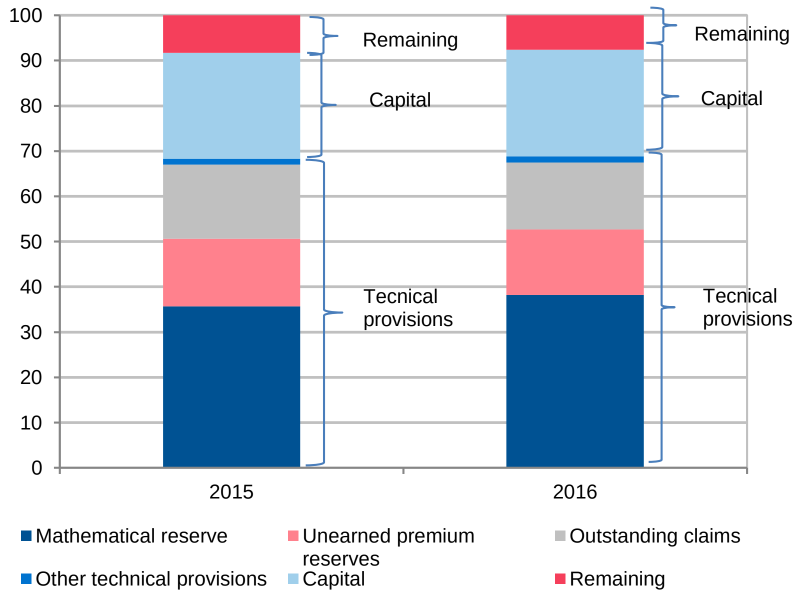
Structure of liabilities

As at 31 December 2016, technical provisions accounted for 68.8%, and capital and reserves for 23.6% of total liabilities.

[7] "Other" includes: intangible investments, goodwill, software and other rights, participating interest in capital, other long-term financial placements (other than fixed-income debt securities), other long-term assets, deferred tax assets, inventories, non-current assets available for sale, other securities within financial placements, other short-term financial placements, value added tax, accruals and deferred income and technical provisions borne by the coinsurer and reinsurer.

In 2016, capital grew by 13.4%, reaching RSD 50.8 bln. Technical provisions increased by 13.2% in the same period and came at RSD 148.4 bln, the most significant portion relating to mathematical reserve which recorded growth of 20.1%.

Chart 3.4.3 Structure of liabilities (in %)



Source: NBS.

Technical provisions enjoyed an interrupted growth in both nominal and real terms.

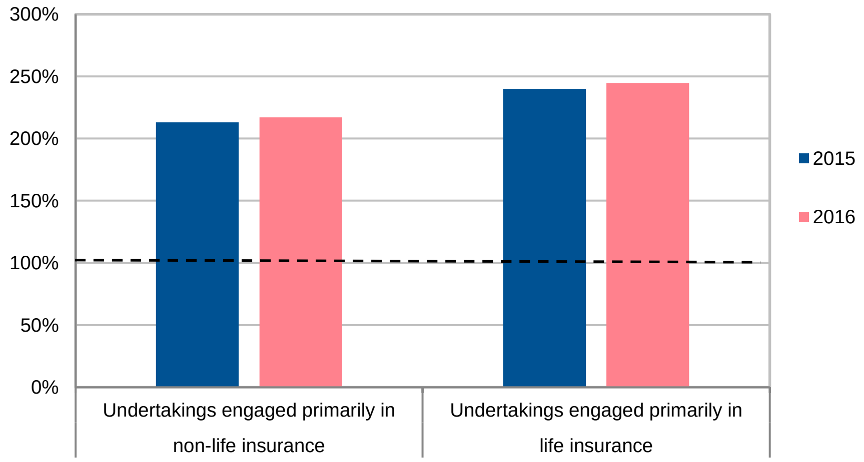
4. Performance indicators

4.1. Capital adequacy

The solvency of an insurance undertaking depends on the adequacy of its technical provisions for liabilities assumed and on capital adequacy (ratio of available to required solvency margin).

The available solvency margin of the Serbian insurance sector (insurance and reinsurance undertakings) as at 31 December 2016 amounted to RSD 35.6 bln and required solvency margin RSD 15.2 bln. The **capital adequacy ratio** (ratio of available to required solvency margin) was 217.0% for all *non-life insurers* and 244.7% for all *life insurers.*

Chart 4.1.1 **Capital adequacy of insurance undertakings**



Source: NBS.

A *non-life insurer's* ability to absorb the risk of inadequate premium pricing, unforeseen claims and inadequate transfer of risk to coinsurance and reinsurance etc. (insurance risk) is measured, among other, by the ratio of retained premium to total capital i.e. the **ratio of inadequately assessed non-life insurance risk**. Retained premium is the approximation of undertaken risks and must be sufficient to cover the insurance claims and compensations. In case of inadequacy of premium pricing or risk transfer to coinsurance and reinsurance, as well as in case of other insurance risks, total capital or parts thereof are used to guarantee the coverage.

In 2016, the ratio of inadequately assessed non-life insurance risk for all undertakings primarily engaged in *non-life insurance* equalled 181.8% compared to 189.2% in 2015. The ratio edged up as a result of capital growing faster than retained premium.

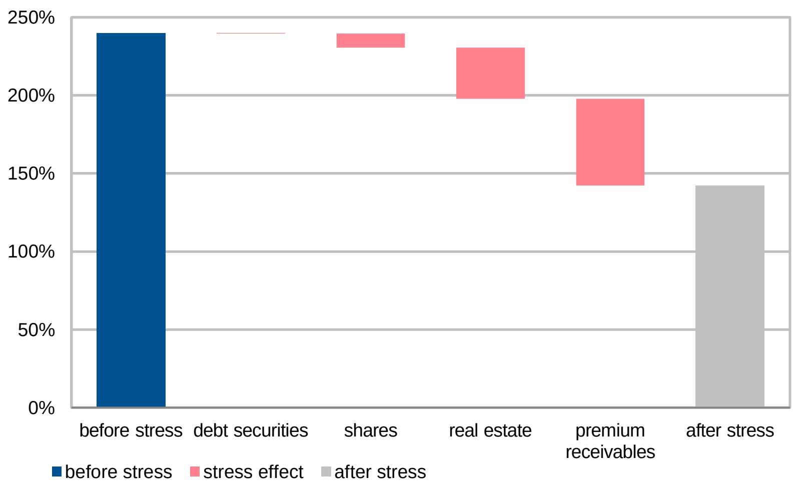
The **ratio of inadequately assessed life insurance risk**, as a ratio of total capital to technical provisions of undertakings engaged primarily in *life insurance*, declined to 27.0% in 2016, compared to 28.1% in 2015, reflecting the mathematical reserve rising at a faster pace than capital.

Such ratio meant that in 2016 there was a "reserve" of 27.0% to cover inadequate assumption of risks by these undertakings (in life insurance, technical provisions represent a good approximation of risks).

Stress test results

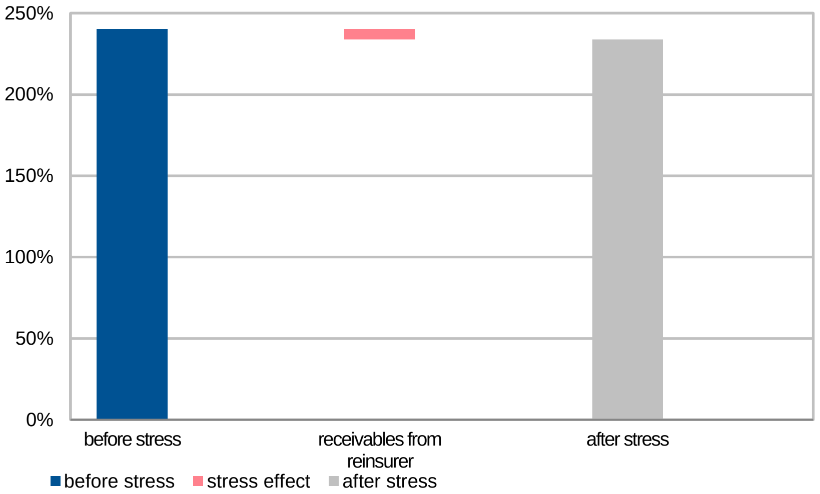
In 2016 the NBS conducted for the first time a micro stress test of the Serbian insurance industry, featuring three unrelated extreme scenarios: (1) scenario "less marketable investments" – loss arising from a decrease in value of debt securities, shares, real estate and premium receivables, (2) scenario "reinsurance" – loss due to reinsurer/retrocessionaire's failure to fulfil the obligation and (3) "actuarial" scenario – loss due to increased mortality arising from a pandemic similar to Spanish flu and insufficiency of provisions for damages. After the analysis, the NBS issued a public statement about the stability of the insurance industry in case of occurrence of extreme shocks, while issuing recommendations aimed at improving risk management to individual undertakings in which a higher level of risk was detected.

Chart 4.1.2 **Serbia - Effects of "less marketable investments" scenario on capital adequacy**



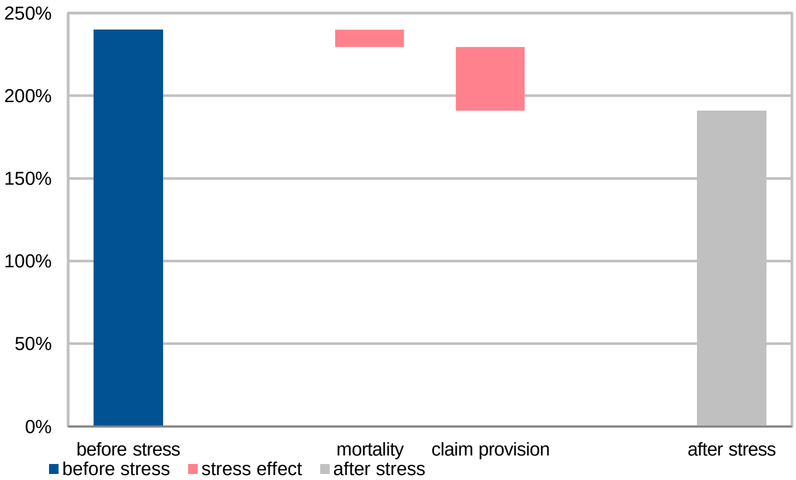
Source: NBS.

Chart 4.1.3 **Serbia - Effects of "reinsurance" scenario on capital adequacy**



Source: NBS.

Chart 4.1.4 **Serbia - Effects of "actuarial" scenario on capital adequacy**



Source: NBS.

The first scenario would have the greatest impact on capital adequacy, primarily due to the decrease in the value of real estate and premium receivables, followed by the third scenario, mainly because of the increase in technical provisions, while the second scenario would not have a significant effect.

4.2. Quality of assets

Judging by the share of intangible investments, property, investment in non-tradable securities and receivables in total assets of undertakings engaged primarily in *non-life insurance*, i.e. **the ratio of assets of lower marketability**, which in 2015 and 2016 measured 19.9% and 18.7%, respectively, it may be concluded that these types of investments increased at a slower pace than total assets in 2016.

In undertakings primarily engaged in *life insurance* this indicator dropped from 2.6% in 2015 to 2.3% in 2016. The ratio changed compared to a year earlier owing to the rise in total assets.

Apart from calculating sufficient premium to compensate for the damages, it is also necessary to ensure premium collection. Otherwise, the insurer may face the risk of being unable to fulfil its obligations to the insured.

The **receivables ratio**, defined as a ratio of premium receivables to total premium written for all *non-life insurers* dropped slightly, from 8.9% in 2015 to 8.8% in 2016, reflecting a faster rise in total premium written compared to the rise in premium receivables.

In undertakings engaged primarily in *life insurance*, the share of receivables to total premium underwritten decreased mildly, from 2.9% in 2015 to 2.6% in 2016.

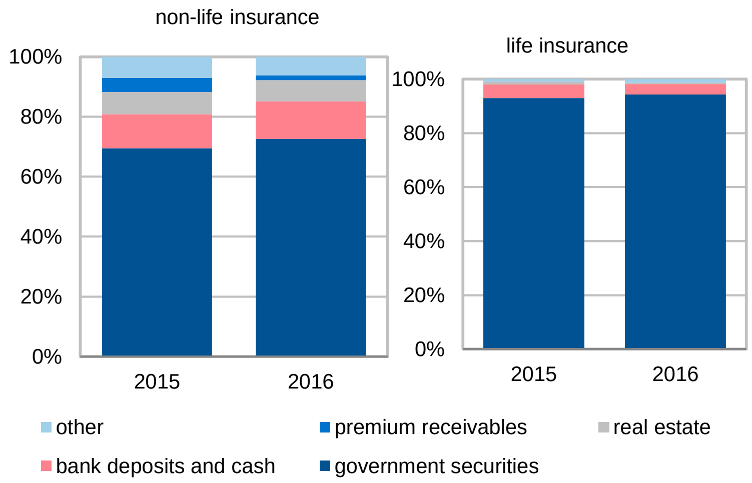
4.3. Investment of technical provisions

In order to protect the interests of the insured and injured parties and to ensure timely payment of damage claims, insurance undertakings need not only allocate adequate technical provisions, but also invest these assets in such a way to ensure that their real value is maintained and increased, so that the undertaken obligations may be fully met, both at present and in the future period. In order to be able to meet its liabilities, an undertaking must invest its assets taking due account of the risk profile and risk tolerance limits (qualitative and quantitative), by pursuing its investment policy.

In 2016, *non-life insurance* technical provisions of all insurance undertakings in Serbia were mostly covered by government securities (72.6%), bank deposits and cash (12.6%), real estate (7.0%) and insurance premium receivables (1.6%).

Life insurance technical provisions were in major part covered by government securities (94.3%), followed by bank deposits and cash (3.8%).

Chart 4.3. **Structure of investment of technical provisions**



Source: NBS.

4.4. Reinsurance

Reinsurance and coinsurance provide the so-called risk offsetting and protection of insurers against major or massive losses that may jeopardise their operations. In relation to the portion of risks which is retained, the undertaking's capital is used as a buffer for unforeseen events and inadequate premium prices.

The **premium retention ratio**, i.e. the share of earned net premium in total earned premium, points to the extent of risks transferred to reinsurance and coinsurance. In undertakings engaged primarily in *non-life insurance,* this indicator increased mildly relative to the year before – from 84.0% to 84.8%.

In terms of types of insurance, the percentage of risk transfer to reinsurance was the largest in aircraft liability insurance and aircraft insurance, followed by general liability insurance, insurance of goods in transport, fire or other hazard insurance, financial loss insurance, rail vehicle insurance, marine liability insurance, other property insurance, warranty and credit insurance, which corresponds to the nature of those types of insurance types and level of risks assumed.

As regards *life insurance* undertakings, this indicator moved around 98%. High indicator values resulted from the transfer of a portion of pure risk premium to reinsurance, while the investment portion (as a significantly larger portion of life insurance premium) remained in insurers' portfolio holdings.

4.5. Profitability

In 2016, the insurance industry posted a positive net result, which after partial distribution of profits after tax came at RSD 5.7 bln.

A measure of profitability of an insurance undertaking is the **combined ratio** (the sum of incurred losses and expenses divided by the premium earned). A ratio below 100% indicates that an undertaking is able to cover damage claims and expenses out of the premium written, while a ratio above 100% means that in premium pricing it takes into account potential income received from investments in the financial and real estate markets, which exposes it to additional market risks. In undertakings primarily engaged in *non-life insurance*, the combined ratio dropped from 94.8% at end-2015 to 89.1% at end-2016. The ratio decline in 2016 resulted from faster growth of premium earned relative to incurred losses and administration expenses.

For undertakings mainly engaged in *non-life insurance*, the **loss ratio** (the ratio of total losses incurred in claims divided by the total premiums earned), as an indicator of price policy and adequacy, i.e. sufficiency of the premium to cover liabilities arising from insurance contracts and adequacy of the transfer of risk to reinsurance and coinsurance, decreased from 53.4% at end-2015 to 50.3% at end-2016.

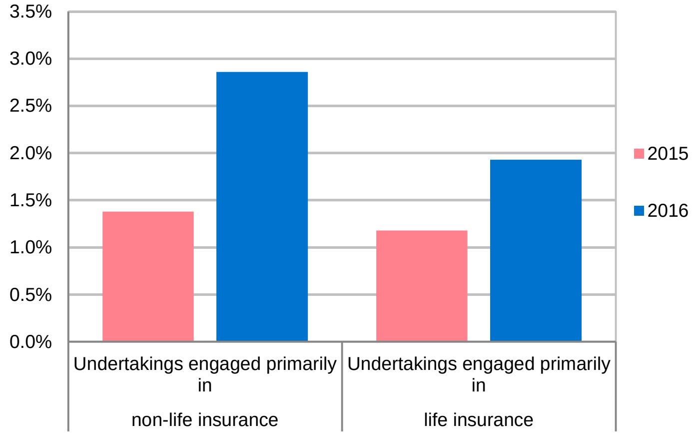
In undertakings engaged primarily in *life insurance*, the **benefit ratio**[8] increased from 86.9% at end-2015 to 90.1% at end-2016.

ROA (net income to total assets) illustrates how well an undertaking employs its total assets in insurance, investment and other activities. In 2016, undertakings that are chiefly *non-life insurers* recorded a positive ROA of 2.9% (compared to 1.4% in 2015).

In undertakings engaged primarily in *life insurance*, ROA continued to record positive values, measuring 1.9% in 2016 (vs. 1.2% in 2015).

[8] Ratio of sum of settled claims and changes in technical provisions, retained, to earned net premium. In interpretation one must take into account the long-term nature of life insurance and a significant impact of changes in technical provisions on this ratio.

Chart 4.5 **Return on assets - RoA**



Source: NBS.

Overall, the Serbian insurance sector posted a positive ROA of 2.7%.

4.6. Liquidity

To be able to meet its liabilities, an insurance undertaking must ensure an asset-liability maturity match and make sure its assets are marketable and of adequate quality. As the size and timing of individual damage claims cannot be predicted, an insurance undertaking must carefully plan the composition of its assets in order to be able to first meet its liabilities under damage claims, and then all other liabilities.

The **liquid assets to liquid liabilities ratio**[9] for the insurance sector (insurance and reinsurance undertakings) stood at 163.1% in 2016, compared to 155.3% in 2015.

Movement of this ratio suggests that liquid assets were sufficient for timely servicing of short-term liabilities in the insurance sector.

5. Supervisory measures that are publicly disclosed

The part of the Insurance Sector Report about supervisory activities is published without stating the names of individual supervised entities, except where the imposed supervisory measures belong to the category of measures that are publicly disclosed according to the Insurance Law. Those are the measures that may be of special interest

[9] For the purposes of this Report, liquid assets comprise: financial investments, cash and deposits with banks and other long-term financial investments, while liabilities refer to: short-term liabilities, accrued costs and deferred revenues, outstanding claims and other technical provisions in insurance up to one year.

to the public and the issuance of which significantly impacts the operation of an insurance/reinsurance undertaking. Immediately after issuing such measures, the NBS publishes them on its website and they are also covered by the next quarterly report on the insurance sector.

In 2016 (fourth quarter) the NBS issued one decision on supervisory measures that are publicly disclosed. Namely, based on the on-site examination procedure and according to the decision G No 7697 of 7 October 2016, the NBS issued a measure to "AMS osiguranje" a.d.o. Belgrade requiring the dismissal of two members of management (Vučeta Mandić and Branislava Beloševac – members of the Executive Board). The measure was imposed after it was established that these persons acted contrary to the provisions of the Insurance Law and were responsible for illegalities and irregularities in the undertaking's operation. Namely, it was found that certain reports that the undertaking published and submitted to the NBS contained inaccurate information as regards the amounts of illiquid assets, revaluation reserves and unrealised profit, intangible assets, guarantee capital and guarantee reserve. It was found that the aforesaid members of management signed contradictory documents and retroactively amended reports that had previously been published. Furthermore, it was established that business objectives and strategy were not implemented as envisaged in the business plan. The measure was issued in order to prevent further illegalities and irregularities in the undertaking's operation and was implemented within the deadline specified by the Law.

6. Social responsibility and protection of citizens' rights

Insurance supervision is conducted primarily in order to protect citizens and companies in the capacity of the insured, insurance beneficiaries and injured parties. Activities conducted by the NBS aim to preserve stable and solvent operation of the insurance sector, so that it remains capable of meeting its liabilities at all times. However, financial means do not necessarily imply the fulfilment of liabilities, which is why this issue must be addressed separately.

The existing regulatory framework, effective as of 2015, with which the insurance sector complied in 2016, provided to the NBS, as the insurance supervisor, a whole range of new mechanisms that enable it to directly influence the quality of insurance services provided to citizens and corporates. The purpose is to ensure that insurance services are easily accessible, easily understandable and voluntary (unless stated otherwise by law), and that they are distributed by authorised and adequately trained persons.

Socially responsible insurance supervision includes a range of new activities by which the NBS achieves the set objectives. To this aim, it established cooperation with consumer protection associations and other supervisory authorities, primarily the State Audit Institution.

One of the most important results achieved in this area in 2016 is the regulation of unauthorised, non-transparent and illegal insurance distribution. The NBS discontinued the compulsory sale of insurance along with bus tickets at the Belgrade bus station and prohibited insurance undertakings from applying similar business models in other Serbian cities. Passengers were relieved from paying an unnecessary item in the price of their bus ticket, without being deprived of the service, given that their travel risks are already covered by insurance of passengers in public transport, which must be contracted and financed by the transporting company. Also, the NBS participated in a coordinated action of several authorities which stopped the charging of compulsory property insurance along with utility bills and subsequently took a series of actions in order to place these insurance services within the confines of law, and to prevent any new distribution until the status of utility companies in terms of charging property insurance premium is finally regulated.

As so far, the NBS will continue to strictly supervise whether policyholders are duly informed prior to contract conclusion. Citizens should buy insurance services which they fully understand, which fulfil their needs and about which they received unambiguous information as to the terms of the contract, the risks covered, and the manner of exercising the rights arising from insurance. Special attention in this area is paid to collective insurance.

Citizens who deem that their rights have been violated in the relationship with an insurance undertaking may file a complaint to the undertaking. In 2016, the NBS set up a system for reporting on the number and frequency of those complaints, based on which it plans its future supervisory activities and acts preventively to reduce the number of complaints and/or to resolve them within the financial institution, before they are addressed to the NBS's consumer protection unit.

7. Conclusion

The comparison of indicators for 2016 and 2015 points to the following changes in the year under review:

- The insurance sector balance sheet total rose by 12.4% to RSD 215.6 bln;
- Capital increased by 13.4% to RSD 50.8 bln;
- Technical provisions gained 13,2%, and reached RSD 148.4 bln, being mainly covered by government securities, in both life and non-life insurance;
- Total premium grew at a rate of 10.1% to RSD 89.1 bln;
- Non-life insurance continued to account for the largest share of total premium (74.1%), while at the same time recording an unbroken decline. Non-life insurance premium rose by 7.2%, with MTPL insurance, property insurance and full coverage motor vehicle insurance going up;
- The share of life insurance in total premium increased from 23.9% to 25.9%;
- The number of insurance undertakings fell from 24 to 23, while total insurance sector employment grew by 0.9% to 10,954.

Insurance regulations adopted in late 2014 and the first half of 2015 laid the legislative ground for significant convergence of the Serbian insurance sector to that of the EU, with a view to ensuring the level of protection of insured persons equivalent to that enjoyed in the EU. At the time of drafting the regulations, the EU applied the Solvency I regime and hence the domestic framework was designed as Solvency I-compliant, while incorporating some requirements of Solvency II, in response to the level of development of the Serbian insurance market. Accordingly, it may be said that Solvency 1½ regime is currently in force in Serbia. To be exact, domestic regulations have transposed certain Solvency II provisions pertaining to the qualitative requirements under Pillar 2 (governance system comprising four key functions: risk management, system of internal controls, internal audit and actuarial function, as well as own risk and solvency assessment – ORSA, risk-based supervision, fit and proper requirements in licensing of supervised entities etc.).

The completion of the first stage of strategic activities aimed at the implementation of the new methodological framework – compliance analysis, and the proceeding with the following two stages – impact assessment[10] and harmonisation of the regulatory framework will ensure that by the time Serbia joins the EU, its insurance sector will have achieved full compliance with the EU rules, i.e. even greater stability and beneficiary protection.

[10] The impact assessment will also include quantitative studies about the impact of new requirements under Solvency II on capital adequacy and technical provisions of individual undertakings and the overall insurance sector.