

ASIAN DEVELOPMENT BANK

TAR:UZB 34033

TECHNICAL ASSISTANCE
TO THE
REPUBLIC OF UZBEKISTAN
FOR
DEVELOPMENT OF THE INSURANCE INDUSTRY

May 2000

CURRENCY EQUIVALENTS

(as of 4 May 2000)

Currency Unit	–	Sum
SUM1.00	=	\$0.0043
\$1.00	=	SUM231

ABBREVIATIONS

ADB	–	Asian Development Bank
MIS	–	management information system
GDP	–	gross domestic product
TA	–	technical assistance

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

I. INTRODUCTION

1. The Government of the Republic of Uzbekistan has recognized the need to develop a broad and sound financial sector. With this objective, efforts are underway to enhance competition in the banking sector, strengthen prudential regulation, and build capacities in commercial banking. In parallel, the Government has launched reviews of pension¹ and insurance industry² with the support of the Asian Development Bank (ADB). Social protection is being reduced due to public expenditure constraints, and has to be replaced, or complemented, by regular insurance. Domestic and foreign enterprises need various types of insurance services. While there are many insurance companies operating, the range of services offered by them is limited. Customers have difficulty evaluating the quality of insurance companies, and the industry has yet to be prudentially regulated and supervised. Therefore, development of prudential regulation and supervision of the insurance industry is a priority area for the Government. In view of these considerations, the Government has requested ADB's technical assistance (TA) for development of the insurance industry.³ A Fact-Finding Mission visited Uzbekistan in March 2000 and reached an understanding with the Government on the objectives, scope, and implementation arrangements of the TA. The TA framework is presented in Appendix 1.

II. BACKGROUND AND RATIONALE

2. The insurance industry in Uzbekistan is at an early stage of development. After independence, a state insurance company was set up to replace Gosstrakh, the Soviet state insurance company, which ceased operation in Uzbekistan. In 1994, the state insurance company was split into two separate companies, namely, Kafolat and Uzagrosugurta. Kafolat mainly provides insurance in urban areas, and Uzagrosugurta specializes in agricultural insurance. Subsequently, the Government allowed more private insurance companies to start operations. Most prominent of these is Uzbekinvest which provides export and import insurance.

3. As of March 2000, the insurance industry comprised 27 registered insurance companies. The sector is highly concentrated with the five largest companies accounting for 89 percent of premiums in 1999. Four insurance companies have direct state ownership: Kafolat, Uzagrosugurta, Uzbekinvest, and Madad, which specializes in insurance for small and medium-sized enterprises. Four insurance companies are foreign joint-ventures; two are majority foreign-owned. However, the market share of the foreign joint-ventures in terms of premiums is small, and they mainly offer insurance for enterprises and foreign investors.

4. Total insurance premiums in 1999, amounted to SUM4.9 billion, and total indemnities to SUM1.3 billion. Virtually all of this is non-life. Uzbekistan's insurance penetration ratio—the ratio of premiums to gross domestic product (GDP)—is only 0.21 percent. In Western countries, the ratio of premiums to GDP is around 5 percent, and the corresponding figures for Latvia and the Russian Federation are 2.1, and 1.4 percent. Voluntary property insurance accounts for 54.3 percent of premiums, various types of mandatory insurance⁴ for 30.3 percent, voluntary personal 12 percent, and voluntary liability insurance 3.3 percent.

5. There are several reasons for the low penetration of insurance in Uzbekistan. Lack of regulation in the immediate post-independence years reduced public confidence in the industry. Price instability has undermined the effectiveness and therefore the credibility of insurance.

¹ TA 3134-UZB: *Pension Reform*, for \$850,000, approved on 22 December 1998.

² Smith, James. 1999. Review of the Insurance Industry in Uzbekistan. Asian Development Bank, Manila.

³ The TA first appeared in *ADB Business Opportunities* (Internet edition) on 27 March 2000.

⁴ See para. 6.

Long-term life insurance policy as a product is virtually nonexistent since there is no tradition of life-insurance, and sums insured are unable to keep pace with the decline in purchasing power. Tax rules do not recognize insurance as a business expense. The prevalence of mandatory insurance for matters such as private property, and the low sums insured and low claims ratios on such business, appear to have fostered a perception that insurance is a tax rather than a service.

6. The sector is even more concentrated if evaluated by the number of insurance contracts written. Kafolat and Uzagrosugurta accounted for 99 percent of all insurance contracts in 1999. This concentration of contracts reflects the dominant position in the market of these two companies, the only ones with countrywide presence, but also the practice, inherited from the time before independence, of mandatory insurance covering a wide range of classes of business. The classes of mandatory insurance include, among others, personal insurance for passengers on public transport, insurance of private property (inflation has rendered past sums insured almost nominal in value), insurance of property collateral for bank loans, and insurance of agricultural output for repayment of credits. State companies have a monopoly of mandatory insurance and this business represents about half of the premium income of Kafolat and Uzagrosugurta.

7. The types of voluntary insurance available include property insurance, travel insurance, medical insurance, and trade insurance. Long-term insurance, such as life and private pension insurance, is not yet available. Life insurance is limited to group life protections and short-term investment products. High inflation makes the development of long-term products unlikely in the short term. In 1999, the average monthly wage was SUM8,000 (\$55 at the official exchange rate in 1999), suggesting that households have limited resources for buying voluntary insurance. However, while the present demand for individual insurance is comparatively low, it is likely to rise as the public social protection scheme that offers generous pension payments is scaled down, the economy develops, and incomes rise. Enterprises' demand for insurance is also likely to rise, especially in view of continued privatization, and opening up of the domestic economy.

8. Insurance companies invest the majority of their funds in bank deposits and short-term treasury bills. There is no investment code for the insurance industry, and there are few investment alternatives available. Some insurance companies have investments in shares in state-owned enterprises, and Uzbekinvest has a large share of its funds in its own subsidiary (a British-based political risk insurer). Lack of investment opportunities in Uzbekistan hampers the development of the insurance industry, in particular for long-term policies such as life and private pension insurance.

9. Insurance is regulated by the Law on Insurance, which was enacted in May 1993, and amended in December 1997. The Civil Code also contains a chapter on insurance, which focuses on contractual matters. However, the law lacks certain elements such as minimum capital requirements and minimum solvency requirements for insurance companies. The State Insurance Supervision Board, Gosstrakhnadzor, was established under the Ministry of Finance in 1999. Gosstrakhnadzor is responsible for registration of insurance companies, on- and off-site supervision to determine compliance with existing regulations, and record keeping of insurance companies' activities. The agency currently has nine staff and two departments. The Inspections Department of Gosstrakhnadzor, with a staff of three, is responsible for inspecting companies. The Methodology Department, with a staff of three, is responsible for developing regulatory norms, including proposals to amend existing legislation, statistical analysis, and training. However, the present level of staffing is inadequate, and staff has insufficient training in regulation and supervision of the insurance sector. Regulations do not specify financial

accounting and reporting requirements; in the absence of information, it is difficult to assess the financial status of insurance companies.

10. The Government has recognized these shortcomings. Development of the insurance industry is a priority in financial sector reforms, to ensure that the industry will be properly governed, regulated, and supervised as it grows. On 12 May 1999, the Ministry of Finance adopted a resolution that sets a framework for developing the insurance industry, including measures to be undertaken in 1999 and 2000. As of March 2000, only temporary regulations regarding asset-liability ratios, and the activities of insurance agents had been introduced. The framework includes regulation and supervision, and a range of legislation for insurance and associated areas including pension and taxes.

11. While many reforms are needed to support the insurance industry, regulation and supervision of insurance companies is a priority. Although the industry is small, the range of insurance products limited, and the usage of insurance is relatively novel in Uzbekistan at present, it is imperative that the industry develops in a sound, regulatory, and legal environment. This TA aims to support the development of the insurance industry by providing targeted assistance to Gosstrakhnadzor to strengthen the regulatory framework, and build institutional capacity to enable Gosstrakhnadzor to effectively carry out its supervisory responsibilities.

12. This TA is consistent with ADB's country operational strategy for Uzbekistan, which was approved by the Board on 29 March 2000. The strategy advocates ADB's support for policy reform, capacity building, and institutional strengthening in the financial sector. ADB has selectively supported capacity building in banking⁵ and has recently provided support to undertake a comprehensive diagnosis of the banking system, develop a holistic reform strategy, and strengthen selected commercial banks.⁶ In addition, ADB has extended TA for pension reform which aims to strengthen collection and payment of pensions, develop a legal and regulatory environment for nonstate pensions, and introduce financial audits of the state pension fund.⁷ Recognizing that Uzbekistan's financial sector is small and fragile, and its regulatory oversight is limited, the Government is taking steps to develop capacity in the regulatory authorities. The insurance industry has been identified as a priority, and the current TA aims to support the Government in this area. This TA is the first external assistance provided to the insurance industry.

III. THE TECHNICAL ASSISTANCE

A. Objectives

13. The objective of the TA is to support the development of the insurance industry by (i) strengthening the legal and regulatory framework, (ii) upgrading the institutional capability of Gosstrakhnadzor as the regulator and supervisor to ensure adequate supervision of insurance companies, and (iii) developing a management information system (MIS).

B. Scope

14. The scope of work will include:

⁵ TA 2714-UZB: *Institutional Strengthening of National Bank of Uzbekistan*, for \$830,000, approved on 17 December 1996; and TA 3045-UZB: *Developing Commercial Banking Skills*, for \$1,000,000, approved on 10 July 1998.

⁶ TA 3352-UZB: *Strengthening the Banking Sector*, \$1,000,000, approved on 20 December 1999.

⁷ TA 3134-UZB: *Pension Reform*, \$850,000, approved on 22 December 1998.

- (i) development of prudential regulations for insurance companies in line with international best practice, and transitional measures for their adoption;
- (ii) advice on improvements to existing legislation in order to adopt necessary regulations with the aim of creating a comprehensive legal and regulatory framework;
- (iii) development of supervisory methods and measures for implementation;
- (iv) capacity building in Gosstrakhnadzor, including training in supervisory methods, evaluation of insurance companies' financial statements and status, and other subjects associated with insurance; and
- (v) development of an MIS within Gosstrakhnadzor.

C. Cost Estimates and Financing Plan

15. The TA is estimated to cost \$390,000 equivalent, comprising a foreign exchange cost of \$292,000 and a local currency cost of \$98,000 equivalent. The Government has requested ADB to finance \$300,000 equivalent, to cover the entire foreign exchange cost of \$292,000, and \$8,000 equivalent of the local currency costs. The TA will be financed by ADB on a grant basis from the ADB-funded TA program. The Government will finance the remaining \$90,000 equivalent of local costs. The cost estimates and financing plan of the TA are given in Appendix 2.

D. Implementation Arrangements

16. Gosstrakhnadzor will be the Executing Agency for the TA, and will provide the necessary office support, counterpart staff, and administrative services to the consultants.

17. The TA will be implemented over a period of nine months and will involve a total of 8 person-months of international, and 8 person-months of domestic consulting services. The international consultants will include (i) an insurance regulation expert (6 person-months), and (ii) an MIS expert (2 person-months). The domestic consultants will include (i) an insurance specialist/economist (6 person-months), and (ii) a computer specialist (2 person-months). Individual consultants will be selected in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB on the engagement of domestic consultants. The terms of reference for consultants are given in Appendix 3.

18. The consultants will provide inception reports to Gosstrakhnadzor and ADB within one month of the commencement of services. The consultants will also provide ADB with monthly progress reports and key developments. The consultants will present draft final reports to Gosstrakhnadzor and ADB four weeks before the end of the TA. The TA will commence in July 2000, and is expected to be completed in March 2001.

IV. THE PRESIDENT'S DECISION

19. The President, acting under the authority delegated by the Board, has approved the provision of the technical assistance, on a grant basis, to the Government of the Republic of Uzbekistan in an amount not exceeding the equivalent of \$300,000 for the purpose of Development of the Insurance Industry, and hereby reports such action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Targets	Monitoring Mechanisms	Risks and Assumptions
Goal <ul style="list-style-type: none"> Promote development of a well-regulated and –supervised insurance sector 	<ul style="list-style-type: none"> Enable Gosstrakhnadzor to effectively perform its role as regulator and supervisor 	<ul style="list-style-type: none"> Progress reports Review missions Consultation with the Government 	<ul style="list-style-type: none"> Continued Government support for insurance sector development
Purpose <ul style="list-style-type: none"> Strengthen the legal and regulatory framework for insurance Capacity building of Gosstrakhnadzor Development of a management information system (MIS) 	<ul style="list-style-type: none"> Capacity within Gosstrakhnadzor to carry out its responsibilities by the end of the TA Establishment of supervision and information system in Gosstrakhnadzor 	<ul style="list-style-type: none"> Review missions Consultant reports 	<ul style="list-style-type: none"> Continued commitment from the Government and Gosstrakhnadzor in strengthening the regulatory framework and building institutional capacity Quality of information provided by insurance companies to Gosstrakhnadzor
Outputs <ul style="list-style-type: none"> Prudential regulations Established supervisory methods and guidelines, and evaluation of companies' financial status Training of Gosstrakhnadzor staff Seminars for industry participants MIS in Gosstrakhnadzor 	<ul style="list-style-type: none"> Documented regulations and supervisory methods Gosstrakhnadzor staff trained in regulations and supervision Seminars held for industry participants MIS in place 	<ul style="list-style-type: none"> Review missions Consultant reports Operational MIS 	<ul style="list-style-type: none"> Commitment of Gosstrakhnadzor staff to collaborate with consultants and implement the recommendations Quality of consulting services
Activities <ul style="list-style-type: none"> Development of prudential regulations Development of supervisory methods On the job training of Gosstrakhnadzor staff Seminars for industry participants Development of an MIS 	Inputs <ul style="list-style-type: none"> Eight months of international consulting services Eight months of domestic consulting services Hardware, software, and communications infrastructure 	<ul style="list-style-type: none"> Consultant reports Midterm and final review meetings 	<ul style="list-style-type: none"> Availability of counterpart support, and full cooperation between consultants and counterpart staff

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. ADB Financing			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	220	0	220
ii. Domestic Consultants	0	8	8
b. International Travel	15	0	15
2. Equipment and Office Supplies	15	0	15
3. Reports and Communication	4	0	4
4. Misc. Administration & Support Costs	8	0	8
5. Contingencies	30	0	30
Subtotal (A)	292	8	300
B. Government Financing			
1. Office Accommodation, Communication, and Transport	0	25	25
2. Counterpart Staff	0	20	20
3. Translators	0	20	20
4. Seminars	0	10	10
5. Contingencies	0	15	15
Subtotal (B)	0	90	90
Total	292	98	390

ADB = Asian Development Bank.

Source: Staff estimates.

TERMS OF REFERENCE FOR CONSULTANTS

A. Insurance Regulation Expert (6 person-months)

1. The insurance regulation expert should have considerable experience in regulation and supervision of insurance industries, in-depth knowledge of international best practice and standards, and preferably, have experience in other transition economies. Proficiency in Russian would be an advantage. Training and project management experience is also desirable. The consultant will, in collaboration with Gosstrakhnadzor,

- (i) review current prudential regulations, and recommend revisions to bring these in line with international standards and best practice;
- (ii) develop transitional measures for the implementation of suggested regulations;
- (iii) review current supervisory methods, recommend revisions, and train Gosstrakhnadzor staff in implementing new methods;
- (iv) review the functions, authority, and organizational structure of Gosstrakhnadzor, and recommend an appropriate structure for enforcement and supervision of regulation;
- (v) advise on improvements to existing legislation in order to adopt necessary regulations to create a comprehensive legal and regulatory framework for the insurance industry; and
- (vi) conduct seminars for industry participants to disseminate knowledge about the revised regulations and reporting requirements.

B. Management Information Systems (MIS) Expert (2 person-months)

2. The MIS expert should have adequate training and sufficient experience in developing information systems relevant to a regulatory authority. Proficiency in Russian would be an advantage. The consultant will

- (i) examine the current information system in Gosstrakhnadzor, particularly statistical analysis, enforcement, reporting systems; revise/upgrade the present system to accommodate the revised regulations and supervisory methods; and manage statistical analysis and management records; and
- (ii) assess the present state of information technology in Gosstrakhnadzor, and identify the software and hardware needed.

C. Insurance Specialist/Economist (6 person-months)

3. The domestic consultant will, under the supervision of the regulatory expert,

- (i) help the regulatory expert develop regulations and supervision methods;

(Reference in text: page 4, para. 17)

- (ii) assist with seminars for industry participants; and
- (iii) liaise with relevant ministries, agencies, and industry participants to facilitate implementation of the technical assistance.

D. Computer Specialist (2 person-months)

- 4. The domestic consultant will, under the supervision of the MIS expert,
 - (i) help develop an MIS system; and
 - (ii) assist with procurement and set-up of computerized systems.