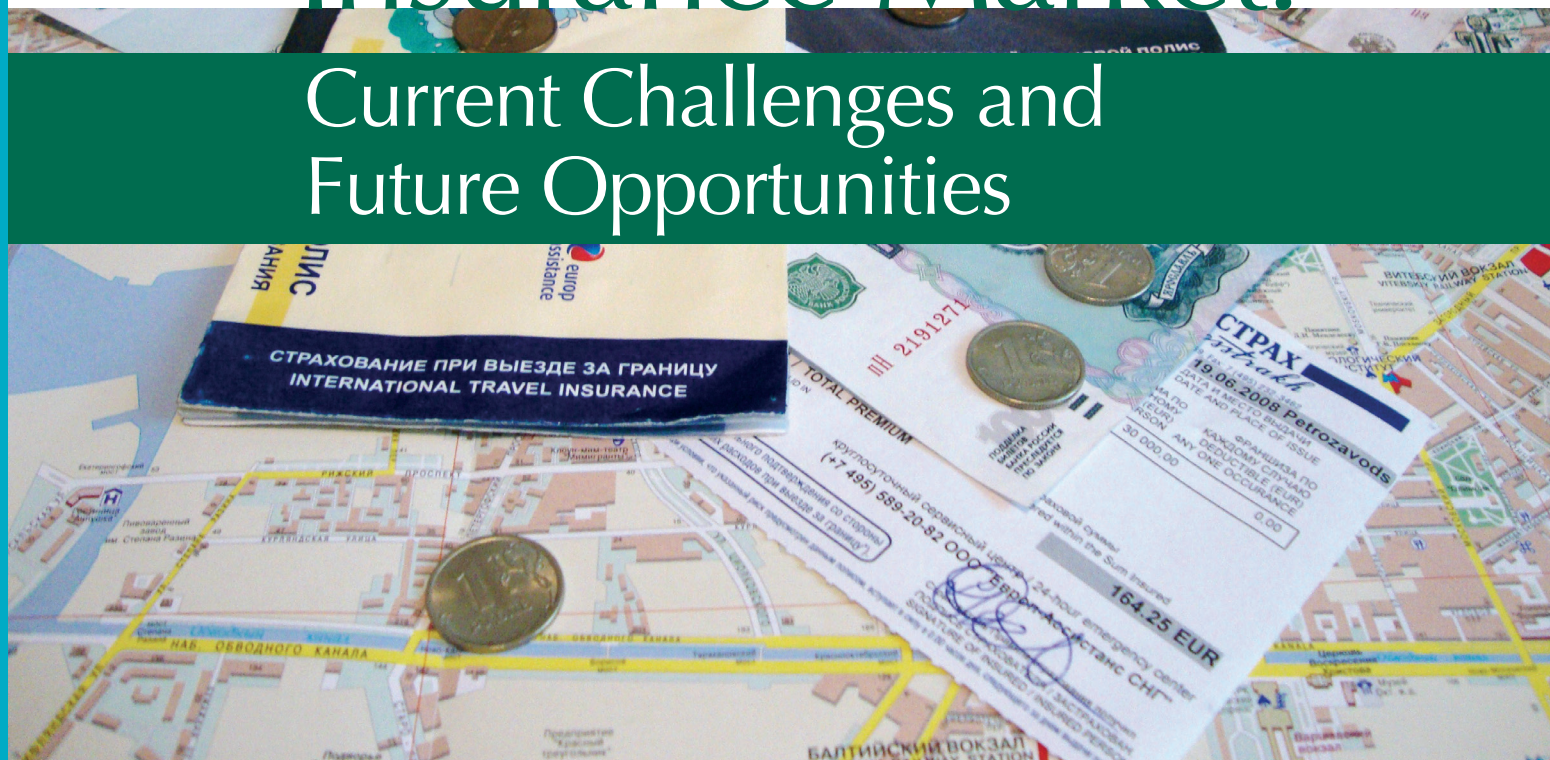


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# The St. Petersburg Insurance Market:

## Current Challenges and Future Opportunities



HELSINGIN KAUPPAKORKEAKOULU  
HELSINKI SCHOOL OF ECONOMICS

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# The St. Petersburg Insurance Market: Current Challenges and Future Opportunities

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## **Abstract**

The report examines the development of the Russian insurance market in general and the St. Petersburg market in particular. It looks into the history and the current situation in the insurance industry in Russia. The report analyzes the recent developments in the different segments of the insurance market of Russia and St. Petersburg. Using the interviews taken from Russian and Finnish insurance professionals, the report discusses the current challenges of the St. Petersburg insurance market with special attention to the impact of the global financial crisis, and draws conclusions on the future prospects and opportunities particularly for foreign insurers.

Although insurance as such has existed in Russia since the 18<sup>th</sup> century, its current history dates back from the beginning of 1990s when the first private insurance companies were founded. The Russian insurance industry has made a long way from infant grey scheme based businesses to a multibillion industry with a significant foreign presence that is striving to become as transparent and significant in the Russian economy, as are the insurance sectors of the developed countries.

However, there is still a lot to go. Currently one half of the market volume is represented by the mandatory health and automobile insurance and another quarter falls on the implicitly mandatory insurance of property bought on credit and risks insured in order to comply with the requirements of the investment contracts. The Russian citizens and enterprises still have little understanding of the benefits of insurance products as such and the main decision factor when choosing the insurance provider is the price.

In this sense, the incumbent global financial crisis is seen as a positive development for the industry. It is expected to purify the market of imprudent and shady players thus clearing the way for well-established insurers. The on-going market consolidation and the entrance of foreign players are expected to accelerate and are also seen as a benefit for the industry. Most importantly, client preferences are expected to shift towards quality-rather than price-based decision making. Even now it is clear that despite the sharp decrease of incomes at the disposal of households and enterprises, the insurance market has not seen a sharp decline in revenues showing that insurance as such has become an important part in everyday life in Russia.

In the long term, the Russian insurance market is expected to become very much like its counterparts from the developed countries. Life insurance segment will increase substantially while the growth of other segments will be stable yet smooth. The market structure in St. Petersburg is expected to resemble that of the Western countries with the big players controlling most of the market and the small players being either acquired or exiting the market. Foreign entrants are expected to increase their market share mostly via acquisitions, although the Russian insurers will not give up easily. When entering the Russian market, foreigners should pay close attention to the local traditions of doing business and dealing with the authorities. Bureaucracy and legislative barriers are still seen as impediments to the development of the market, yet a lot has recently been done to improve the situation.

## Preface

The St. Petersburg insurance market, as the Russian insurance market in general, was until the global financial crisis of 2008 one of the fastest growing insurance markets in the world. St. Petersburg as the second most important economic center in Russia has been at the forefront of insurance market development in Russia, and a driver of growth for the rest of the country. It is, however, important to keep in mind that insurance has been available in Russia only for two decades, and the insurance awareness of Russians is still rather low. The financial crisis started to affect the St. Petersburg insurance market in the end of 2008, and many insurance companies in the city are now experiencing severe difficulties. The crisis is likely to cause drastic changes in the St. Petersburg insurance sector and determine its structure for the years to come. The aim of this report is to analyze the development of the St. Petersburg insurance market from foreign insurers' perspective. The report provides an analysis of the regulatory environment, the structure of the market, and its potential by segment. Moreover, views by both Finnish and Russian insurance experts are presented to outline current problems and future perspectives of the St. Petersburg insurance market.

The study was conducted at the Center for Markets in Transition (CEMAT), which was founded in 1998 at the Helsinki School of Economics (HSE). The Center conducts research, education and training activities on transition and other emerging markets, such as Russia, Asia and Latin America. The research program of the CEMAT consists of both academic and applied research, focusing on questions such as foreign business activities, strategies of local companies, and economic development on the target markets.

The research was carried out under the supervision of Prof. Riitta Kosonen and Dr. Päivi Karhunen. Dmitry Filatov and Sinikka Parviainen conducted the data collection, analysis and reporting of the results.

We thank "*Niilo Helanderin säätiö*", which provided the financial support for carrying out this research. We extend our thanks to all Russian and Finnish experts, whom we interviewed for the study, particularly Ville Haapalinna (If P&C Insurance), Katriina Tala (Pohjola Insurance Ltd.), Igor Panfilov (A24), Sergei Brovko (RESO Garantia) and Evgeniy Egorushkin (Allianz ROSNO Life).

Helsinki, 26 October 2009

Prof. Riitta Kosonen  
Director, CEMAT

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# **1 Introduction**

Along with the growth of the Russian economy and the rising income of population and enterprises, Russians have become increasingly interested in financial products. As a result, the Russian financial sector started to boom in the years preceding the global economic crisis of 2008. The insurance industry played an important role in this process. In parallel with the increasing market demand for insurance products, the Russian government fostered the growth of the industry by implementing several laws on obligatory insurance. The most important of them is the act on Mandatory Motor Third Party Liability, which was introduced in 2003.

The insurance market in Russia, however, is still relatively young and underdeveloped. In 2008 total premiums collected amounted to 2.3 % of the country's gross domestic product. In the 15 "old" EU member states the corresponding figure is 9.3 %, in Poland 3.3 %, and in Czech Republic – nearly 4 % (IF-vahinkovakuutusyhtiö 2007). Nevertheless, the Russian insurance market has shown rapid growth figures. In 2008, total premiums collected grew by 22.7 % as compared to 2007, and in the preceding year the growth was even greater – 27.1 % (FSIS). As of the end of 2008 there were 786 players in the market offering a wide range of insurance products. The structure of the premiums collected in Russia is, nevertheless, still very different from that in developed countries. The share of life insurance premiums is still very low with mandatory insurance types constituting the lion's share of the insurance revenue (50.1 % in 2007). Moreover, in 2007 the share of life insurance comprised 2 % of the total insurance revenue in Russia, whereas the corresponding figure in the EU was 62 % (FSIS).

St. Petersburg, being the second largest city in Russia, has been on the forefront of the insurance market growth. In 2008 total insurance premiums collected in the city amounted to 42.2 billion rubles (4.5 % of total national market), having grown by 35.7 % as compared to 2007 (Strakhovanie Segodnya). St. Petersburg is home to many insurance

companies, including those with nation-wide significance. It is also the city where some foreign insurance companies decide to establish their first Russian subsidiary (e.g. IF P&C Insurance).

The situation, however, on both the national and St. Petersburg market changes rapidly, especially now under the global financial crisis. When we started writing this report in the early fall of 2008, the prospects, both short- and long-term, of the Russian economy and its insurance industry seemed bright and promising. Yet, after the financial collapse the forecasts are rather pessimistic. The Russian Ministry for Economic Development predicts an up to 8.5 % decline of the GDP in 2009;<sup>1</sup> some the insurance industry participants hope that the market will at least maintain the volumes of 2008, but skeptics find that hardly possible. One of the recent victims of the crisis was Russkiy Mir insurance company – one of the leading insurers of St. Petersburg – which was acquired by Rosgosstrakh – Russia’s largest insurance company on March 1<sup>st</sup>, 2009.

Despite the tough situation, many insurers are optimistic about the long-term prospects of the industry. It is a common belief that the crisis will clean the market from inefficient players. The consolidation of the highly fragmented national and St. Petersburg markets that started several years ago is accelerating. Although it is commonly believed that St. Petersburg will lose all its local players to federal and international insurance companies, the consolidation is seen as a positive thing for the industry and for the clients.

The purpose of this report is to examine the development of the Russian insurance market in general and the St. Petersburg market in particular. We look into the current challenges and future potential of the city’s market with particular attention to the opportunities for foreign players. This is done by analyzing the existing legal framework, risks and the major players of the different segments of the St. Petersburg’s insurance market. Furthermore, we take a deep insight into the views of market analysts and industry

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<sup>1</sup> <http://www.economy.gov.ru/wps/wcm/myconnect/economylib/mert/welcome/pressservice/news/doc1247673294248>

professionals on the current situation and the future prospects and challenges. The study builds on multiple sources of data, including statistics (state and independent), business press, and reports on the industry prepared by different parties inside and outside Russia. In addition, several interviews with insurance company representatives from St. Petersburg and Finland were conducted.

## **2 Development of the Russian insurance market**

This chapter gives an overview of the market for insurance in Russia. We begin with the historical development of the insurance sector. Further on, the chapter proceeds with the major legislative and regulatory issues, which are of importance for the Russian insurance industry. We continue with an overview of the structure of the market and its different insurance segments. The chapter concludes with the introduction of the major market players.

### **2.1 The Soviet era**

The history of the Russian insurance sector dates back to the Imperial Russia. The first fire insurance company emerged in Russia in the end of the 18<sup>th</sup> century. On the eve of the 1<sup>st</sup> world war in 1914, Russia had 19 active joint stock insurance companies with an aggregate capital of 48 million rubles and assets of ca. 300 million rubles – an amount comparable to a tenth of the national budget (Siren & Sultanov 2004). It held the second place in the world by the amount of total fire insurance premiums collected and the total volume of the insurance business was consistent with the country's share in the global industrial production.

In 1918 the Soviet Government nationalized all Russian private insurance companies and created a state monopoly. Gosstrakh of USSR (Госстрах СССР) – the state insurance company – was established in 1925. The company performed operations both domestically and abroad via its Department for Foreign Operations. The latter became a separate company called Ingosstrakh (Ингосстрах) in 1947. (Ingostrakh)

The operations performed by Gosstrakh included both the compulsory insurance of some state-owned enterprises and property and the voluntary insurance of individuals, both life and property. At the same time, many Soviet enterprises and units of government

property were not insured at all and all the incurred losses were covered from government reserve funds. That made perfect sense: since Gosstrakh was a governmental body, all insurance of state-owned property was actually self-insurance. Also few individuals engaged in insuring their property. (Rosgosstrakh)

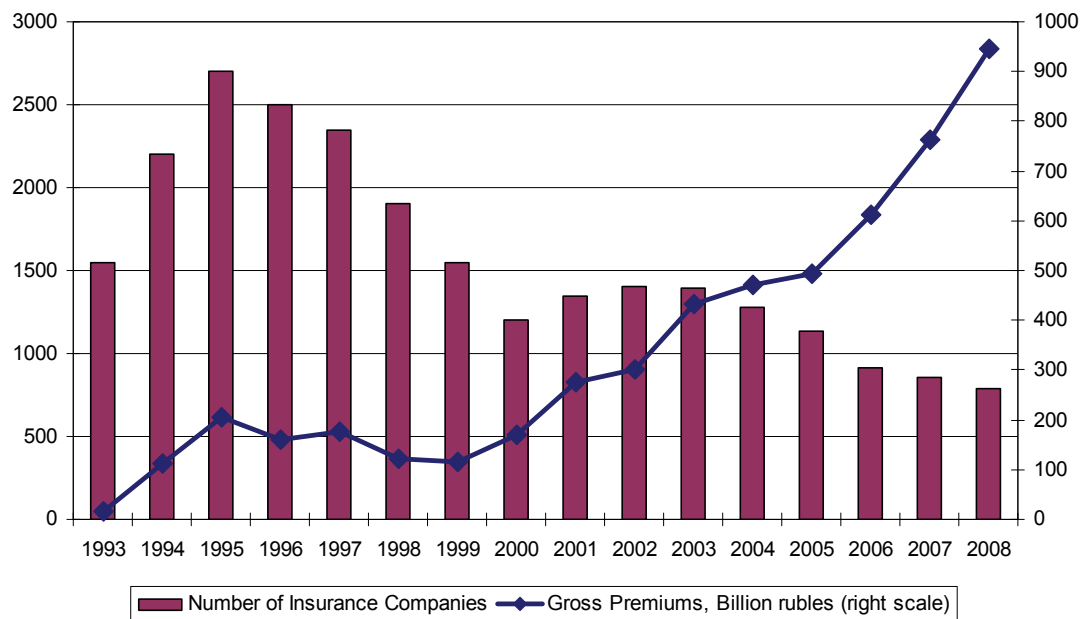
Ingosstrakh operated mostly outside the USSR and specialized in marine cargo, marine hull, fire insurance, liability insurance and reinsurance. Throughout its existence until present, Ingosstrakh has established its representative offices all over the world. Most of these function nowadays as local insurance companies owned by Ingosstrakh. For example, the Finnish insurer Ingonord was established as Ingosstrakh's representative office in 1952. In 1972, Ingosstrakh received the rights to function as a joint stock company while still remaining a part of the state structure. (Ingostrakh)

## **2.2 Post-Soviet era**

As the Soviet Union dissolved and the market economy was introduced in Russia, it was evident that a state monopoly in the insurance sector was not adequate. The 1991 Basics of Civil Law, however, contained only few definitions of insurance. The true beginning of the insurance market in Russia is considered to be the 1992 Law on Insurance. It was followed by several other laws and decrees including those that established the industry's supervising body that is currently known as Federal Service for Insurance Supervision (FSIS). However, the non-systematically adopted legislation was evidently not able to keep pace with the rapidly growing insurance market. The lack of regulation even fostered the fast growth of the market in the beginning of the 1990s. Weak regulation and almost non-existent barriers of entry made it very easy for virtually everyone to establish a private insurance company. At the same time the biggest players were the above mentioned state-owned Gosstrakh that had changed its name to Rosgosstrakh, and Ingosstrakh. However, these two were not flexible enough to be really competitive and their adaptation to market realities took a long time. (Siren & Sultanov 2004)

Due to the low entry barriers to the market, many insurance companies emerged purely for the purposes of tax evasion and money laundering. Many insurers saw their business as a quick and easy way to earn a profit, as claims followed premiums with a significant delay. However, the main drivers of market growth at that time were the tax evasion schemes. Often these gave insurance companies the only possibility to survive at the early stages of the transition period. There were few companies in the 1990s, including big and well-established ones that were not involved in 'scheme' operations. (Siren & Sultanov 2004) However, even engaging into profitable grey schemes was not enough to save all insurance companies. As it can be seen from Figure 1, the number of insurance companies in Russia started to gradually decline in 1995.

**Figure 1. Number of insurance companies in Russia and gross premiums collected, 1993–2008**



Source: FSIS

The development illustrated in the figure was due to several factors such as the worsening economic situation, increased barriers of entry and tighter regulation by the state. The government eventually became concerned with the amount of illegal activity in the insurance sector as well as lost tax revenue and started calling off licenses. During 1998 –

2001 the number of retracted licenses fluctuated between 350 and 500 per year (Siren & Sultanov 2004). Even currently the supervision authority is retracting insurers' licenses in suspicion of illegal schemes. In 2007, for example, 114 licenses were recalled (FSIS). Moreover, as of January 1<sup>st</sup>, 2006 new requirements for capital solvency were introduced (see Section 2.3). This government measure was aimed at decreasing the total number of insurance companies along with further wiping out of captive and scheme players. At the same time, the overall market size as measured by gross premiums collected has grown substantially especially after the August 1998 crisis (see Figure 1).

One of the key drivers of the insurance market growth in Russia has been the mandatory insurance segment. In the early 1990s the government adopted several acts on individual medical insurance. The basic principle of these acts is that all Russian citizens must have health insurance. According to the law, employers in Russia pay a social tax into the state Mandatory Insurance Fund, which in turn finances the mandatory insurances for all citizens. Although this system has many drawbacks (e.g. the Fund's income is not enough to cover its expenses), it still exists. More importantly, it was the key means of survival for many insurance companies in the 1990s.<sup>2</sup>

### **2.3 Market and regulation in the third millennium**

The true boom in the volume of the legitimate insurance market in Russia started only some years ago. It was fostered by the adoption of the Mandatory Motor Third Party Liability Act in July 2003, which basically implied that all cars in Russia have to be insured against liability to third parties. (See Section 2.3.2) Another important driver of the insurance market development was the credit boom of the 2000s. When people started borrowing money to buy cars and homes, banks demanded that individuals insure both the purchased object and also the life of the borrower. The credit boom was a result of the rapid economic growth, another side effect of which was the increasing shortage of

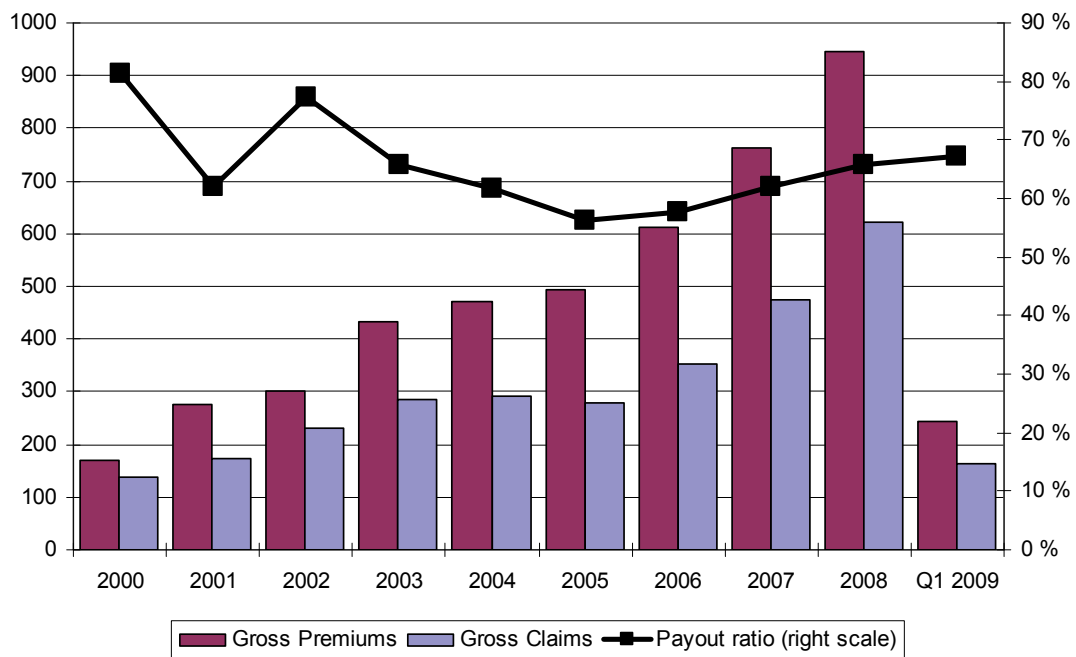
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<sup>2</sup> <http://ora.ffoms.ru/portal/page/portal/top/about>



workforce. Under these conditions many employers wishing to retain their staff adopted voluntary medical insurance programs for their employees. This had a positive effect on the insurance market as well. (Komleva 2007) Figure 2 shows the aggregate insurance premiums and claims dynamics in 2000–2007.

**Figure 2. Gross insurance premiums and claims (billion Rubles) in Russia 2000–2007 and payout ratio 2000–2009**



Source: FSIS

As illustrated in the figure, along with the growth of premiums collected, claims have been increasing at an even greater pace. This is demonstrated by the growing payout ratio, i.e. the ratio of claims paid to premiums collected. The increase in payouts can largely be attributed to increasing competition and growing customer awareness of the insurance products as such. (Yanin 2008)

### **2.3.1 General legislation on insurance**

Currently, the main legislative item governing the insurance market in Russia is the new edition of the Law on Insurance that has been in force since January 2004. According to experts, the main aim of this new legislation is to reach the Western standards of insurance (Zhilkina 2008). Correspondingly, the whole supervision system was reconstructed in parallel to the legislative reform. Previously, both regulation and supervision were performed by the same body – the Department of Insurance supervision of the Ministry of Finance. This led to certain ambiguities and inefficiencies (Polishyk 2004). Therefore, in 2004 a new supervising authority was established – the Federal Service of Insurance Supervision (FSIS, *Федеральная служба страхового надзора*). FSIS is independent of the Ministry of Finance and responsible for the control and supervision of the industry. However, all the legislative functions remain with the Department of Financial Policy of the Ministry of Finance.

When founded, FSIS claimed fighting tax evasion schemes as its top priority. Several legislative novelties were introduced that are in force still today. First, the separation of different insurance types was implemented. Before 2004 life, non-life insurance and reinsurance businesses could be sold by a single legal entity. Currently, these different products must be provided by different entities, so one firm cannot get a license for more than one of these. In practice, most of the companies that perform more than one type of insurance activity simply have several entities organized as a consolidated corporation.

Second, minimum requirements on capital of insurance companies were adopted. These are 30 million rubles for non-life insurers, 60 million – for life, and 120 million for reinsurance (FSIS). In addition, there are certain requirements as to how much of available capital the insurance company can invest into different asset categories (Siren & Sultanov 2004). Interestingly, although the separation of formerly ‘universal’ companies into life, non-life and reinsurance players was expected to give an increase to the total

number of insurers in Russia, the aggregate statistics do not show this (see Figure 1). This is largely attributed to the fact that under the new capital requirements many small and shady dealers have opted to leave the market. Hence, the artificial increase of the amount of insurers was outweighed by the insignificant players leaving the market. (Expert RA Research)

The current Law on Insurance includes also requirements considering the composition of managerial staff in insurance companies. The qualification of general managers and chief accountants are outlined in the form of years of experience in the insurance sector, and citizenship. Currently only Russian citizens are allowed to hold these positions.

### **2.3.2 Major legislative changes in different insurance segments**

In addition to the development of the general regulation on the insurance market, the Russian government has in 2009 introduced a number of legislative reforms that address the different segments of the insurance market. These include first, amendments to the Mandatory Motor Third Party Liability Act (OSAGO), which introduced the mechanism of direct refund and EuroProtocol of filing the car accident in Russia. Second, new decrees on the Mandatory Health Insurance (OMS) have been adopted on the regional level, including St. Petersburg. Finally, regulation concerning liability insurance in tourism and construction industries has been amended.

First, the most recent amendments into the Federal law on **mandatory third-party motor liability insurance (OSAGO)** came into force as of 1 March 2009. The key changes were the introduction of a mechanism of direct refund and EuroProtocol of filing the car accident. Direct refund allows the car owner to address his or her own insurance company for compensation instead of doing so with the insurer of the party responsible for the accident. Moreover, EuroProtocol allows the drivers to file small accidents without calling the police. Small accidents are by definition those in which the damage is

less than 25 thousand rubles, the accident involves not more than 2 automobiles, there are no injured persons and one of the drivers acknowledges his or her fault.

The amendments are aimed at increasing convenience for clients; ideally insurance cases should be easier to file and the damages should be compensated faster than earlier. In reality, industry professionals expect that the new routine will bring problems to both insurers and the insured due to inferior quality of preparatory work that was done prior to the amendments. The reasons why the system would not work are obvious: direct refund is a system that has multiple components. First of all the system of mutual accounts among the insurance companies is yet to be created. As the automated database of OSAGO has not been created yet, there is no clearing center where the settlements among insurance companies would take place. Moreover, there is neither national ledger of authorized independent technical experts, who would perform the damage assessments, nor approved standards of determining the damage size and a catalogue of typical automobile accidents' schemes. (Denisenko 2009a)

However, the direct refund system is now in force in testing mode and will be fully in force starting January 1<sup>st</sup>, 2010. Although in principle the EuroProtocol and direct refund are a benefit for the insurance companies, during the transition period they do not show too much eagerness in making this system work. Rather, they do everything in their power to halt the changes or at least postpone them.<sup>3</sup>

Second, as it will be described more in detail in Section 2.4.1 of this report, according to the 1991 Act on Medical Insurance for Citizens, each Russian citizen has the freedom to choose the insurance company to provide the **obligatory medical insurance policy (OMS)**. However, the regional governments have interpreted the legislation in various ways. For example, according to the rules adopted until recently in St. Petersburg, there was a strict binding of the insured: working citizens received their policies via their employers who in turn were allowed to have an insurance agreement with only one

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<sup>3</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7SDGUF250509985?OpenDocument>

insurer. Those not working (students, elderly, unemployed etc.) were assigned to certain insurance companies based on the place of the citizen's residence (registration). The insurance companies to deal with non-working population used to be selected by the St. Petersburg Territorial Obligatory Insurance Fund<sup>4</sup> based on a tender offer. These tenders were often followed by scandals. Losing insurance companies criticized the unfair nature of the selection process and viewed the tender offers to be overly corrupt.<sup>5</sup>

In April 2009, the government of St.-Petersburg adopted new decrees on OMS. For the first time in history, the citizens, both working and non-working, are allowed to choose the insurance company where to purchase their policies. The aim is to create more competition in the market. (Neptunskiy 2009) For the non-working citizens the procedure of choosing the insurer is quite simple. They have to submit an application to the city healthcare department or the insurance company of choice. In 10 days the applicant should receive his or her policy. The citizens can seek for advice on the website of the St. Petersburg Territorial Mandatory Medical Insurance Fund, which provides quarterly ratings of insurers. For the working citizens the procedure is more tedious. According to the new rules, if an employee wishes to change his or her OMS insurance company, he or she will have to write an application for the employer. The latter will have to sign an additional insurance agreement with another insurance company only because of one or few workers. This implies extra paper work, negotiations and administrative cost and thus is not likely to become a common practice. (Neptunskiy 2009)

Furthermore, new laws concerning liability insurance of **tourism companies** were adopted in 2007. The aim was to ensure that tourism companies have sufficient capital to cover for their professional liability. However, in 2008 a scandal occurred, in which a tour operator was not able to cover all its liabilities with the insurance policy at hand, and many of its clients lost their money as the company went bankrupt (Zhibulskaya 2008).

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<sup>4</sup> <http://www.tfoms.spb.ru/info.htm>

<sup>5</sup> <http://www.spbgid.ru/index.php?news=175609>

Due to this, the Duma (the lower house of the Russian parliament) adopted in 2009 a new law, which increases the amount of insurance liability of tour operators. The minimal mandatory provision for each operator was increased to 100 million rubles, depending on the total volume and types of service. Experts expect this to have a major positive influence on the market for liability insurance (Shokhina 2008).

Another sub-segment of liability insurance, where the legislation has recently changed, is the construction sector. Prior to 2009 all construction companies had to obtain a license to perform their operations. However, in summer 2008 amendments to the Urban Development Code were adopted, which imply the substitution of licensing with mandatory insurance. According to these amendments, which are to go into force in 2010, all construction companies are supposed to become members of self-regulating organizations (SRO). Each of them is required to have at least 100 members.

When in SRO, developers are expected to make contributions, which are meant to cover the possible losses of the member companies' clients in case something goes wrong. The contributions amount to 1 million rubles per member or 300 thousand rubles if the construction company agrees to insure its liabilities before its clients. It is expected that up to 90 % of developers' SRO's will require their members to purchase insurances (Basova 2009). There are two underlying reasons for that. First, for most of the construction companies the difference between the two sums is significant – only the largest developers will be able to afford themselves the 1 million ruble deposit. An annual policy for the majority of developers will cost as little as 50 thousand rubles<sup>6</sup>. Second and most important, in the worst case scenario the aggregate contributions of one single SRO members will not be enough to cover all the losses. Hence, the SRO will naturally prefer to transfer the risks to insurance companies. (Tikhonov 2009)

Finally, a significant part of insurance related legislation is dedicated to the regulation of foreign insurance companies. This will be discussed in the following section.

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<sup>6</sup> <http://www.insur-info.ru/news/12825/>

### **2.3.3 Regulation of foreign insurance companies and Russia's WTO negotiations**

The 2004 laws lay down several limitations for the presence of foreign companies on the Russian insurance market. The first and major limitation is the prohibition to open foreign subsidiaries. Instead, non-residents (i.e. foreign insurance companies) can open or acquire insurance companies that are registered as Russian companies and follow the Russian legislation (IF-vahinkovakuutusyhtiö 2007). However, there are limitations to the ownership stake as well. Non-residents from outside the European Union (EU) are limited to owning not more than a 49 % stake in Russian insurance companies that operate in the life insurance, mandatory insurance or the insurance of government property. This cap was removed for EU companies in 2005, after which a spree of foreign acquisitions has occurred. EU companies may even appoint foreigners to be general managers or chief accountants (Siren & Sultanov 2004).

Another limitation lies in the overall share of foreign companies on the Russian insurance market. The overall share of foreigners in the total capital of Russian insurance companies is limited to 25 %. Apparently, when this threshold is reached, the regulator would ban further mergers and acquisitions as well as the founding of new insurance companies by foreigners. At the end of 2007 and 2008, this share was 9.9 % and respectively 13.5 % (FSIS 2008). However, according to the regulator's 2008 annual report, the recent growth in the share of foreign capital was achieved mainly due to investments from Cyprus. These investments can actually be considered as Russian off-shore investments. FSIS estimates the real foreign investments to constitute only one half of total foreigners' share in the aggregate insurance sector capital (FSIS).

The regulation of foreign insurance companies has been an important part of the negotiations on Russia's membership in the World Trade Organization (WTO). Although it is still uncertain when exactly will Russia enter the WTO, agreements have been made about the conditions for the insurance sector. First of all, foreign companies would be allowed to open full-scale subsidiaries in Russia. The preliminary agreement states,

however, that there will be a transition period of nine years after the WTO accession, only after which foreigners would be allowed to open their offices in Russia. Secondly, the foreign capital quota will be increased from 25 % to 50 % and the 50 % will include both stakes of foreigners in Russian insurance companies and the foreign subsidiaries. Hence, at least 50 % of the Russian insurance market will be controlled by national players. Moreover, the limitation for non-EU foreigners of owning not more than 49 % stake in life and mandatory insurance companies will be removed in 5 years after joining the WTO (Strakhovanie Segodnya Opinions 2007). With all this in mind, it is evident that the foreign insurance companies' presence on the Russian market will be limited for a long time.

There are still outstanding issues in the WTO negotiations, but during 2008 Russia's leaders as well as EU leaders declared their devotion to the process (WTO 2008b) and Russia announced, prematurely, that it wants to be a member by 2010 (WTO 2008a). However, in June 2009 Russia put its accessions in doubt when it suddenly announced that it will pursue entry to the WTO as a combined customs zone with Belarus and Kazakhstan (Belton & Williams 2009). This worried both the United States and the EU, which had hoped for a quick accession for Russia as these three states are in very different stages in their negotiations. According to experts, this change of heart that surprised both Russian and Western observers is seen as a part of Russia's efforts to increase its influence in the territory of the former Soviet Union. Despite this Russia has declared its commitment to the process, but its negotiating counterparts do not see an end to the more than 15 year-long negotiations (Belton & Gorst 2009).

## **2.4 Structure and dynamics of the Russian insurance market**

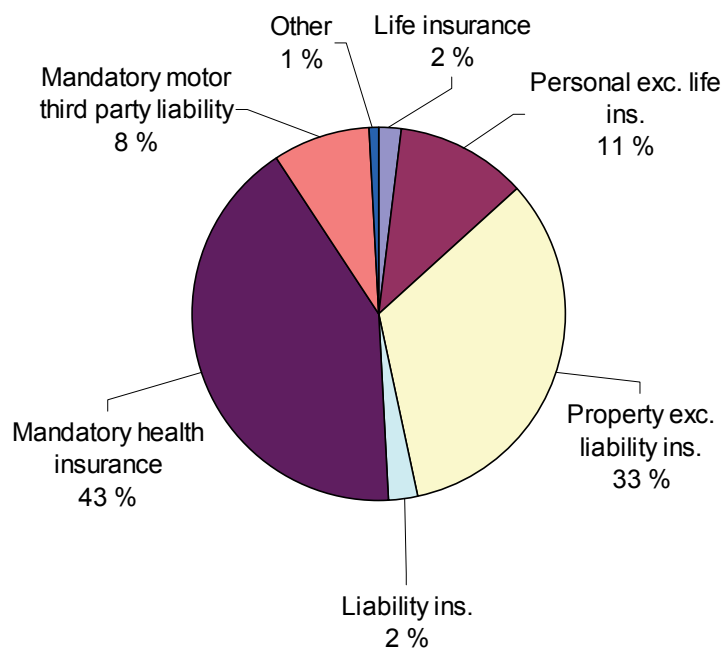
The chapter will proceed further with an overview of the different segments of the Russian insurance industry, and their growth dynamics.



In 2008 the total amount of gross premiums collected on the Russian insurance market amounted to 946 billion rubles showing a growth of 6 % as compared to 2007. The number of market players at the end of 2008 was at 786, whereas a year ago it had been 857. This indicates that 71 insurance companies left the market mainly due to the industry supervisor's fight against illegal tax evasion schemes, the financial crisis and other reasons. The supervisory body estimates that the illegal schemes still amount to 10–15 % of all insurance sales in Russia (Grigoryeva 2008).

According to the supervision requirements, the insurance activities in Russia are divided into two segments: voluntary and mandatory insurance, which are further divided into sub-segments. These are shown in Figure 3.

**Figure 3. Distribution of the Russian insurance market by segment in 2008 (gross premiums collected, %)**



Source: FSIS

As can be seen from the figure, mandatory and voluntary insurance segments constitute roughly equal shares of the aggregate market. In the rest of the chapter we will look into the development of the different insurance segments more in detail.

#### **2.4.1 Mandatory insurance**

Mandatory insurance refers to all insurance types that are required by the government for both enterprises and individuals. These are set in the legislation and are compulsory in the whole country. The whole mandatory insurance market in Russia in 2008 created 50.1 % of total premiums collected (FSIS) and is thus a very important segment. The main mandatory insurance types are **Mandatory Health Insurance (OMS)** and **Mandatory Motor Third Party Liability (OSAGO)**.

During the Soviet era, a system of government healthcare guaranteed equal access to healthcare services for all citizens. However, when the USSR dissolved, it was decided that an insurance mechanism has to be introduced into the social system. The 1991 Act on Citizen Medical Insurance stated that all the citizens of the Russian Federation are to have a medical insurance, the cost of which would be covered by the government and its agencies (namely, the Mandatory Health Insurance Fund)<sup>7</sup>. Since then all citizens are required to hold an insurance policy. Currently, the system works so that the regional governments select several authorized commercial insurance companies that issue medical insurance policies to the population on behalf of the state.

Although this mechanism was developed basically as a replacement for the Soviet government-funded healthcare system, it has had a major effect on the development of the insurance market as a whole, and it still constitutes a significant part of total premiums (43 % in 2008)<sup>8</sup>. According to the FSIS 2008 annual report, the payout ratio

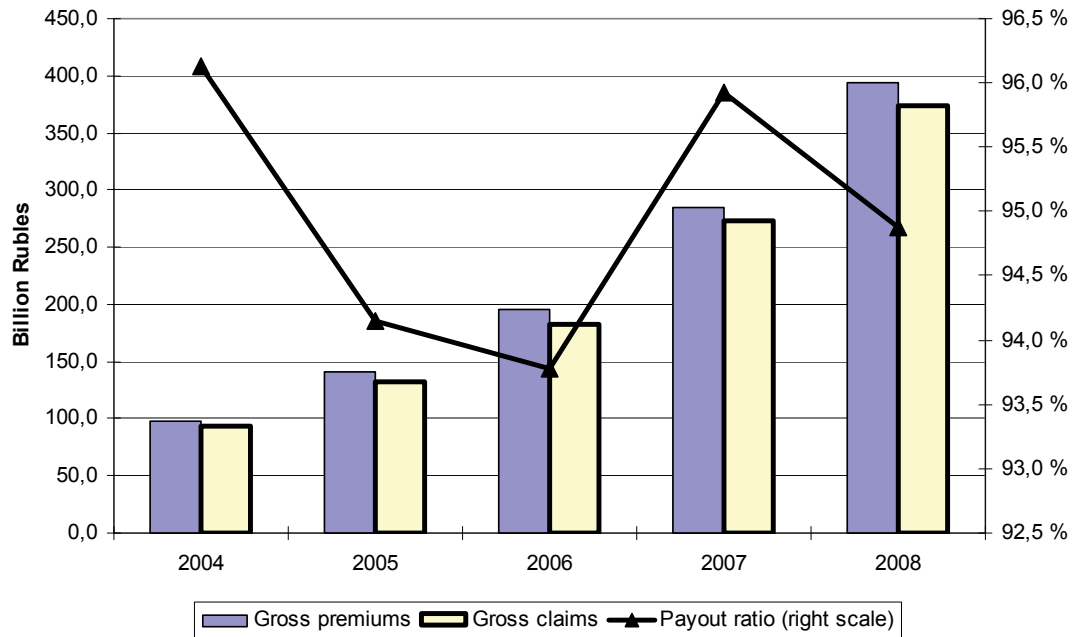
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<sup>7</sup> Federal Obligatory Health Insurance Fund official website <http://www.ffoms.ru>

<sup>8</sup> FSIS 2008 annual report

for this segment was as high as 94.9 % – an decrease of 1 percentage points from 2007 (Figure 4).

**Figure 4. Dynamics of the Market for Mandatory Health Insurance in Russia, 2004–2008**



Source: FSIS 2008

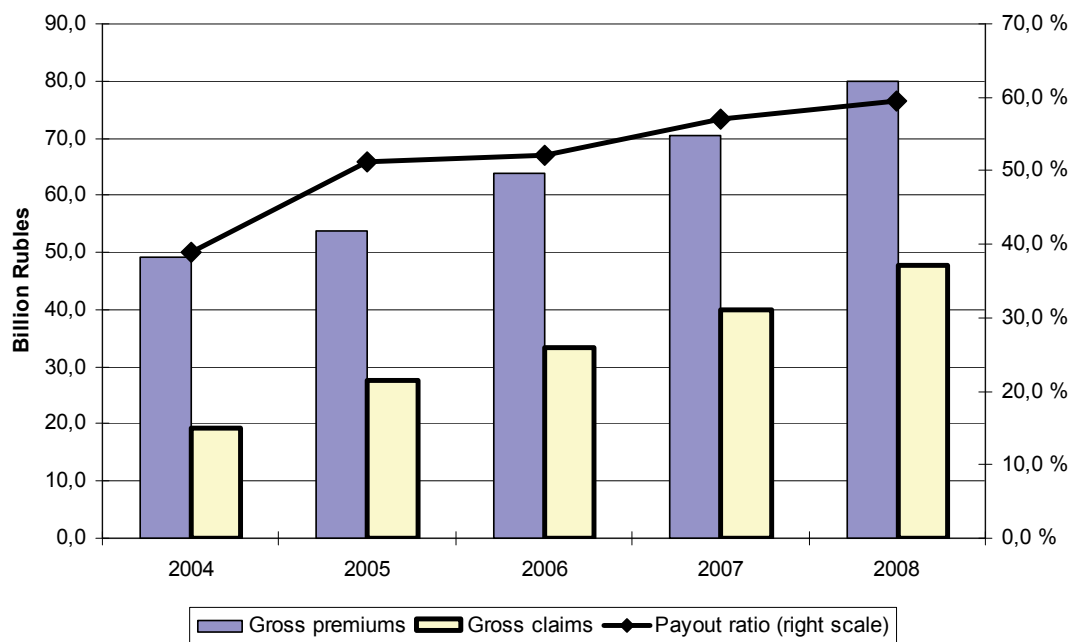
The extraordinarily high payout ratio simply indicates that the money the government allocates to healthcare is enough to cover the medical expenses of the nation. Even though there is no or little profit for the insurance companies in this sector, it is still quite a lucrative segment as it increases the company turnover and customer base. (Komleva 2007)

Furthermore, the act on Mandatory Motor Third Party Liability (OSAGO) was adopted in Russia on the 1<sup>st</sup> of July 2003. It is mandatory for all automobile owners (private and corporate) and is aimed at insuring the liability before third parties in case of car accident. The principles are rather straightforward and are similar to those adopted in many developed countries. In Russia, the government sets out the main parameters of the

OSAGO insurance, such as maximum premium, minimal claims and the general procedure in case of accident (Russian Motor Insurers' Union 2009).

Nowadays, to purchase OSAGO is a normal procedure for all Russian car owners. The aggregate market amounts to 79.9 billion rubles which represents 8 % of total insurance premiums in 2008 (RSA Annual report 2008). The mandatory automobile insurance has been a significant driver of the insurance market growth in the past years. Not only did the insurance companies collect the premiums, they were also able to sell other products to their new clients such as voluntary car insurance. Figure 5 shows how the OSAGO market has developed in the recent years.

**Figure 5. Dynamics of the Market for Mandatory Third Party Motor Liability Insurance in Russia, 2004–2008**

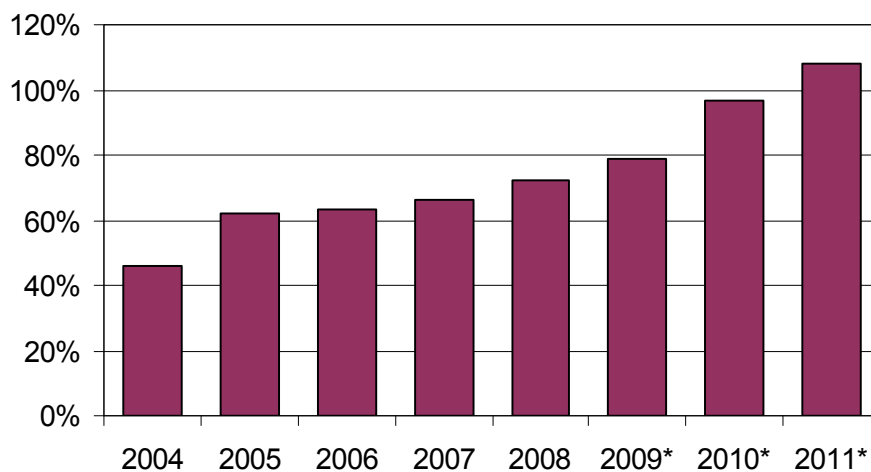


Source: FSIS

However, the early excitement of the insurance companies over OSAGO has been declining recently as more and more inefficiencies of this product have become evident. The loss ratio is growing due to the amount of car accidents increasing from year to year

(Department of Road Traffic Safety 2008), the growing sum of average claim, and increasing citizen pressure to make the procedure of claims easier and faster. Although the official payout ratio in July 2008 was at a satisfactory level of 73 %, industry analysts view that if one includes all the overhead expenses of the insurers, the ratio is as high as 96 % (Komleva 2008a). Moreover, the new amendments to the legislation concerning OSAGO that were adopted in 2009 are expected a sharp increase in the loss ratio for insurers if the overhead expenses are included (Figure 6).

**Figure 6. Payout Ratio in the Mandatory Third Party Motor Liability in Russia, including overhead expenses, 2004–2011\***



\* - forecast

Source: Expert RA; Russian Motor Insurers' Union 2009

Unless rapid changes are done in the form of raising the caps for premiums and adjusting the coefficients for different territories and customer segments, experts predict mass bankruptcies in the industry. Expert RA estimated in the summer of 2008 the payout ratio to be at 100.5 % as early as the 1<sup>st</sup> of July 2009. When this report was submitted to print, data on the premiums and losses for the 1<sup>st</sup> half of 2009 were not yet available. Finally, the insurance companies are expecting further hardship in the form of increased amount

of insurance fraud. It is expected to reach at least 10 % of aggregate annual insurance compensation payments (Alexandr Potitov, CIT Finance Strakhovanie).<sup>9</sup>

**Other mandatory insurance** types have a marginal weight (<1 %) of all premiums collected. These include the mandatory insurance for passengers on international and tourist routes and state insurance of military men and other uniformed servicemen.<sup>10</sup> The government also insures all the employees of the Federal Tax Service. The passenger insurance is automatically included in the price of the ticket and is hence sold by the seller of the ticket who in turn has an agreement with an insurance company. This means that this market is in fact strongly business-to-business oriented. The premiums per passenger are very small 0.1–2.3 rubles per trip (ROSEK). Therefore it is not surprising that the aggregate volume of the market is only 557.5 million rubles, of which almost 40 % is controlled by “ZHASO” (ЖАСО) – the Russian Railroads’ insurance company (FSIS).

As for the mandatory insurance of military and service men and Federal Tax Service workers, it is fully executed by the Military Insurance Company VSK (ВСК) – a 100 % government owned enterprise.

#### **2.4.2 Voluntary insurance**

The volume of the voluntary insurance market, both personal and corporate, has shown a significant growth in the recent years. The main drivers for growth have been the fast economic development along with increasing sophistication of the economy. More and more financial products have been introduced to the market, which attracts clients to purchase different types of insurance policies. (Sologub 2008) The regulator classifies the voluntary insurance products into four categories: life, personal, property and liability insurance (FSIS).

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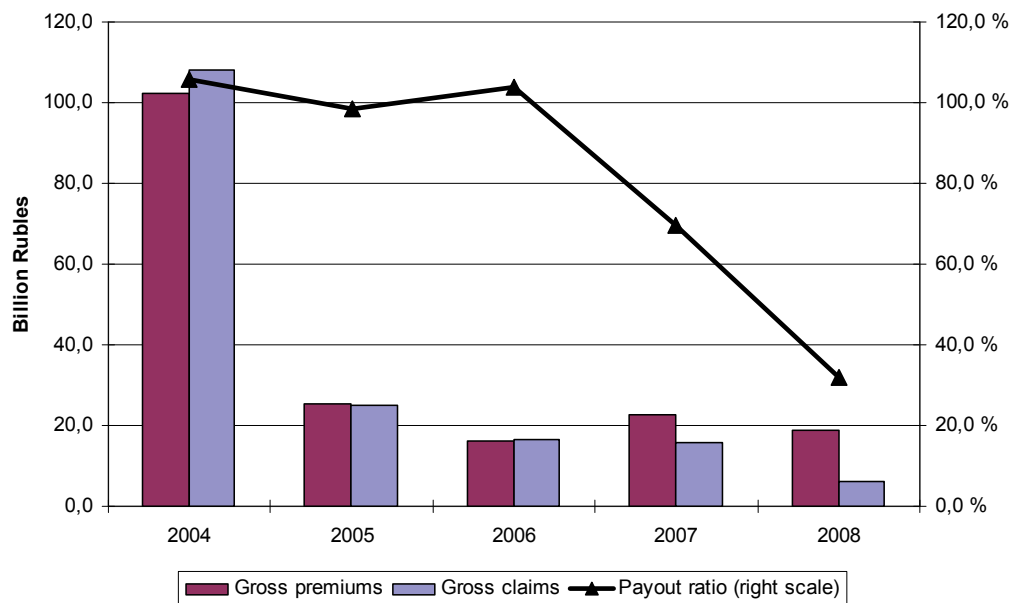
<sup>9</sup> Denisenko, E. (2009a) Офф-роуд для ОСАГО. «Эксперт Северо-Запад» №12, 2009.

<sup>10</sup> FSIS 2008 annual report

According to the Russian legislation, a **life insurance** policy is a whole life insurance with a long-term savings feature. Basically, the product implies that the insured person pays a monthly fee that guarantees his or her relatives certain compensation in case of his or her death. The insured can also withdraw his or her investment at any point in time. All other products that claim to be life insuring (e.g. injury insurance with a single payment) are classified as personal insurance under the Russian insurance law (ROSNO).

In 2008, total life insurance premiums collected amounted to 18.6 billion rubles (a 17 % decline from 2007) with claims being as high as 6 billion rubles. The life insurance market segment constitutes roughly 2 % of the total market volume. This segment is the only one in the insurance industry that has shown a significant decrease in the recent years (Figure 7). However, the market downfall was initiated mainly by the regulator's fight against money laundering. Several experts claim that in fact the real life insurance sector is growing quite fast with illegal schemes rapidly leaving the market (IF-vahinkovakuutusyhtiö 2007).

**Figure 7. Dynamics of the Market for Life Insurance in Russia, 2004–2008**



Source: FSIS

The fight against schemes for tax evasion has been the most important task for the supervisor in the past 3–4 years. Tax optimization schemes were a result of the progressive income tax system and high social security payments, which were introduced in Russia in the 1990's. Monthly life insurance deals were nothing else but an indirect way to pay wages without paying taxes. Through these schemes the employee received his or her salary under the label of life insurance, and the employer saved money on tax payments.

However, in the turn of the century the government introduced a flat income tax system, lowered social taxes and increased the supervisory pressure overall (Siren & Sultanov 2004). The pressure on illegal schemes has been especially strong since 2003 when the FSIS officially declared fighting money laundering as a priority. As a consequence, the life insurance market had a sharp decline in the number of insurance companies and up to 2008 540 insurance companies have gone out of business as most of them were previously actively engaged in tax optimization schemes (Komleva 2008d).

All the instability on the life insurance market has resulted in a fragmented field. In 2008, experts claimed that the market is facing a boom and that basically any market participant can become the leader, depending on the marketing effort and financing. The drivers for the boom in the Russian life insurance market have been the recent legislative amendments that made tax treatment of some insurance premiums for corporate employees more appealing, the expectation of future legislative initiatives and product innovations (e.g. in 2007 several market players launched the so called unit-linked products which are basically a package of life insurance policy and mutual fund shares). (Komleva 2008b)

Nevertheless, there are certain barriers for growth. Apart from the current economic crisis, there is simply lack in demand for life insurance products. The reasons for that are numerous, but they are all related to customer behavior. An average Russian is hardly

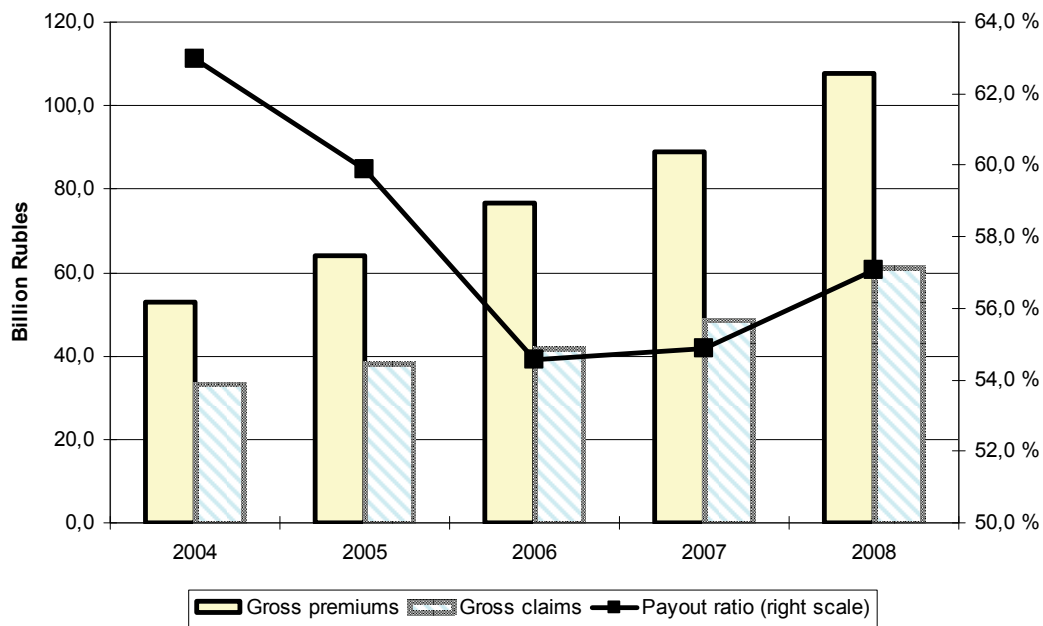


aware of life insurance products and their benefits. Moreover, industry specialists say there is a lot of mistrust towards the insurance companies amongst the people (Koval 2008). In addition, the demand can be further reduced due to the general instability in the economy (i.e. high inflation, unpredictability of the stock market etc.) (DatamonitorLife 2008).

However, the life insurance market seems to be lucrative enough for some international insurance companies. The FSIS 2007 report stated that ING Life, FORTIS and ACE Group entered the market in that year. American AIG Group has been on the Russian market for a while and as of 2007 controlled 12.8 % of this sub-segment by premiums collected (Expert RA) (see section 2.5 for more information on key players).

**Personal insurance** in Russia refers to insuring citizens from the occurrence of unexpected events. The two main categories are accident insurance and voluntary medical insurance. The former implies a payoff in case of an accident, whereas the latter entitles the insured person to additional healthcare services that can be provided by both government and private clinics. In 2008, the total market for voluntary personal insurance (excluding life insurance) amounted to 107.6 billion rubles, which is 11 % of total national insurance market. The growth totaled 20.8 % to the preceding year (Figure 8). The main drivers for growth in this sector before the current economic crisis were corporate insurance programs. Due to growing competition for skilled workers, more and more companies in Russia (especially in large cities) were forced to introduce social packages in order to attract new employees and retain the existing ones. Furthermore, often companies insure not only their workers, but also the employees' family members. (Komleva 2007) Figure 8 summarizes the development of the personal insurance market in recent years.

**Figure 8. Dynamics of the Market for Personal Insurance in Russia, 2004–2008**



Source: FSIS

Before the crisis, Expert RA rating agency forecasted a further growth for the voluntary medical insurance sub-sector. Although this segment has been increasing quite rapidly in the past years, there are certain barriers that have held it back. The main factors that slow down the growth of voluntary medical insurance market, according to industry experts, are the following (Komleva 2008c):

- The doubling of obligatory and voluntary medical insurance payments for employers. According to the current legislation, a company can not subtract the obligatory payments made from the voluntary ones. As a result, companies have to bear the same expense twice. The government officials have been discussing reforming this paradox, but no official law amendment projects have been revealed yet.
- The deficit of quality medical institutions. Both the insurance companies and their clients are not satisfied with the level and the availability of medical services. Government clinics provide inferior service most of the time (even if it is a ward liable to charge), and the amount of private clinics, though

growing, is not enough to satisfy increasing demand. (Komleva 2007) In addition, the clinics are criticized by the insurance companies for constantly increasing their tariffs at a pace exceeding the inflation rate (Aleksei Kuznetsov, Kapital-Polis)<sup>11</sup> As a result, some insurance companies that are actively engaged in voluntary medical insurance have announced plans of opening their own specialized clinics (e.g. Ingosstrakh will invest 100 million euro into its own healthcare institutions) (Komleva 2007). The government has also announced plans of increasing the quality standards and financing of state healthcare institutions.

- The inadequacy of tax relief. While it is common in developed countries to allow companies to write down the medical insurance costs as expenses, in Russia there is a cap of 3 % of the gross salary for such purposes. The rest is considered as part of the worker's salary and is hence subject to social taxes. There are some other problems in the field of taxation. Although the government is lifting some of the barriers (e.g. the cap was increased to 6 % starting January 1<sup>st</sup> 2009), there is still much to be done. The tax reliefs will have even smaller effect under the current crisis as the companies are expected to downsize their insurance programs in cost-cutting attempts.

As for the accident insurance sub-sector, its growth has also been substantial; a growth rate of 11.0 % totaling 25.3 billion rubles in 2007. In the first half of 2008 the growth rate was even more impressive: 33.8 % as compared to the same period of 2007 (Expert RA). Similarly to voluntary medical insurance, the corporate sector has had a major influence on the growth of this insurance type. However, in addition to this, the growth in the personal accident sub-sector was largely influenced by the booming mortgage sector in the recent years preceding the financial crisis (Maloletnev 2008). When a person took a mortgage loan the bank usually required the borrower to take an accident insurance so that the bank does not have to bear the risk of the client losing his ability to work. This market is somewhat non-transparent because almost all insurance policies are sold by

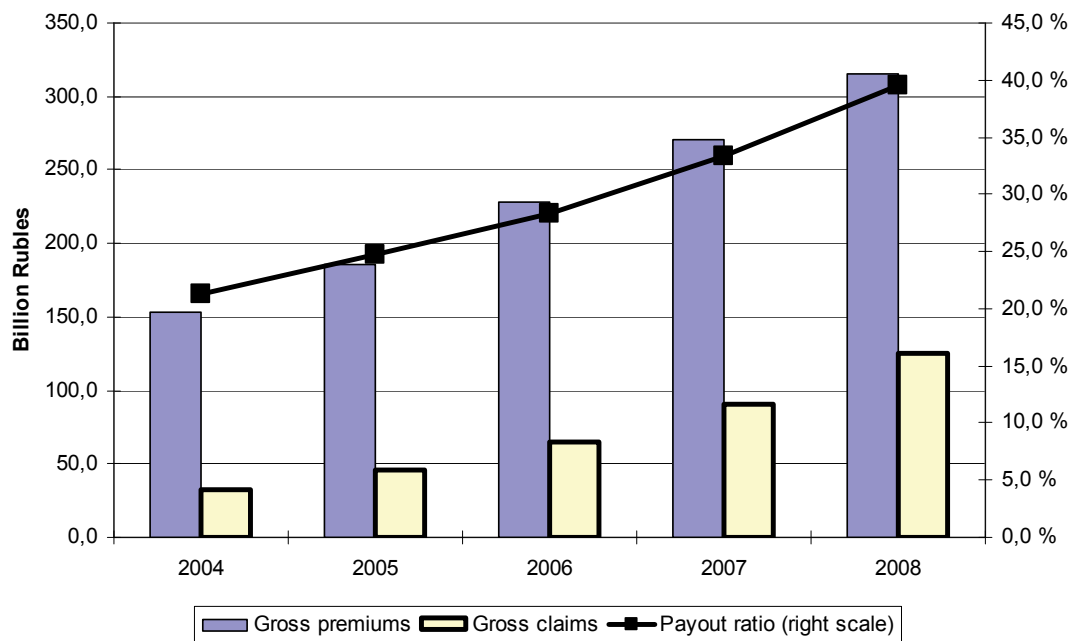
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<sup>11</sup> Sologub, Alexandr (2009) Зона рискованного страхования. «Эксперт Северо-Запад» № 7, 2009.

“accredited” insurance companies, i.e. insurers with whom the mortgage bank has a partner agreement (official or more often unofficial). However, also this segment is closely related to the development in the mortgage sector, which is somewhat ailing under the current crisis.

Voluntary **property insurance** in Russia consists of the actual property insurance and risk insurance. In 2008, the gross premiums collected amounted to 315.6 billion rubles (growth rate of 16.5 %), which is roughly 33 % of the total insurance market. This market segment has a high level of competition due to its large size and high growth rate (Bondarenko). Of all the property insurance sub-segments, the most important ones are voluntary motor insurance and real-estate insurance.

**Figure 9. Dynamics of the Market for Property Insurance in Russia 2004–2008**



Source: FSIS

There are no official statistics as for the voluntary motor insurance available. However, experts estimate this segment to constitute up to 50 % of the total property insurance market in 2007 (43 % in 2006) (Bogdanov 2007). The growth rate of the voluntary motor

insurance purchases in 2006–2007 was estimated to be 60 % (Maloletnev 2008). One of the main drivers of growth for this sub-segment before the crisis was the pre-crisis boom in car loans. When a person or a company takes credit to purchase an automobile (or leases it as is more common in case for companies), the bank requires that the car be fully insured against all risks (KASKO insurance). However, this growth is likely to decline in 2009 due to the credit crunch that has caused an overall decrease in the sales of new cars.

Mandatory third party motor liability (OSAGO) has been another driver of voluntary motor insurance in the recent years. The introduction of OSAGO made car owners come to those insurance companies they were acquainted with to purchase additional car insurance. Often the insurers offered significant discounts if the car owner purchased the “bundle”: OSAGO and KASKO. (Komleva 2008a)

Furthermore, in the past years the real-estate insurance market growth was boosted by a boom in the credit market. The pattern here is similar to motor insurance. When property purchase is financed with credit, the bank requires that it be insured against most risks. In addition, many cottage owners have been keen on insuring their real estate, and companies active in insuring their property for reasons of hedging risks and obtaining credits. (Yanin 2008)

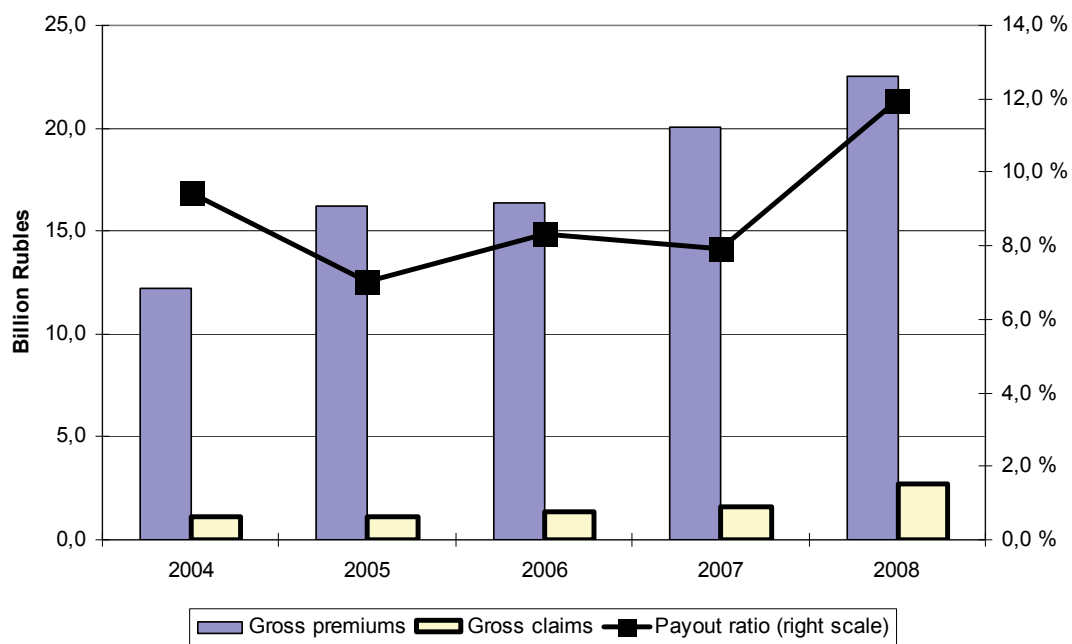
According to Expert RA, the personal real-estate sub-segment increased in 2007 by 117.9 % (Maloletnev 2008). One distinctive characteristic of the property insurance market is its low loss ratio. As a result, the premiums required by the insurance companies are rather low: 0.8–1.5 % and they are expected to decrease even further (Maloletnev 2008). However, as mentioned above, due to the financial crisis the home mortgage market has declined sharply leading to a substantial decrease in the real estate insurance market growth rate.

Finally, corporate risk insurance has not shown much significant growth in the recent years. However, experts say that it is mostly due to illegal schemes and dishonest insurers

leaving the market. Hence, the development of the quality of the market is yet to come (Komleva 2008d). More and more companies realize the advantages of insuring against corporate risks and actively use hedging. The most popular corporate insurance products are corporate property insurance and insurance against operational risks (e.g. risk of temporary shutting down of production).

Total **liability insurance** premiums collected in 2008 amounted to 22.5 billion rubles, feature of this segment is its extremely low loss ratio, which was 11.9 % in 2008 (FSIS). Figure 10 gives an overview of the growth dynamics of the liability insurance sub-segment. The main sub-segments include the insurance of hazardous production sites and tourism insurance. These insurance types are somewhat mandatory for the companies operating in specified areas or running hazardous operations.

**Figure 10. Dynamics of the Market for Liability Insurance in Russia, 2004–2008**



Source: FSIS

The legislation on the compulsory insurance of hazardous production facilities was adopted in 2008. However, the law does not guarantee a full coverage of the risks. The maximum coverage limit set in the law, i.e. the limit which the government may demand, equals only 7 million rubles. This is not enough to cover even a medium scale incident. In addition, there is a wide list of hazardous enterprise types that are not subject to the law. As a result, few companies have insured their liability. Most of them did so without really realizing the benefits, the major selection criterion being the price of the insurance. At the same time the insurers have not acquired sufficient experience in this field and hence they are not able to evaluate the risks and price policies correctly. A secondary edition of this law, which would include more hazardous enterprises and increase the coverage sums is expected not earlier than 2011. Only after that do experts predict a significant growth in this market segment. (Komleva 2008f)

As for the tourism sub-sector, the growth in this segment has been driven by legislation as well. The new legislative requirements concerning the liability insurance of tourism operators, which were introduced in 2009, increased the minimum provision to 100 million rubles. Experts expect this to have a major positive influence on the market for liability insurance (Shokhina 2008). In a similar vein, the new legislation on the construction companies' liability is expected to increase the market volume of liability insurance as the newly formed self-regulating organizations of construction companies will require their members to purchase insurance. The insurance company Gefest estimates the potential market for the SRO insurance to amount to 1–2 billion rubles annually. This year's market volume is estimated at 200 million rubles.<sup>12</sup>

The **reinsurance** market in Russia is rather small in comparison to developed countries (FINAM 2008). Although the insurance market regulator reported that 196 insurance companies were officially engaged into reinsurance activity at the end of 2008, the government has confirmed that during that year this amount decreased by 55 (FSIS).

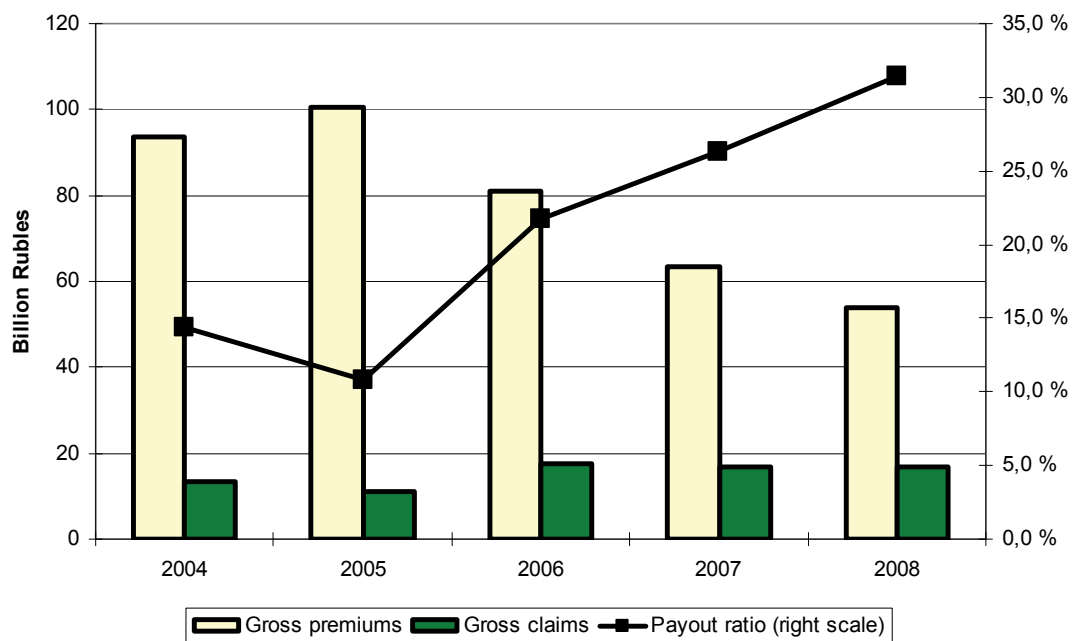
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<sup>12</sup> <http://www.insur-info.ru/news/12825/>

According to experts, the real players on the market are even fewer in number (Expert RA).

Decreasing number of market players along with somewhat decreasing market volume (see Figure 11) is driven by the regulator's struggle against illegal schemes. Earlier much of the life insurance-based tax evasion schemes were further leveraged with reinsurance. Hence, the real growth of the market is not too high. Reasons for that are the low efficiency of the reinsurance, which is proved by the loss ratio being more than 2 times lower than that in the insurance market as a whole: 31.5 % against 65.8 % in 2008 (FSIS). This basically implies somewhat higher premiums collected by reinsurers. In addition, the general culture and understanding of the reinsurance benefits by the insurance business and in the society is rather low (Komleva 2008e).

**Figure 11. Dynamics of the Market for reinsurance in Russia, 2004–2008**



Source: FSIS

Nevertheless, the reinsurance market is expected to grow in the near future due to the increasing volume of the insurance market and growing competition, which will force insurance companies to improve their risk management. However, at the end of 2008 the



then director of FSIS, Ilya Lomakin-Rumyantsev, expected the crisis to have a diminishing effect on the reinsurance market due to the increasing costs of reinsurance protection worldwide and the re-evaluation of reinsurance agreements by large international actors (Grigoryeva 2008). Meanwhile, the market is being aggressively captured by foreign reinsurance companies. According to Expert RA, in 2007 reinsurance premiums collected by foreigners increased by almost 30 % compared to 2006 whereas the Russian reinsurers' share declined by 25 % (Komleva 2008e).

After examining the Russian insurance market by segment, next we analyze its structure in terms of key players.

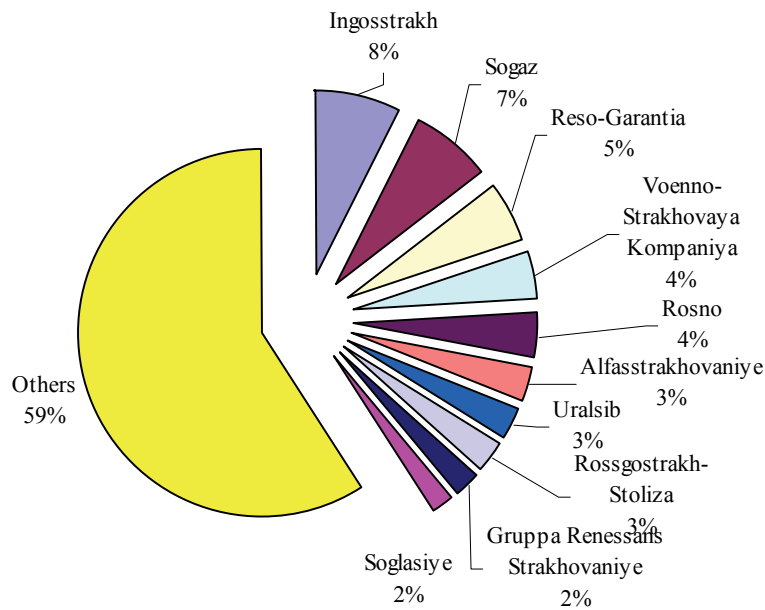
## **2.5 Key players in the Russian insurance market**

The Russian Insurance Market is severely fragmented, as illustrated in Figure 12. Another characteristic of the market is the significant influence of industrial insurers such as Sogaz that was developed from a department of the Gazprom<sup>13</sup> – Russia's natural gas producing monopoly – and companies that started in the 1990's by insuring the military or government instances and had a large government ownership like Ingostrakh and Voennno-Strakhovaya Kompaniya. These companies, which still have a strong foothold in the heavy industry or government, have fared better in the difficult last months of 2008 than private insurance companies, which suffered from the fall in demand for motor insurance.

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<sup>13</sup> <http://ru.wikipedia.org/wiki/%D0%A1%D0%BE%D0%B3%D0%B0%D0%B7>

**Figure 12. Key Players of the Russian Insurance Market 2008\***



\* The market share is calculated from the total revenue in the Russian insurance market in 2008 excluding mandatory health insurance (OMS) because this segment is generally considered by experts (FSIS, Expert RA) separately when comparing insurance revenues. Even though this segment is a significant source of revenue in the market, it is severely regulated and currently only 12 companies have a license to issue OMS-policies (see sections on OMS in Russia and St. Petersburg). Therefore it cannot be considered as a competitive market.

Source: Strakhovanie Segodnya

Despite restrictions in the market, a number of international insurance companies have entered the Russian market. From those companies, which entered the Russian market in the 1990s, still very much present are the Allianz Group (Allianz Rosno, Allianz Rosno Life and ownership in other companies), AIG (in life insurance), Alte Leipziger (now Ergo), which bought a shareholding in the “Rus” insurance company, and Zurich Financial Services (an international reinsurance giant) (OECD 2005). Other foreign companies that have purchased shares in Russian insurance companies include Groupe AXA (the Rossiya Insurance Company, RESO Garantia and other companies), and Lloyd’s syndicate group Amlin (in the Transsiberian Reinsurance Corporation). Most of

these companies specialize in non-life business, although AIG has made a considerable effort in developing AIG Life. Furthermore, a number of foreign investors, including the European Bank for Reconstruction and Development (EBRD) that has small share in some of the biggest insurance companies, have entered the market. EBRD also set up a life insurance company, the Principal Insurance Company, in the mid 1990s together with the Finnish Pohjola Ltd. insurances. However, the venture failed due to a lack of demand and the company since ceased its operations and surrendered its license (OECD 2005).

In 2004, when some of the restrictions on foreign insurance companies were lifted, there was not an immediate surge of foreign companies to the Russian market, as was feared by Russian insurers. The number of foreign players has, however, steadily increased (OECD 2005). The recent major foreign entrants to the Russian insurance market include:

- Generali (Italy), which in November 2007 acquired an indirect stake in Ingosstrakh
- Cardif, the insurance division of the financial group BNP Paribas (France), which in December 2007 registered a subsidiary in Russia
- AXA (France), which in January 2008 signed an agreement to purchase a 37 %–stake in one of the largest insurers in Russia, Reso-Garantia, for EUR 810 million, making it the largest foreign acquisition in the Russian insurance market.

Furthermore, the Nordic company If P&C insurance enhanced its penetration into the Russian markets in March 2008 by acquiring the Russian insurance company Region. Currently, If P&C Insurance is the only Nordic insurance company in Russia with its Russian headquarters in St. Petersburg. It offers insurance mainly to Nordic corporate clients operating in Russia (If P&C Insurance). All the other major international brokers like AON, Marsh and Willis have already operated in Russia for many years.

For foreign insurance companies many legal changes have been made since the turn of the century, but their scope of operation is still very limited. The situation would improve if Russia joined the WTO. It is expected that after the WTO accession the insurance

market will open up, the share of foreign capital permitted by law will increase, and more foreign companies will come to Russia who will require services from their 'own' insurance companies.

## **2.6 Implications of the financial crisis on the Russian insurance market**

In 2008 the global crisis spread to the Russian financial sector. In October 2008, insurers were still waiting for the financial crisis to have an effect in the insurance market, even though it had already stalled the market for bank credit insurance (Denisenko 2008). Later on the crisis spread to the housing, automobile and mortgage-related insurance segments. Finally, the diffusion of the crisis to the real economy started to show in insurance market as well. For example, companies started to save in voluntary medical and car insurance as part of cost-cutting programs. Moreover, as the situation worsens some enterprises reduce their spending even on obligatory insurances.

Even though the crisis had not affected the insurance markets significantly in autumn of 2008, insurers started already then to prepare themselves to reductions in revenues. In October 2008 many of the biggest insurance companies announced that they anticipate cuts in personnel and lowering of tariffs (Savelyeva 2008) and in November the number two company in St. Petersburg (and number one in Russia) Rossgostrakh Severo-Zapad announced that it has reduced 20 % of its work force (Zborovskaya 2008a).

In 2009, the crisis had spread on all segments of the insurance market, most severely on the voluntary motor insurances or KASKO-insurances. Only the volume of mandatory motor insurance (OSAGO) has not declined as much as the other segments. In corporate insurances voluntary insuring of employees like health insurances or against accidents has declined sharply.

According to expert estimates, in the St. Petersburg area as of February 2009 there were approximately 200 insurance companies registered and only about a half are able to

conduct their business as before. The rest have downsized their operations and lay off workers (Igor Panfilov, A24/27.2.2009). Due to the crisis small insurance companies that are specialized in motor insurance are most likely to close down their business or sell their operations to a larger company. Large companies that have extra reserves will acquire smaller companies as they can be purchased relatively cheaply. Also, the motor insurance and related departments in larger insurance companies have been closed down or reduced their personnel significantly (Igor Panfilov, A24/27.2.2009).

In May 2009, the international rating agency Fitch Ratings lowered its rating of the Russian insurance sector to “negative” (Gaydash 2009). The analysis expects many companies to leave the market and many others to resort to unsustainable dumping. Other threats to the market are expected to come from increasing insurance fraud on behalf of some of the customers and dishonest agents. According to the calculation of the FSIS, revenues declined by 8 % as payments increased by 22 % in the first quarter of 2009 compared to the same period in the previous year (Gaydash 2009).

Moreover, five to six of the largest insurance companies in Russia have asked for government assistance due to the crisis. The subsidies are expected to be granted at some stage, but the government is not expected to increase its stake in insurance market (Igor Panfilov, A24/27.2.2009). This is consistent with the policy that the government stake in the government owned companies has diminished in the recent years.

Ilya Lomakyn-Rumyanzev<sup>14</sup>, in November 2008 the director of FSIS, admitted that it is still not clear how the crisis will affect the insurance markets and therefore there is no comprehensive plan to for its rescue (Roszkov 2008). If the situation comes down to government rescue, Lomakyn-Rumyanzev announced that help will be provided only to ‘healthy’ companies. At the moment the FSIS is not, therefore, offering any normative advice or help to insurance companies suffering from the crisis but some exceptions can

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<sup>14</sup> Since April 2009 the head FSIS is Alexander Koval.

be made depending on the situation (Roszkov 2008). In May 2009 as the crisis had progressed in the insurance market, the finance minister Aleksey Kudrin announced that the government is not ready to recapitalize the insurance market. While the whole financial sector is in severe distress, the insurance market is not one of the priorities for government rescue. Kudrin, however, reassured distressed insurers by saying that the ministry “*will be able to react in time*” (Gaydash 2009).

### **3 Development of the St. Petersburg insurance market**

St. Petersburg has the third largest regional insurance market in Russia after Moscow city and the Moscow region (Strakhovanie Segodnya). According to experts, the development of the St. Petersburg insurance market mainly follows the tendencies of the whole country. It, however, has some characteristics that make it distinct from the average regional insurance market. These were summarized by one of the experts interviewed for this study as follows:

*“The specialty of St.-Petersburg market is that it is very similar to that of Moscow, with the exception of a 1–1.5 year lag. The second peculiarity is the trans-border contacts, for example, the Green card. For us it is not a big share of premiums collected, but as a product complimentary to the market it is very important. The same goes for transit cargo shipments. The third difference from the national market lies in the property interests of the people: summer cottages, apartments, houses.”* (Sergei Brovko, RESO-Garantiya/27.02.2009)

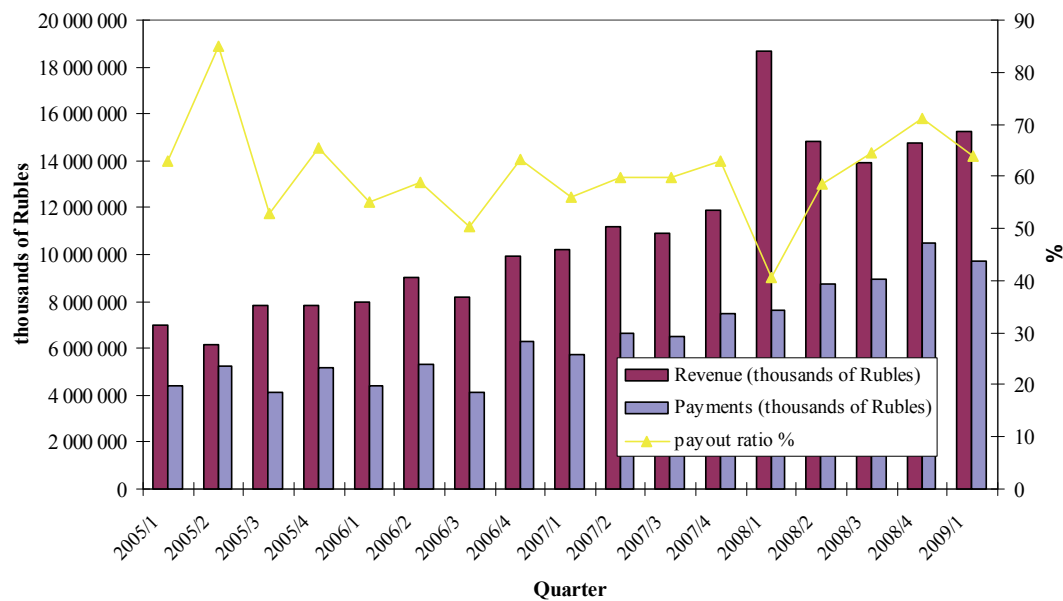
The report proceeds further by focusing on the St. Petersburg market and its recent developments, and continues with a description of development of the mandatory as well as the voluntary insurance market as well as their sub-segments.

#### **3.1 Growth dynamics on the St. Petersburg insurance market**

In 2008 the St. Petersburg insurance market generated revenues up to 57 billion rubles, which accounted for 6 % of the whole Russian insurance market revenue (Strakhovanie Segodnya). This resulted in a growth rate of 33.6 % (including OMS) from 2007, which is a significant increase from the 16.6 % growth rate of 2007 to 2006 (Strakhovanie Segodnya). In the first three quarters of 2008 the strong growth continued with revenues growing by 26.5 up to 31.1 billion rubles. The corresponding figure in the previous year

was only 24.6 billion rubles (Strakhovanie Segodnya). Interestingly, the financial crisis did not decrease revenues in the last quarter of 2008 as was expected by some experts (Aleynikova 2008). Figure 13 illustrates the quarterly growth dynamics of the St. Petersburg insurance market in the recent years.

**Figure 13. St. Petersburg Insurance Market 2005–2009\*: Quarterly revenue and claims paid**



Source: Strakhovanie Segodnya

The growth rates of the St. Petersburg insurance market indicators are high as compared to the EU averages<sup>15</sup> and the overall Russian growth rates (Strakhovanie Segodnya). In the period of 2004–2008, the year 2008 stands out as a record one in revenues. The annual growth rate in 2004–2008 in St. Petersburg insurance market was on average 21.8 % with peaks in 2006 and 2008. On the other hand, the St. Petersburg market has had more volatile growth rates than the Russian market which has experienced more constant growth rates as well as slightly higher rates until 2008 (Strakhovanie Segodnya). However, the director of FSIS reminds that the annual growth in the Russian as well as St.

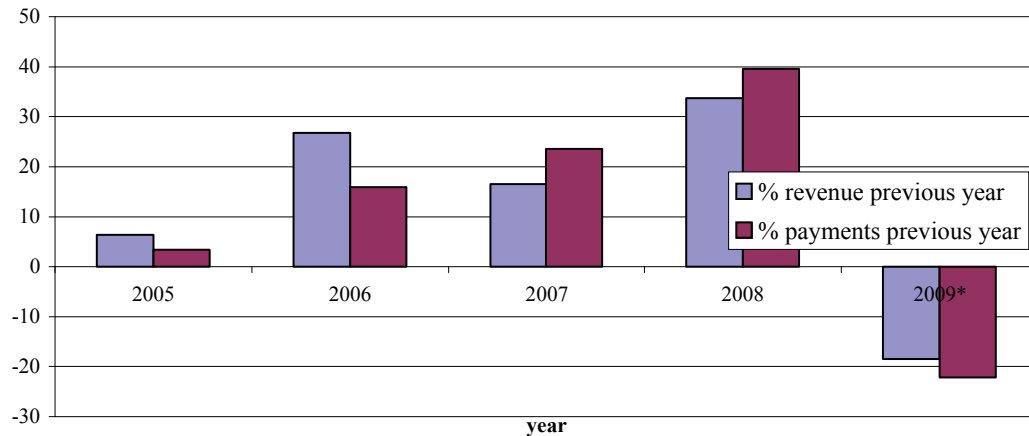
<sup>15</sup> see for example [http://www.finanssivalvonta.fi/en/Statistics/Insurance\\_market/Pages/Default.aspx](http://www.finanssivalvonta.fi/en/Statistics/Insurance_market/Pages/Default.aspx)



Petersburg markets cannot be considered as strong and solid, when the double digit inflation of the recent years is accounted for (Grigoryeva 2008).

Furthermore, as shown in Figure 13, the payments made by insurance companies have been growing faster than revenues in St. Petersburg. In 2008 payments rose by 39.5 % from the previous year to reach 35.8 billion rubles (Strakhovanie Segodnya). This means that the St. Petersburg market amounted to 5.7 % of the claims paid in the whole country in 2008 (Strakhovanie Segodnya). The higher growth rate of payments compared to revenues followed the overall development in the country with the 37 % growth in payments in 2007 (BOFIT 2008). The same tendencies continued for the first nine months of 2008 (Aleynikova 2008) with a growth of 35.6 % in payments (Strakhovanie Segodnya). The effects of the financial crisis, however, started to show in the insurance market revenue in 2009 (Figure 14).

**Figure 14. St. Petersburg insurance market: % change of revenue and claims paid 2004–2009\***



\* 2009 figures are only from the first quarter compared to the first quarter of 2008.

Source: Strakhovanie Segodnya

In the first three months of 2009 the sales declined in almost all segments of insurance. In the same quarter, the payments declined at a faster pace than revenues, which is contrary to what usually happens in Western countries during economically difficult times as

incentives for insurance fraud increase<sup>16</sup>. However, the revenue from housing credit insurances in St. Petersburg decreased to 50–70 % from the pre-crisis level already in October 2008 (Zborovskaya 2008b).

In general, St. Petersburg has similar consumer preferences and insurance market characteristics to the overall Russian market with some differences deriving from its geographical location at the Western border of Russia and as a seaport. In 2007, over a half of all the payments made in the North-Western area and St. Petersburg were related to road transport (Kamenshikova 2008). In addition, in St. Petersburg small scale sea transport insurance has become a high-risk segment with particularly high number of yacht and speedboat accidents. Due to the high level of competition in St. Petersburg, these clients cannot be ignored as they have usually concentrated all insurances of their often vast property to one insurer and are therefore important clients. There is also a problem with confusing government regulations and registration requirements on boats. In addition to this, no adequate maintenance services are available, which makes these boats especially prone to accidents. (Kamenshikova 2008).

Furthermore, insurances for construction companies were a great source of revenue for many St. Petersburg insurance companies in 2007, but also a source of a substantial amount of claims (Kamenshikova 2008). In St. Petersburg the risk of inundations is great due to its location and numerous canals. This may even worsen due to the climate change. However, global warming is still not a great source of anxiety in St. Petersburg in comparison to insurers in the United States and Great Britain (Kamenshikova 2008).

Moreover, in insurance awareness St. Petersburg is still lagging behind Moscow and the Moscow region. Insurance penetration, i.e. the share of insurance payments of the gross regional product (GRP) was in 2008 as low as 3.2 %<sup>17</sup>, which corresponds to the country average (Swiss Reinsurance 2009). When excluding the obligatory health insurance

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<sup>16</sup> see for example <http://www.guardian.co.uk/money/blog/2009/jan/30/insurance-scams>

<sup>17</sup> Based on the St. Petersburg City Government announced GRP figures and Strakhovanie Segodnya 2008 figures.

payments, the portion lowers down to 1.5 %. In comparison, Finland had an insurance penetration rate of 8.5 % in 2008 (Swiss Reinsurance 2009). The insurance density (insurance payments per capita) in St. Petersburg was \$251<sup>18</sup> in 2008, but including the obligatory health insurance payments it falls down to the low figure of \$150 (Rosstat 2009; Strakhovanie Segodnya). The same figure for Russia as a whole was \$274 in 2008 (Swiss Reinsurance 2009).

The largest contributor to the insurance payments in 2008 in St. Petersburg was the company Reso-Garantia with over 2.5 billion rubles (when excluding mandatory health insurance) given as paid claims. When including Mandatory health insurance (OMS) sales, Russkiy Mir stands clearly as the largest insurer in the region, but the OMS segment is considered separately to other segments for reasons explained in the previous sections of this report.

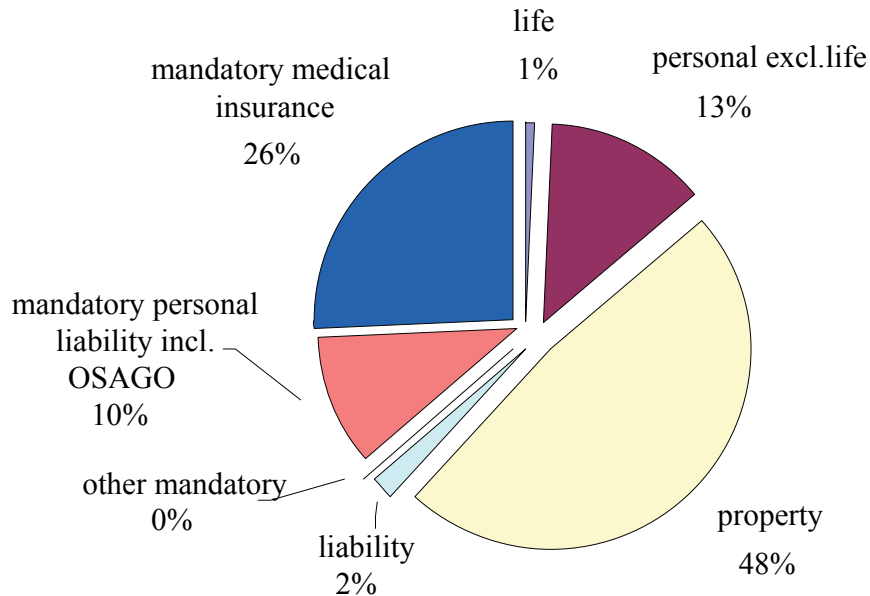
### **3.2 Market structure**

This section gives an overview of the St. Petersburg insurance market by segment including their shares in the total industry. The St. Petersburg insurance market is divided into the voluntary and compulsory insurance segments due to the fairly large share of compulsory insurances in Russia. The voluntary insurance market then consists of the life and non-life insurance segments. Figure 15 illustrates the distribution of revenues among different segments.

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<sup>18</sup> The measures are based on the Central Bank of Russia exchange rates 24.11.2008.

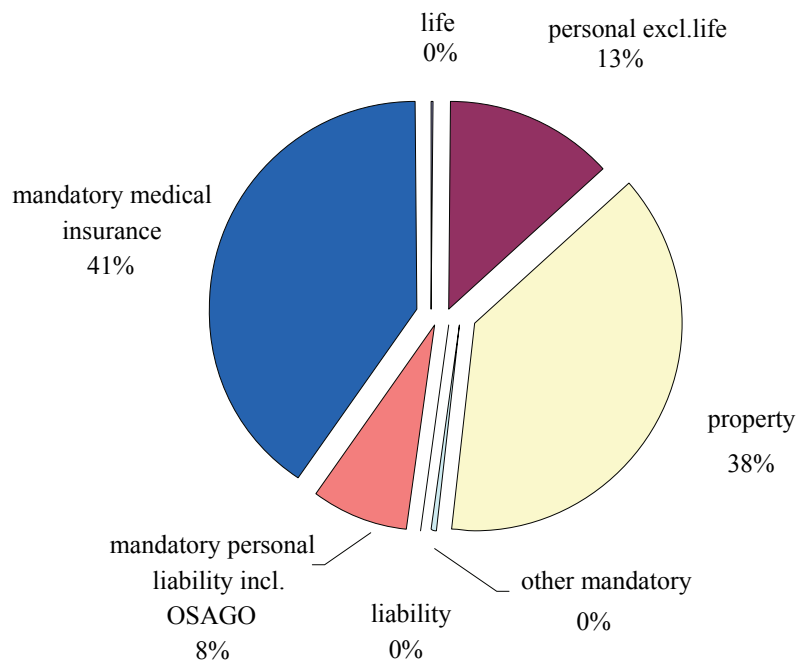
**Figure 15. St. Petersburg insurance market 2008: share of revenue by segment**



Source: Strakhovanie Segodnya

As seen in Figure 15, mandatory insurances created more than a third of all the insurance revenues in 2008 (Strakhovanie Segodnya). This is less than the Russian average, where slightly over half of insurance premium income comes from mandatory insurance policies (FSIS). However, the share of mandatory insurance of the St. Petersburg insurance market is larger when looking at the distribution of claims paid by segment as can be seen from Figure 16.

**Figure 16. St. Petersburg insurance market 2008: share of claims paid by segment**



Source: Strakhovanie Segodnya

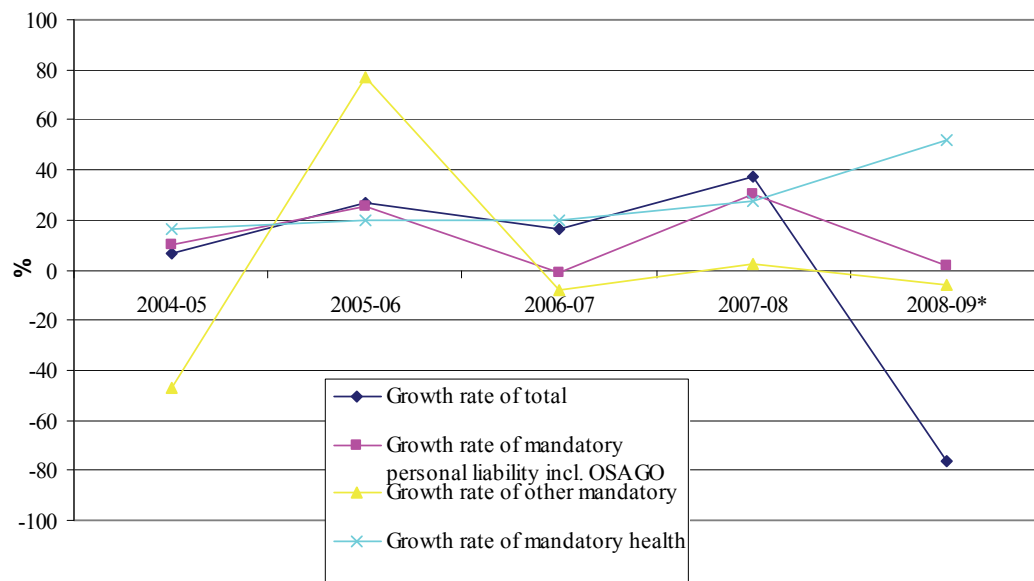
When measured by claims paid on policies, the mandatory insurances comprise almost two thirds of the market with most payments originating from compulsory health insurance policies. This is consistent with the overall Russian market structure for paid claims, except that mandatory health insurance payments comprise a much larger share of 60 % of all the payments made in the Russian insurance market as a whole (Strakhovanie Segodnya).

### **3.2.1 Mandatory insurance market**

As illustrated in Figure 15, mandatory insurances contribute for a 36 % share of the total insurance revenue in the St. Petersburg insurance market (Strakhovanie Segodnya). In 2008 St. Petersburg held the third place among Russian regions as the source of revenues and payments of mandatory insurance, just after Moscow City and the Moscow region (Strakhovanie Segodnya). Mandatory insurance includes mandatory health insurance

(OMS), mandatory third party motor insurance (OSAGO), and other mandatory insurances like mandatory government liability insurances. Mandatory health policies made up the bulk of mandatory insurances by generating 71 % of the revenues of this segment in St. Petersburg (Strakhovanie Segodnya). Figure 17 illustrates the dynamics of the different mandatory insurance segments.

**Figure 17. St. Petersburg Insurance Market: Growth rate of mandatory insurance revenues by segment 2004–2009\***



\* 2009 figures are only from the first quarter change on the first quarter of 2008

Source: Strakhovanie Segodnya

As can be seen from Figure 17, the growth rate of the total mandatory insurances has been declining after 2005. Furthermore, the different segments have had fairly volatile growth rates with no clear detectable trend. Mandatory insurance has, however, been clearly affected by the financial crisis, probably mainly due to a decrease in car sales and consequently in OSAGO revenues. Moreover, mandatory insurances are strictly regulated and their profitability depends largely on the Insurance Regulator and changes in legislation (FSIS). In addition, growth in volume in the mandatory insurance market is

linked to government regulatory actions. In times of tightening or liberalizing legislative changes there can be significant changes in sales (Data Monitor 2008).

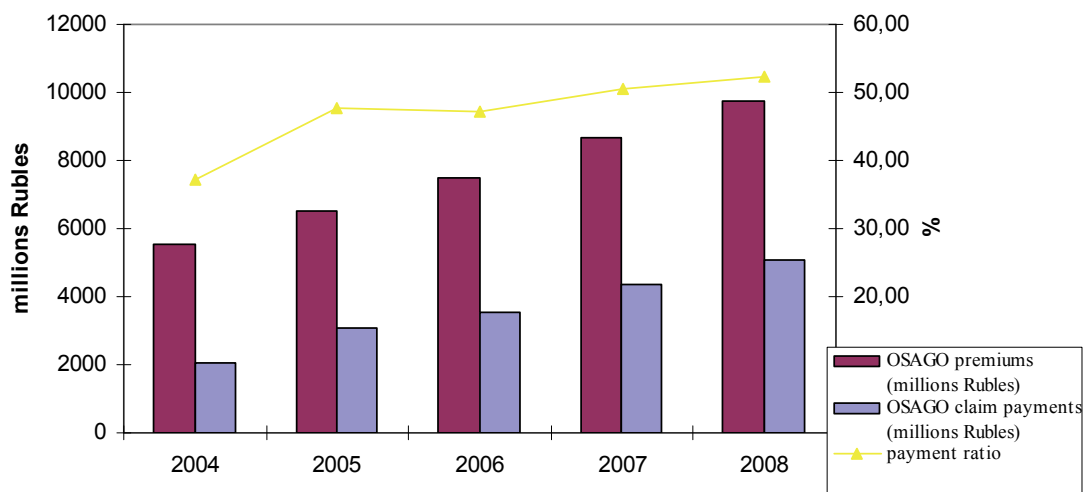
Nevertheless, Figure 17 shows that contrary to the overall development in the market, the growth rate of **mandatory health insurance (OMS)** policies accelerated in the first quarter of 2009. This is understandable as the mandatory health insurance is not a competitive market segment and therefore can resist market tendencies. The aggregate revenue of all OMS insurers in the city equals 10.4 million rubles per month.<sup>19</sup> Mandatory health insurance (OMS) is the segment with the largest payment on claims in St. Petersburg as well as the whole of Russia.

Furthermore, the **Mandatory Motor Third Party Liability (OSAGO)** has significantly lower payments than OMS insurance as well as a low payment ratio as can be seen from Figure 18. The OSAGO insurance market had a record year in sales revenue in 2008 with 9.7 billion rubles in premiums collected. This amounts to a significant share of 17 % of all insurance revenues in 2008.

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<sup>19</sup> <http://www.spbgid.ru/index.php?news=175609>

**Figure 18. St. Petersburg Insurance market 2004–2008: OSAGO premiums and claims paid**



Source: RSA

As illustrated in Figure 18, the annual growth rate of OSAGO sales has been constant since 2004 at approximately 15 %. However, the growth slowed down in the first quarter of 2009 together with decreasing new car purchases (RSA).

As previously noted in this report, other types of mandatory insurances constitute a marginal share of all premiums collected and are usually performed by few pre-determined companies which have close ties to the government. As for the compulsory insurance of liabilities (tourism and construction) and hazardous industries, the regulator (FSIS) classifies these under the voluntary liability insurance.

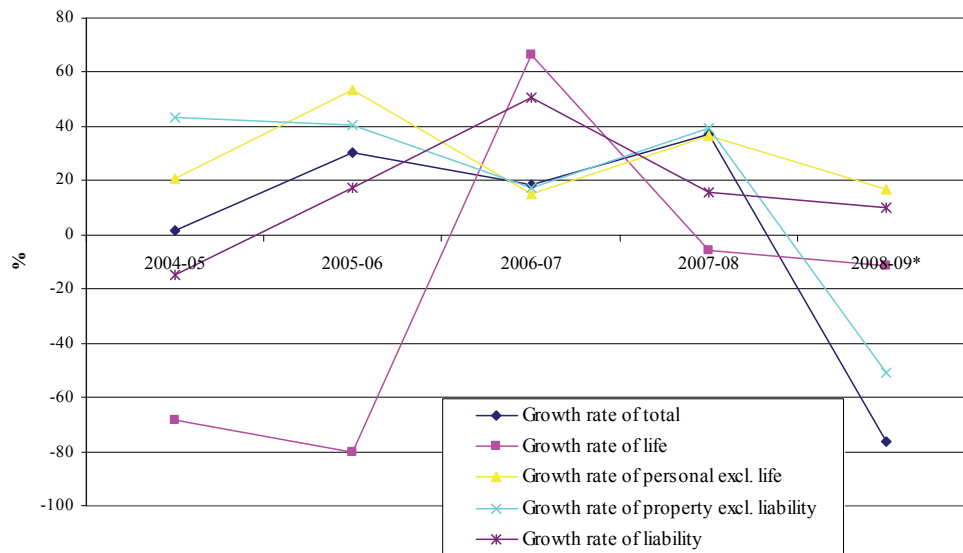
### **3.2.2 Voluntary insurance market**

The voluntary insurances include life, property, liability and personal insurances. In 2008, voluntary insurances generated 64 % of all insurance revenues in St. Petersburg (Strakhovanie Segodnya). Property insurances created two thirds of all voluntary insurance revenues. Property insurance has been an important driver for growth in recent



years in the St. Petersburg insurance market as a whole as well as in the voluntary insurance segment (Figure 19).

**Figure 19. St. Petersburg insurance market: growth rates of voluntary insurance revenues 2004–2009\* by segment**



\* For 2009 the first quarter figures are compared to those of 2008

Sources: Strakhovanie Segodnya

The entire voluntary insurance segment experienced a decline in growth rate in the first quarter of 2009. Property and personal insurances have followed the overall tendencies in the insurance market. As illustrated in Figure 19, life insurance, however, experienced a development in sales in 2004–2008 contrary to the general market trend. Also liability insurance that depends on purchases from the public sector had contradictory growth rates in 2004–2008.

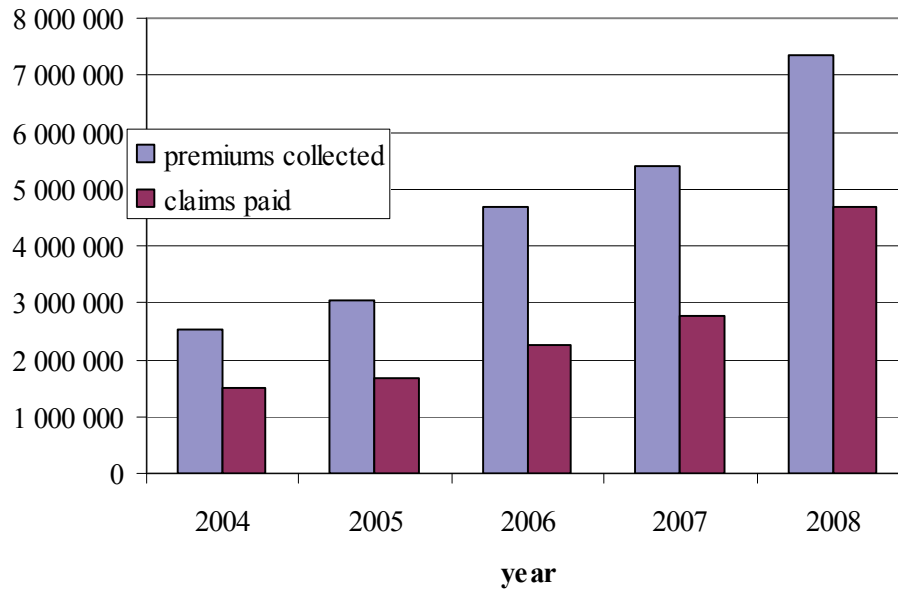
The **life insurance** market in St. Petersburg generated total revenues of 525 million rubles in 2008, which accounts for 0.9 % of total insurance premiums collected in the city and 2.8 % of the whole Russian life insurance market (Strakhovanie Segodnya). Growth in the life markets slowed down slightly in the first nine months of 2008 (Strakhovanie

Segodnya). Moreover, the remaining quarter was affected by the crisis sentiment, which grew stronger in the markets towards the end of the year. This resulted in a negative growth rate of -5 % and the decline accelerated in the first quarter of 2009 (Strakhovanye Segodnya).

After 2003 the Russian life insurance market has experienced considerable decline as has the St. Petersburg market with the exception of 2007 that witnessed a growth rate of almost 70 % on the previous year (see Figure 19). The change in 2004–2007 represented an average annual decline of 27.4 % (Strakhovanie Segodnya) and an even heavier annual decline of 37.4 % for the whole country during 2003–2007 (DataMonitorLife 2008). In comparison, over 2003–2007 the Polish and Hungarian markets grew with average annual rates of 25.2 % and 20.5 %, to reach respective values of \$8 billion and \$3.4 billion in 2007 (DataMonitorLife 2008). In 2008 the life insurance market revenue resumed its decline with a reduction of 6 % following the same pattern as life insurance revenues for the whole country that declined by as much as 18 % (FSIS).

The **personal insurance** segment has continued strong growth throughout the period 2004–2008 (Figure 20). In 2008 it generated revenues of 7.4 billion rubles (Strakhovanie Segodnya). Furthermore, personal insurance premiums grew by 36 % in 2008 which was a significant acceleration from the more modest growth of 15 % in the previous year (see Figure 19 for time series on growth rates).

**Figure 20. Personal insurance: premiums collected and claims paid (thousand Rubles), 2004–2008**

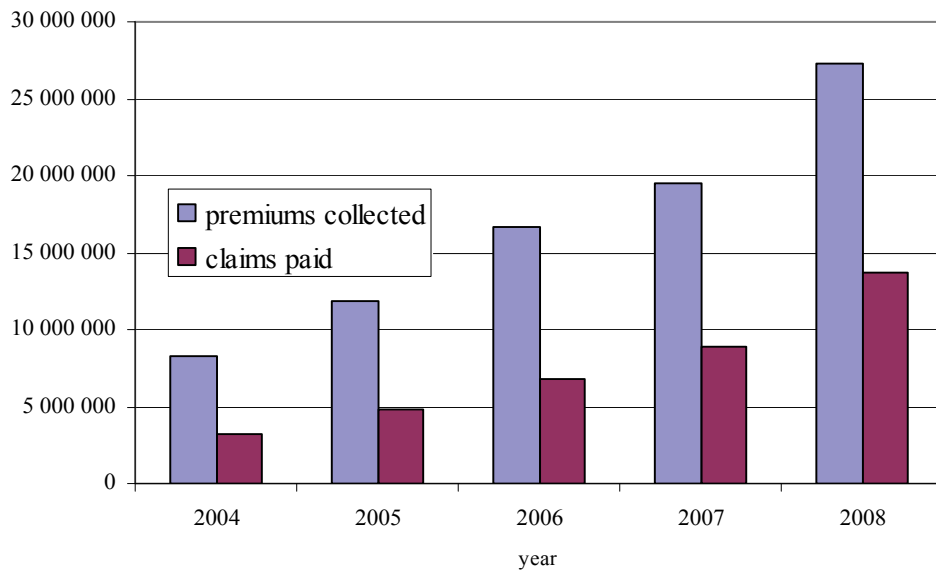


Source: Strakhovanie Segodnya

The personal insurance segment comprises approximately 12 % of the whole insurance market premiums, and its share has been increasing since the beginning of the 2000's (Strakhovanie Segodnya). In voluntary insurances personal insurance has the largest share (20 %) after property insurance. In the first quarter of 2009 sales in personal insurance increased from the same quarter in the previous year by 16 % as nearly all the other segments of voluntary insurance experienced negative tendencies (Strakhovanie Segodnya).

Similar to the personal insurance segment, property insurance was in 2008 one of the main sources of growth in St. Petersburg as well as the rest of Russia (Figure 20) with a growth of 39.5 % from the previous year. As can be seen from Figure 21 the property segment generated revenues of over 27 billion rubles in total. It is the largest single source of revenue both for total insurance revenues (48 %) and in the category of voluntary insurances (75 %).

**Figure 21. Property insurance: premiums collected and claims paid (thousand Rubles), 2004–2008**



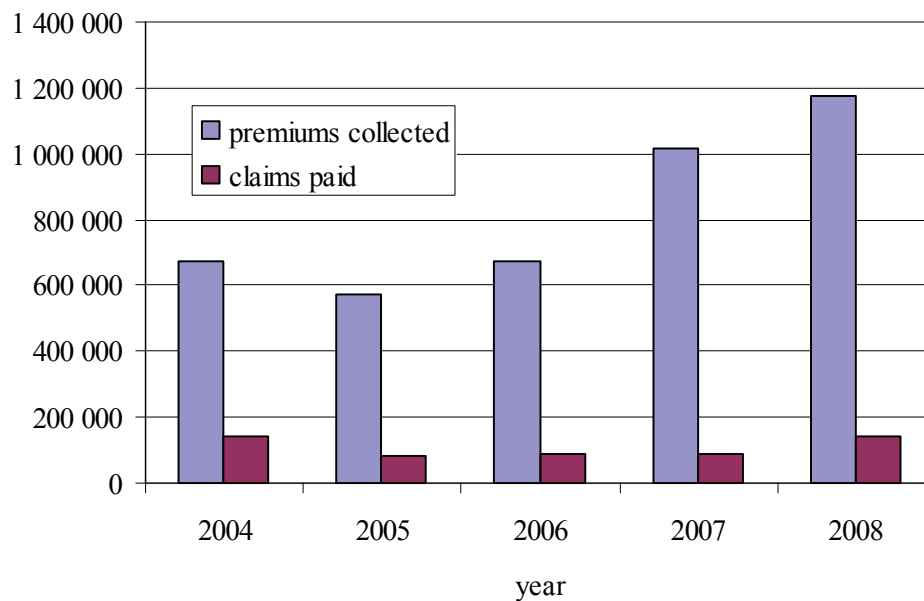
Source: Strakhovanie Segodnya

Clearly, one of the most important sub-segments of property insurance includes the voluntary motor insurance (KASKO), which represents a share of 46 % insurance premiums collected (Sologub 2009). In the last three years it was largely this segment that pulled the aggregate insurance market and its great growth rates. According to Expert RA rating agency, in the first half of 2008 (pre-crisis) total KASKO premiums collected nation-wide increased by 35.1 %. In the second half of 2008 the growth rate decreased to 15.3 % mainly because of the failing November and December (Yanin 2009b). The overall annual growth in 2008 as compared to the previous year amounted to 15 %. The worst is ahead: according to the rating agency's estimate, in 2009 the total premiums collected will be 25 % less than those in 2008 (Yanin 2009a). In the first quarter of 2009, the property insurance segment contracted by over 50 % mainly due to declining sales in motor insurances.

Finally, the **liability insurance** segment generated revenues of 1.2 billion rubles in 2008 (Figure 22), which resulted in a growth rate of 15 % on the previous year. The liability

insurance market is a proportionally small market in Russia and St. Petersburg; its share in the aggregate premiums collected is only 2 %.

**Figure 22. Liability insurance: premiums collected and claims paid (thousands Ruble), 2004–2008**



Source: Strakhovanie Segodnya

Despite its small size, the liability insurance segment is a considerably profitable segment as can be deduced from the graph above. Liability policy sales have grown in the latter part of 2000's with a considerably high rate, except of a slight reduction in 2005 (Figure 19). In addition, liability insurance segment clearly stands out from other segments by its low payment ratio.

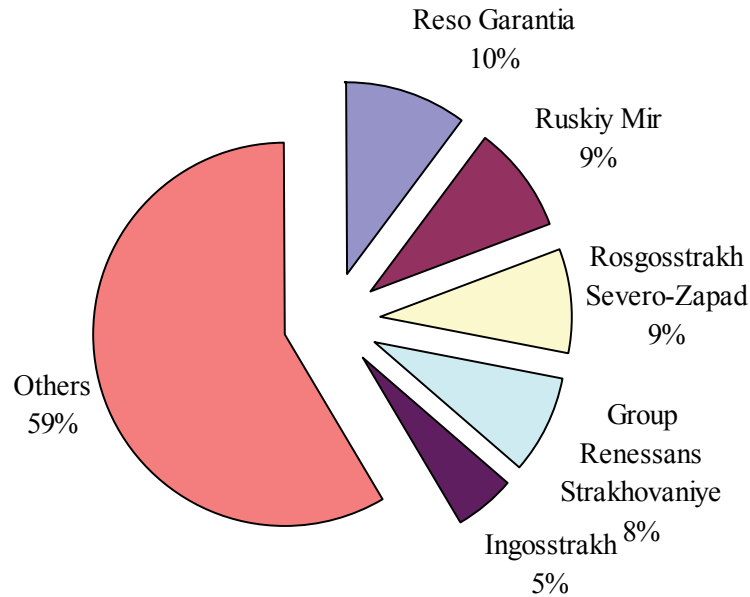
### **3.3 Key players in the St. Petersburg insurance market**

This section first introduces the main insurance companies in the St. Petersburg insurance market. Then we discuss the key players in the restricted segments of the market, namely the mandatory health and life insurance markets, which differ from the other insurance segments in market entry either due to strict regulation or small market size.

The competition in the insurance market in St. Petersburg has been tough in the recent years and the market has been fragmented. However, according to Expert RA, the consolidation in the market somewhat increased during 2007 and 2008. Among other reasons, the new regulations on mandatory motor insurance (OSAGO) accelerated this process. According to a manager from the company Russkiy Mir, an insurance company that cannot provide OSAGO policies would not survive in the markets (Sologub 2008).

The St. Petersburg insurance market is, nevertheless, slightly more concentrated than the overall Russian market. The five top insurance companies generating 36.5 % of all the revenues in 2008 (Strakhovanie Segodnya). In addition, the leading companies' list in the property insurance segment determines the overall ranking in the market. Consequently, Reso-Garantiya, the leading company in terms of revenues in the St. Petersburg property insurance market, has the first place in the insurance market as a whole as well. Figure 23 illustrates the distribution of the market shares among the five leading companies.

**Figure 23. Five largest insurance companies in St. Petersburg 2008\***



\* The market share is calculated from the total revenue in the Russian insurance market in 2008 excluding mandatory health insurance (OMS) because this segment is generally considered by experts (FSIS, Expert RA) separately when comparing insurance revenues.

Source: Strakhovanie Segodnya

Those insurance segments that are under heavy regulation, such as the OMS segment, or have special requirements for separate licensing such as the life insurance market, are comprised of companies that are specialized in those segments. Therefore the market ranking differs from the overall leading companies' list in St. Petersburg. Furthermore, specifically to Russia the liability insurance segment is dependant on demand from the public sector and, therefore, the leading two companies in liability insurances – Ingostrakh and Voyenno-Strakhovaya Kompaniya – have significant government ownerships and are specialized in insuring governmental institutions and ministries.

The consolidation process in the St. Petersburg insurance market started in 2005. It continued throughout 2007, when there was a surge of acquisitions and an inflow of foreign capital to the markets (Starikh 2008). The acquisitions of the recent years were

conducted both in view of consolidation and of becoming general insurers instead of concentrating on one segment only. In October 2008 some observers of the insurance market felt that the process of consolidation will continue, but with somewhat slower pace despite the financial crisis (Starikh 2008).

Furthermore, in 2007, the number of registered insurance companies in the St. Petersburg area fell from 63 to 56 (FSIS) due to stricter government requirements for insurance companies that has reduced their number considerably in the whole country (BOFIT 2008). Table 1 presents the five leading insurance companies in the St. Petersburg market.



**Table 1. Five largest insurance companies in St. Petersburg**

Ranking 2008	1.	2.	3.	4.	5.
Company	Reso Garantia	Russkiy Mir	Rosgosstrakh	Renessans Strakhovanie	Ingosstrakh
Revenues 2008 in St. Petersburg (thousand Rubles)	4 344 205	3 859 770	3 703 907	3 422 916	2 223 626
Main segments	- Market leader in OSAGO and KASKO sales in St. Petersburg	- largest provider of OSAGO-policies in the NWFD*, and of compulsory medical insurance in St. Petersburg	- licenses for nearly all types of insurance	- main focus on KASKO and OSAGO-policies	-main focus on corporate and retail insurance
Main shareholders	- 56.6 % privately owned - 36.6 % French AXA Group - 6.3 % EBRD <sup>20</sup>	- see Rosgosstrakh	- 25 % state ownership	- CEO Boris Jordan via his Sputnik Investment Company - EBRD	- >50 % direct and indirect ownership by oligarch Oleg Deripaska
Facts of interest	- sold 80 % of all KASKO policies in the NWFD* in 2008 - 3 <sup>rd</sup> largest company in Russia in the non-life insurance market	- recently acquired by Rosgosstrakh (3.) to create the largest insurance company to date in St. Petersburg.	- best known national insurance brand in Russia - largest number of branches in Russia as well as most extensive geographical distribution	- in the top ten of Russian insurance companies - a pioneer in developing insurance via the Internet in Russia	- the oldest insurance company in Russia - offices in 16 countries (mainly CIS), including the Finnish subsidiary IngoNord.

\* NWFD – North-Western Federal District: comprises of 11 regions of Russia, including St. Petersburg  
Sources: BOFIT 2008; Expert RA; Strakhovanie Segodnya; DataMonitor 2008; Reso-Garantia; Russkiy Mir; Rossgostrakh; Ingostrakh; Renessans Strakhovanie

All the major international insurance companies operating in Russia are also present in St. Petersburg. The German group Allianz has been investing particularly actively into the market in recent years and is a strong player in the St. Petersburg insurance market. (Starikh 2008) Currently, If P&C Insurance – that has had a representation in St.

<sup>20</sup> European Bank for Reconstruction and Development

Petersburg since the beginning of 2007 – is the only Nordic insurance company in Russia. Its Russian headquarters are located in St. Petersburg. If P&C operates both under its own brand name offering services mainly to Nordic corporate clients and through the recently acquired Region insurance company (IF-vahinkovakuutusyhtiö 2007).

Currently, half of the ten largest insurance companies in St. Petersburg have foreign shareholders (Dranitsyna 2008). The number of companies that are completely owned by foreign insurers is smaller, but their share is expected to increase as foreign investors become increasingly interested in the Russian market, said Pavel Muretov, head of the Northwest branch of Renaissance Strakhovanie insurance company quoted in St. Petersburg Times (Dranitsyna 2008). For example Allianz has already acquired almost full ownership in Allianz-Rosno that is in the top tier of insurance companies in St. Petersburg (Allianz-Rosno Life). Also the French owned AXA Groupe, a large international player, has a significant ownership in the biggest insurer in St. Petersburg – Reso-Garantia (see Table 1). The share of foreign ownership in St. Petersburg's insurance sector is likely to increase, especially if Russia joins the WTO. It will most likely happen by foreign companies acquiring local companies with large regional networks of offices, according to an analyst from FINAM Investment Company (Dranitsyna 2008).

### **3.3.1 Market leaders in mandatory health insurance (OMS)**

As explained earlier in this report, the OMS segment is highly regulated and licenses are hard to obtain. The market share is calculated from the total revenue in the St. Petersburg insurance market in 2008 excluding mandatory health insurance (OMS) because this segment is generally considered by experts (FSIS, Expert RA) separately when comparing insurance revenues. Even though this segment is a significant source of revenue in the market, it is severely regulated (therefore cannot be considered as a

competitive market. Currently, there are only 13 insurance companies in St. Petersburg, which have a license to sell OMS insurance policies (Table 2).<sup>21</sup>

**Table 2. Companies licensed to provide OMS-policies in St. Petersburg in order of premiums collected in 2008**

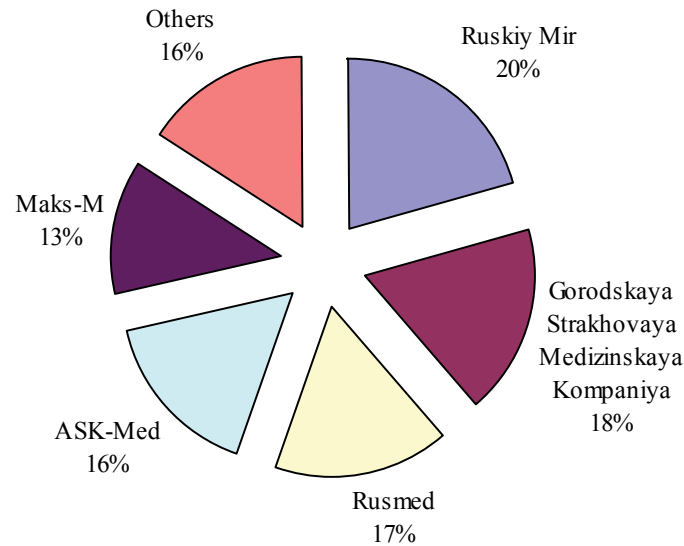
Ranking 2008	Company	Ownership
1.	Russkiy Mir	Part of Rosgosstrakh
2.	Gorodskaya Strakhovaya Medizinskaya Kompaniya	100 % -owned by the city of St.-Petersburg
3.	Rusmed	Part of ROSNO (and hence Allianz SE) as of June 4th, 2009
4.	ASK-MED	Information not available
5.	MAX-M	Rumored to belong to the ex-minister of healthcare and social development Mikhail Zurabov
6.	Reso-MED	56.6 % - founders, private Russian citizens 6.3 % - EBRD 36.6 % - AXA Group (foreign)
7.	Medexpressplus	Part of Allianz SE since 2006
8.	Rosno MS	99.4 % - Allianz SE
9.	Rossgostrakh Sankt-Peterburg Medizina	25 % minus one share - Russian Federation; rest - private Russian investors. Majority stake rumored to belong to Daniil Khatchaturov, current president of the company
10.	Gazprommedstrakh	Largely belongs to Gazprom and its affiliates
11.	Medstrakhkom	Part of Oslo Marine Group registered in St.-Petersburg.
12.	Vesta	Information not available
13.	Peterburgskaya Medizinskaya SK	Information not available

Sources: <http://www.ko.ru/document.php?id=18618>; <http://oslomg.rusmarket.com/>;  
<http://www.rusmed.spb.ru/>; <http://www.kommersant.ru/doc.aspx?DocsID=908977>;  
 FSIS; Strakhovanie Segodnya

As seen in the table, the OMS segment is relatively non-transparent. Information about the ownership of some of the companies is not available from public sources. Furthermore, some foreign companies such as the German company Allianz, have acquired a rather large share of the OMS market in comparison to other segments through acquiring local players which have already had a foothold in the OMS sector. Overall, the OMS market is fairly restricted to new entrants and has relatively few participants with equal shares of the market (Figure 24).

<sup>21</sup> [http://www.spboms.ru/kiop/main?page\\_id=77](http://www.spboms.ru/kiop/main?page_id=77)

**Figure 24. St. Petersburg Insurance Market 2008: Mandatory Medical Insurance – Largest Companies**



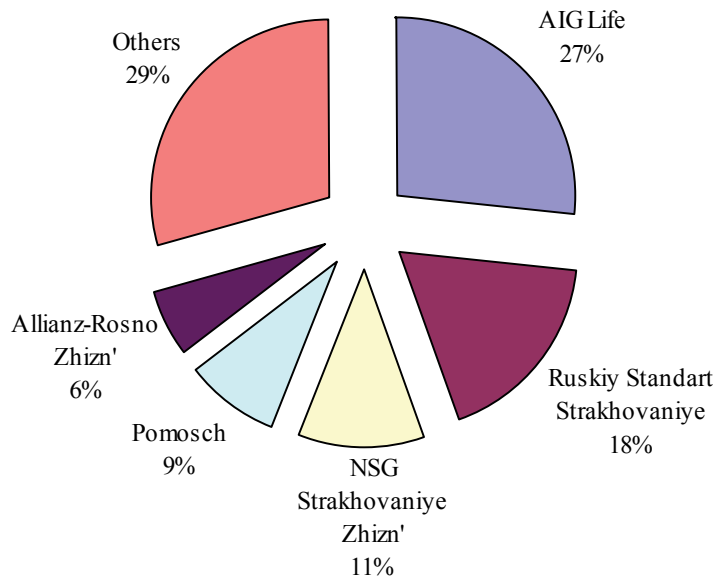
Sources: Strakhovanie Segodnya

As shown in the figure, the largest provider of OMS insurances in Russia and in St. Petersburg is Russkiy Mir. It had in 2008 revenue of 3.1 billion rubles and paid claims nearly for the same amount (3.05 billion Rubles) in OMS claims. Hence, the OMS segment despite its relatively large size can not be said to be a very profitable segment for insurers.

### **3.3.2 Market leaders in the life insurance market**

As discussed in the previous chapters of this report, since 2007 the same company cannot operate in the life and non-life markets. Consequently, many of the largest companies have established separate companies specialized in life products only. Despite this, the list of leading companies in the life insurance in St. Petersburg differs significantly from the other market segments.

**Figure 25. St. Petersburg life insurance market – Key players in 2008**



Source: Strakhovanie Segodnya

The St. Petersburg life insurance market is relatively concentrated with the five top companies generating 71 % of the revenues in 2008. This is in contrast to the overall Russian market that has a more fragmented structure (DataMonitorLife 2008). Table 3 presents the top five companies in this segment.

**Table 3. St. Petersburg insurance market: largest players in life insurance market 2008**

Ranking 2008	Company	Ownership	Facts of interest
1.	AIG Zhizn'	Part of the American AIG Group	- AIG has operations in 130 countries and is one of the world's leading insurance and financial services organizations.
2.	Russkiy Standart Strakhovanie	Part of the Russkiy Standart Group	- had the largest share in the life insurance markets in St. Petersburg in 2007 and Russia - the Russian Standard Group has three major branches: retail banking, production and distribution of alcohol products and premium-class insurance
3.	NSG Strakhovanie Zhizn'	Affiliate of the Nazionalniy Strakhovoy Grup	-the Nazionalniy Strakhovoy Grup, founded in 2004, specializes in life insurances. It has offices in 79 different regions in Russia.
4.	Pomosch	Information not available	- operations concentrated in the NWFD*. - has the license to offer all kinds of insurances in Russia, currently specialized in life and property insurances, compulsory liability insurances relating to government contracts, and insurance policies against financial risk
5.	Allianz-Rosno Zhizn'	Major shareholder is Allianz New Europe (holds 99,9 % stock interest) that is part of the German international insurance conglomerate Allianz SE.	- 60 affiliates and subsidiaries in different parts of Russia - In addition to life insurance specialized in OMS policies, pension plans and accident insurance.

Sources: Strakhovanie Segodnya; Russkiy Standart; AIG Life; DataMonitorLife; <http://www.allianzrosnolife.ru/about/general.php>

Foreign companies, namely AIG Zhizn' – the largest provider of life insurance in St. Petersburg – and Allianz Rosno Zhizn' have a strong foothold in the Russian life insurance markets. AIG has concentrated largely on life segments while the German Allianz has increased its share in different companies in the non-life sector. In particular, in 2008 AIG Life increased its market share aggressively in 2008 to 26.5 % and took the number one place in the life markets from Russkiy Standart Strakhovanie.

\* NWFD – North-Western Federal District of Russia

### 3.3.3 Recent mergers and acquisitions

This section concludes with an overview of some recent mergers and acquisitions on the St. Petersburg insurance market. First, on the 19<sup>th</sup> of February the board of directors of Russkiy Mir (RM) insurance company – largest St. Petersburg based insurance firm – announced that the company would be acquired by Rosgosstrakh (RGS) – Russia's largest insurer.<sup>22</sup> The price of the deal was not disclosed.<sup>23</sup> The combination of the two insurers created a single largest insurance company on the St. Petersburg market with the total combined premiums collected in 2008 amounting to more than 7.5 billion rubles. To compare, the closest competitor – RESO-Garantiya sold 4.3 billion rubles worth of insurance products in the same period. (FSIS) Experts also point out the positive complimentary effect of the two firms: RM traditionally had strong position in the personal and property insurance segments, whereas RGS is one of the leaders in the automobile insurance segment.<sup>24</sup>

The strategy of Russkiy Mir has, however, been mostly based on the aggressive increase of market share at the cost of profitability. In the recent years the company has been actively expanding its subsidiary network and building up its client portfolio, often by selling highly unprofitable products. As a result, half of RM's subsidiaries showed losses by the end of 2008. (Expert 2009b) The company did not wait for its financial situation to worsen under the economic crisis but chose to merge with Rosgosstrakh which can provide financial aid to its newly found partner.

Market participants have several contradicting opinions on the expected results of the integration of RM and RGS and its effect on the market. Some claim that there will be no adverse affects for the two companies and the total market share will simply be the sum

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<sup>22</sup> <http://www.insur-info.ru/pressr/22783/>

<sup>23</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/TLEA-7RZB75130509137?OpenDocument>

<sup>24</sup> [http://www.dp.ru/a/2009/02/24/Rosgosstrah\\_pogloshhaet\\_](http://www.dp.ru/a/2009/02/24/Rosgosstrah_pogloshhaet_)

of the two<sup>25</sup>. Other experts are very skeptical about the prospects of the merged company and expect a re-allocation of market shares (Expert 2009b).

Another acquisition that took place after November 2008 was the acquisition of 100 % of Sheksna insurance company by SOGAZ. This deal is less important for the current market situation in St. Petersburg, since Sheksna's market share is negligible in the city. However, the positions of both firms are stronger in the North-West Federal District of Russia. According to some estimates, the two combined firms will take the 2<sup>nd</sup> place (after Rosgosstrakh) in the Federal District by premiums collected with obligatory medical insurance.<sup>26</sup> Experts estimate the purchase price to be around 2 billion rubles. (Expert 2009a)

The reasons for these acquisitions are manifold. On the one hand the prices of assets have gone down and acquisitions are more attractive to acquirers nowadays. On the other hand, like mentioned above, many insurers are experiencing liquidity problems and selling the only way for their owners to maintain their dignity and not default on the liabilities the companies have to their clients. For example Russkiy Mir is said to have been managed in a non-sustainable fashion and was expected to have liquidity shortages in the near future unless acquired by Rosgosstrakh. (Expert 2009b)

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<sup>25</sup> <http://www.indur-info.ru/press/331328>

<sup>26</sup> <http://www.insur-info.ru/news/12925>



## **4 Expert views of the St. Petersburg insurance market**

After presenting the general statistics for the St. Petersburg insurance market, this chapter will continue by a qualitative analysis based on interviews with Finnish and Russian insurance professionals and literature on the St. Petersburg insurance market. Topics to be discussed include the general and recent tendencies and challenges in the St. Petersburg market as well as future perspectives.

### **4.1 Legislative aspects and state regulation**

The experts interviewed for this study shared the view that the legislation and regulation concerning the insurance market in Russia has in general developed into a positive direction. Despite observed restrictions for entry to the Russian insurance market and its small scale, the attempts to modernize the legislative and regulatory environment in the recent years are perceived as increasing the attractiveness of the market.

*“I think a fundamental change in legislation occurred in the middle of the year 2007 when a new act came into force. According to it, insurance companies were to be separated into those doing life insurance and non-life insurance. Consequently companies with the ‘life’ prefix started appearing in our country: Rosgosstrakh-Life, Allianz-ROSNO-Life... And it was 2007 when the market was penetrated by the largest world insurers. (Evgeniy Egorushkin, Allianz ROSNO Life/28.02.2009)*

However, the frequent introduction of new laws causes major difficulties for the insurance companies to keep informed about the new requirements. Furthermore, the interviewees view that many laws and regulations contradict each other. As a result, even legal compliance is difficult. There is no means of preparing for majority of the changes, as companies are not informed of new amendments in the regulations a priori. In particular, the amendments introduced to the OSAGO system evoked criticism:

*“For example the transition to EuroProtocol in motor insurance that is a major change for insurance companies [...] A few weeks before it would come into force insurance companies had no idea of all the details of the changes required [in their operations] and a week before [the enforcement date] some changes were announced to the regulations.”* (Ville Haapalinna, IF P&C Insurance/23.2.2009).

It is particularly challenging for foreign companies to keep track of changes in legislation and regulatory requirements, due to which they need to invest in legal services:

*“In Russia, compared to other [emerging] markets like the Baltic countries, a bigger ‘army of lawyers’ is required only to ensure legal compliance.”* (Ville Haapalinna, IF P&C Insurance/23.2.2009).

Furthermore, the interviewees note that hired legal professionals should have knowledge and experience in the administrative region in question. A lawyer that has operated in Moscow may not be so successful when dealing with the St. Petersburg officials because local laws and regulation as well as legal procedures differ from one region to another. Therefore, a different lawyer for each region is advisable. However, this ‘army of lawyers’ can become costly.

*“I know a lot of cases...for example small enterprises can’t come to Russia because they don’t have the resources to hire all the lawyers, consultants and experts”* (Finnish banking and insurance professional employed in St. Petersburg/26.2.2009)

In addition to the lack of information about the regulations, the insurance actors’ preparedness to implement them is viewed as insufficient:

*“Direct refund is a convenient mechanism for receiving the claim; it’s common in international practice. And naturally Russia should reform the OSAGO system following*

*that in Europe. But so far the OSAGO market is not ready for direct refund.” (Denis Chigarev, Renessans Strakhovanie)<sup>27</sup>*

The insurers are not too enthusiastic about the implications legislative innovation concerning the citizens’ freedom to select the OMS policy provider, although the change as such is viewed as positive.

*“We are positive about any actions aimed at achieving free market selection by the insured themselves. Only such selection may lead to effective motivation of medical insurance organization to approach citizens individually and to perform its functions in high quality manner. [...] Significant market re-allocation will not be quick to take place. As the experience in Perm’ region shows<sup>28</sup>, the citizens are quite inactive in their individual search for more efficient insurer.” (Press-release of Rosgosstrakh Severo-Zapad)<sup>29</sup>*

Moreover, the cooperation with state officials, including burdensome bureaucracy and corruption, is viewed as a significant impediment to business in St. Petersburg as well as in the rest of Russia. Multiple inspections by different authorities are perceived as hampering the business activity of foreign and Russian enterprises alike.

*“I haven’t noticed that they target foreigners [with inspections] in any special way. Of course there are these infamous cases like TNK-BP where it’s clear that they were targeted because they’re foreign.” (Finnish banking and insurance professional employed in St. Petersburg /26.2.2009)*

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<sup>27</sup> Denisenko, E. (2009a) Офф-роуд для ОСАГО. «Эксперт Северо-Запад» №12, 2009

<sup>28</sup> Perm’ region was the first one to adopt the procedure (see [http://www.pofoms.ru/prava/docs/rassmotr\\_zhalob.rtf](http://www.pofoms.ru/prava/docs/rassmotr_zhalob.rtf))

<sup>29</sup> <http://www.fontanka.ru/2009/04/01/126/>

According to the Finnish interviewees, everything from opening bank accounts to licensing and registration requires local assistance to get it right. In addition, the interpretation of the law can depend from official to another and from region to another.

As illustrated by a Finnish banking and insurance professional residing in St. Petersburg interviewed for the study (26.2.2009), only the health certificate to receive a work permit for a foreigner in St. Petersburg requires 10 stamps from 10 different officials. When applying for operating licenses, work permits etc., one should make sure with the help of local consultants and legal professionals that *“all the required paperwork is done right down to the last detail as correcting them afterwards is ‘absurdly’ hard and can result in being summoned to court”*.

However, the view that the insurance regulator’s (Federal Service for Insurance Supervision) conduct and operations have improved in the recent years, is shared by both Finnish and Russian respondents. As noted by a Russian interviewee:

*“Concerning regulation I would like to note that there is supervision on behalf of Rosstrakhnadzor [Federal Service for Insurance Supervision] and on behalf of RSA [Russian Motor Insurers’ Union]. It is not getting worse. In fact, it is very good. Moreover, we see that they really try hard. They will have a hard time now – it’s understood. But in the last three years the amount of dishonest companies and schemes has decreased. So everything that happens is for the best.”* (Sergei Brovko, RESO-Garantiya/27.02.2009)

A Finnish respondent confirms that there have been some improvements in the FSIS’s activity in the recent years, although there is still room for improvement in the general legislative framework:

*“Positive is the fact that they [FSIS] seem to have ‘woken up’. Monitoring and surveillance has increased considerably, but when considering deficiencies in legislation*

*and protectionism that's practiced in the insurance market in Russia, I wouldn't say that the market has modernized much.” (Katriina Tala, Pohjola Insurance Ltd/5.3.2009)*

In particular, the regulator's actions against illegal schemes and money laundering have been noticed as having an effect:

*“Last year there was a situation where a small company that was last in the [ranking] list suddenly made billions worth of revenue. Off course when the insurance regulator investigated the company it lost its license. In a couple of big companies they said they were selling insurances, but they really weren't even though it was in their books. When the money was returned there was suddenly payments worth of billions. But it's not normal.” (Igor Panfilov, A24/27.2.2009).*

To sum up, the general view is that the regulatory environment is gradually developing into the direction of being more rule of law based and transparent. In addition, the predictability in the market has increased with regard to the actions by the insurance supervisor FSIS. The Finnish interviewees, however, point to a number of deficiencies in the insurance market and the related legislative framework:

*“Preconditions of insurance policies in Russia have been gathered by using the 'copy-paste-method' from international brokers' conditions. There can be unexpected conditions for compensations or exclusions because these preconditions have been gathered from here and there.” (Katriina Tala, Pohjola Insurance Ltd/5.3.2009).*

Finally, from the foreign insurance policy buyers' viewpoint, all the required insurance products are not available, they do not have sufficient coverage especially in mandatory insurances or the pricing does not correspond to coverage (Katriina Tala, Pohjola Insurance Ltd/5.3.2009). These problems become especially sensitive when foreign companies that want to enter Russian markets or their subsidiaries need insurances for bank loans.

## 4.2 Market environment

After presenting the industry professionals' views of the institutional environment (i.e. state regulation), we now focus on the developments observed in the market environment. This includes consumer behavior, sales channels and availability of labor as a central resource for the insurance industry. In addition, the competitive landscape is discussed.

### 4.2.1 Consumer behavior

As illustrated earlier in this report, the fragmented insurance market in Russia has been infested by illegal schemes and payment defaults until recently. Therefore, it is no wonder that the population is not aware of insuring, its benefits or have little faith in insurance companies. From a foreigner's point of view:

*"Intrinsic in Russian culture is the adaption to new situations and acceptance of change [...]. The overall mentality in Russia seems to be that when there is money, it's used up and when there is no money it's not used. They don't worry too much about the future."* (Ville Haapalinna, IF P&C Insurance/23.2.2009)

However, it is important to note that insuring has been available only for two decades compared to a centennial in Finland:

*"Understanding of risk and knowledge of the nature of risk is still very young. Traditionally, they have only insured cars and that's it."* (Katriina Tala, Pohjola Ltd/5.3.2009).

This view is shared by the Russian insurers as well. According to Igor Panfilov, from the insurance broker company A24 in Russia *"the middle class does not insure."*(27.3.2009). Moreover, the interviewees pointed out that the low opinion of the Russian population about the insurance companies' reliability is not completely unjustified:

*“As long as insurance companies have no trust amongst the population and the processing of claims takes a long time and payment for claims cannot be trusted, Russians will not increase their demand for insurances”.* (Igor Panfilov, A24/27.2.2009)

As a consequence, the insurers view that the main competitive advantage in the market is not the price of the policy, but the reliability of the company, manifested by the quality of procedures such as fast processing of claims and due payments. Customers are very loyal to companies that can provide reliable service (Igor Panfilov, A24/27.2.2009).

Furthermore, the awareness of insurances among the population has been increasing as insurance companies have become larger, illegal schemes have mostly disappeared and the regulation for insurance market has improved. However, it is still common that in Russia people are not aware of their rights as policy holders:

*“The insurance market is still young and people are not aware of all their rights [as customers], which in part can reduce claims cost for insurance companies.”* (Ville Haapalinna, IF P&C Insurance/23.2.2009)

Nevertheless, once the development towards insuring has started it cannot be turned back as people and corporations start to see the benefits of insuring more and more (Katriina Tala, Pohjola Ltd/5.3.2009).

In addition to increased awareness of insurance, the economic crisis has made the clients more demanding when buying policies:

*“The new economic conditions induce clients to analyze. During the last year [2008] we have seen changes in the customers’ behavior: they have adopted a careful attitude*

*towards the choice of the supplier of insurance services. Also they carefully evaluate not only the tariff, but also the quality of the service.” (Andrey Martjanov, MAKS)<sup>30</sup>*

In addition, the expected wave of insurance companies’ bankruptcies will show the people that the lowest price is not always the best decision factor when buying a policy. Hence, crisis is the time for insurance companies to gain loyal customers as the reliability of an insurance company becomes the most important criterion for customers.

*“During the crisis the very insurance protection is on the forefront of importance for the consumer. Earlier the person could afford not to insure and in case of unforeseen circumstances usually could find the means to cover the loss. During the crisis that has lead to decreasing salaries, credit restrictions and other consequences, finding a way to cover for unplanned expenditures has become much more complicated.” (Maksim Chernin, Allianz ROSNO Life)<sup>31</sup>*

In the long-term the ongoing financial crisis could result in positive development in customer preferences.

*“There are stimulating factors for the development of the insurance market. It is the growing insurance culture of the Russian society, slow, but notable. It is the guarantee of insurance market growth in the future. The crisis has become some sort of a catalyst for increasing the insurance awareness of the population.” (Galina Maksimova, Rossiya)<sup>32</sup>*

Customer preferences are expected to follow the development of Western countries and customer awareness of insuring will increase. This would increase the volume of voluntary, personal and property insurances in the future and make customers more demanding. As the insurance market in Russia has been severely fragmented there has

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<sup>30</sup> Yanin, A. (2009b) Последний тучный год. «Эксперт» № 17-18, 2009.

<sup>31</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7PKDMC240209283?OpenDocument>

<sup>32</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7RDC2C230409790?OpenDocument>



been small companies specializing in particular segments. In the future customers prefer to get all their insurances from one company:

*“For corporate clients there will be a shift towards packaged (integrated) insurance. In other words, now it is either medical insurance, or liability or something else. There will be a switch to packaged insurance. There will be tender offers for selecting the insurer of all. Like, you are supposed to be able to do this, this, that etc. And so five [largest locally present] insurers plus three outsiders will participate in the tenders offers. We have packaged products for small business, but medium and large business has a more systematic approach. That we have not yet achieved. (Sergei Brovko, RESO-Garantia/27.02.2009)*

Furthermore, in times of crisis direct insurance sales could become more attractive to customers:

*“Liquidity problems will lead to decreased mortgage and automobile credit volumes. As a consequence, the volume of insurance coming from the bank channel will decrease. Never the less, this has become an incentive for the intensification of sales via agents and direct sales. Since during the crisis economizing issues are of special importance, we expect high demand for direct insurance products. These allow the customer to purchase a policy with a significant discount – up to 15 % - since under this sales channel the client effectively takes care of part of our work.” (Pavel Muretov, Renessans Strakhovanie)<sup>33</sup>*

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<sup>33</sup> Sologub, A. (2008) Зона рискованного страхования. «Эксперт Северо-Запад» № 7, 2009

#### 4.2.2 Sales channels

The majority of insurance sales in Russia are conducted traditionally through sales agents. In the recent years the sales channels have, however, started to diversify. Traditional distribution channels have been seriously harmed by the crisis:

*“The insurance market is losing its main sales channels: banking channel – due to the shrinking of credit programs; broker – due to decreased demand for automobiles; corporate sales – due to the reduction of the enterprises’ free cash; direct and agent sales – due to decreased consumer income and, consequently, changed consumption pattern.” (Rustem Garaev, MSK-Standard)<sup>34</sup>*

In particular, the economic crisis, which first affected the banking sector, has resulted in the suspension of bancassurance<sup>35</sup> policies for the time being and the credit insurance market has fallen down to a state of stagnation (Denisenko 2008). Bank insurance makes up a third of the revenue for the biggest insurance companies in the North-Western region. The future developments of the banking sector and credit insurance will depend on the developments in retail credit markets as well as on the global financial markets.

Despite the financial crisis, insurance companies in the North-Western region would like to deepen their cooperation with the banking sector. For example bancassurance in its classic form does not exist in practice in Russia even though it could be offered by insurance companies (Denisenko 2008). Most of the cooperation between insurance companies happens only in the field of credit insurance. Insurance market professionals believe that there would be great potential in deepening this kind of cooperation due to the positive examples of bancassurance in Central Europe (Denisenko 2008).

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<sup>34</sup> Yanin, A. (2009b) Последний тучный год. «Эксперт» № 17-18, 2009.

<sup>35</sup> Bancassurance is a term used to describe the partnership or relationship between a bank and an insurance company whereby the insurance company uses the bank sales channel in order to sell insurance products.

There have been three different problems in deepening cooperation with banks. First, the current legislation is not clear on bancassurance even though it does not pose direct restriction on its use. Secondly, there are different levels of maturity in the insurance and banking markets. The insurance sector is growing faster and at the moment the banking sector has more consolidated competitive positions. Therefore banks have less interest in cooperation than insurance companies that are constantly looking for new competitive angles. Thirdly, the banks do not see the potential for selling insurance products. For example the voluntary car insurance (KASKO) could be a potentially profitable joint product. However, here the car retailers have taken the leading position that is hard to contest (Denisenko 2008).

The growth of bancassurance in more developed countries has been due to the growth in construction and housing credit markets that are now contracting globally. Other insurance products like life insurance are not in demand currently in Russia (Denisenko 2008). Nevertheless, some insurance companies like Allianz-Rosno are actively developing products for alternative sales channels. They believe that by making the sale simple enough with the help of easy-to-use on-line programs, the threshold for selling insurance products will be lowered for bank employees and managers (Denisenko 2008).

When the traditional sales channels suffer under the crisis, the insurance companies face with the dilemma of how to survive the crisis that requires some reductions in staff and operations but still maintain an operational ability, customer base and sales channels that will enable the companies to resume growth when the economic situation improves.

Direct sales, particularly through the Internet, can be said to have been one of the innovations of the year 2008 in the insurance market in Russia and St. Petersburg. The advantages of this marketing channel have been noticed in the markets:

*“We have the opportunity to give 15–20 % discounts because our company unlike other firms doesn’t pay high commissions to middle-men which can account for 20–25 % of the*

*insurance premium. So there is a certain saving for us the major part of which we transfer to our customers.” (Sergei Kovalchuk, CIT Finance Strakhovanie)<sup>36</sup>*

However, because the very idea of phone or Internet sales is still new to the general public, some insurance market professionals see that the majority of Russians are not yet accustomed to impersonal purchases of policies.

*“In my view the level of direct sales in any country depends to a large extent on the mentality of the people: the higher the wish to save money the higher is the level of [direct] sales. In Russia, in my opinion, because the market is young and developing and when taking into account that customers have a high demand for quality and strong habit in dealing ‘eye to eye’ with their insurer, the share of direct sales will not exceed 5 %.” (Dmitry Bolshakov, Director of RESO-Garantia subsidiary in St. Petersburg)<sup>37</sup>*

Moreover, the experts interviewed for this study point out that the direct sales do not have yet an established system for payments and claims, which is sufficient enough to put off many potential customers.

*“Renessans [Strakhovanie] announced that they too have it [direct sales through the Internet]. But at the moment there is no trust. Somebody will take it of course because its 20 % cheaper. But at the moment nobody knows the brands and how it works. Of course the insurance company will take money and when there is an accident nobody knows how the payment mechanism and the procedure to claim compensation works.” (Igor Panfilov, A24/27.2.2009)*

The practicality of these sales would be greatly enhanced by the possibility to pay on-line, the introduction of which involves safety and security issues. Solution to these problems

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<sup>36</sup> Komleva, N. (2009) Идти прямой дорогой. «Эксперт» № 17-18, 2009

<sup>37</sup> Krilov, A. (2008) Страховщики ушли в Интернет.  
<http://www.kommersant.ru/doc.aspx?fromsearch=c64c2280-3c92-4556-a85f-1985cf94271e&docid=1033253>

would also require some legislation changes. Moreover, the verification of a new client's identity in the Internet could also cause problems. (Vladimirova, 2008)

Furthermore, some industry experts are somewhat doubtful about the whole notion of direct insurance being cheaper, especially in the automobile insurance segment:

*“Especially suspicious are those entities that lower the tariff on KASKO [voluntary motor insurance] by 30–40 % supposedly due to the absence of commissions to their agents. However, the advertisement costs of these companies, according to expert estimates, are comparable to that particular “absent” commission.” (Igor Aleksandrov, Ingosstrakh)<sup>38</sup>*

Some industry participants are skeptical about the further development of Internet and phone sales due to the significant investments needed to build the necessary infrastructure. In addition, since there are no agents who could promote the insurance company, the insurer has to invest heavily in advertising:

*“Since the means of promoting the products in the form of middle-men is not there, the only way to convey the information about one's insurance company is advertisement. The advertisement expenses of Russian direct insurers are comparable or even higher than the commission costs of the traditional insurance companies. Not to mention the costs of the other business process [establishing the on-line service and call-center]” (Vitaliy Knyagichev, Ingosstrakh)<sup>39</sup>*

Experts evaluate the average pay back period for the direct sales project to amount to 4–5 years:

*“If we evaluate the short-term planning horizon, the costs associated with direct insurance are much higher than those under classical product promotion. However, there*

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<sup>38</sup> Yanin, A. (2009a) Демпингующие камкадзе. «Эксперт» № 9, 2009

<sup>39</sup> Komleva, N. (2009) Идти прямой дорогой. «Эксперт» № 17-18, 2009

*are significant competitive advantages which in the long-term will have a significant [positive] influence on the business.” (Mikhail Murin, VTB Insurance.)<sup>40</sup>*

To conclude, the general view of the experts is that a wide-scale adoption of direct sales will not appear in the near future, but that development towards adoption of phone and Internet sales is an important trend in the market.

#### **4.2.3 Availability and quality of labor in the insurance sector**

In addition to the consumers’ general attitude towards insurance and their buying behavior, the short history of the insurance market in Russia shows also in the availability of industry professionals. The interviewees raised the problem of finding staff as a feature typical to the St. Petersburg insurance sector:

*“Now there is personnel available, but it has been quite difficult to find staff especially when the economy was in upswing and so forth. Also, if you remember that St. Petersburg is not such a cheap city and you think about how much are the costs for office premises, getting qualified staff is fairly expensive.” (Ville Haapalinna, IF P&C Insurance/23.2.2009)*

The shortage of labor is, however, temporarily alleviated due to the economic crisis and increased unemployment:

*“Until recently [before the crisis] the job market was highly overheated. If half a year ago employees requested the money they were hardly worth, now we can hire highly professional specialists for comparable compensation. The demands of new coming potential workers have gone down by 20–30 %... [...]While in other financial sectors there is shrinking of operations due to decreasing demand, insurance has all prospects for further development. That is why during the crisis almost all insurance companies*

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<sup>40</sup> Komleva, N. (2009) Идти прямой дорогой. «Эксперт» № 17-18, 2009

*have the opportunity to improve the quality of their staff.” (Maksim Tchernin, Allianz ROSNO Life)<sup>41</sup>*

Furthermore, the overall personnel quality in the insurance industry is perceived as rather low. Historically, at the initial stage when the insurance companies as such were emerging, they employed people who came from other industries and did not have any insurance education. They were learning on the job. It took time for universities to develop new study programs for future insurers, and even now the level of higher insurance education is perceived as rather low both in terms of quality and quantity:

*“Even now good higher education in the Insurance specialization can be obtained only on the insurance departments of Academy of National Economy under the Government of the Russian Federation, Russian Economic Academy, State University of Management, Moscow State Institute of International Relations and some others. However, every year the amount of these departments’ graduates in Moscow is just slightly more than 100 persons. And even these universities are criticized for insufficiently narrow specialization of education, for the gap between the study programs and real practice of insurance work.” (Aleksandr Millerman, Gefest)<sup>42</sup>*

An obvious solution for the problem of finding qualified labor would be that the insurance companies would provide training themselves. However, the representatives of the educational institutions criticize that few insurance companies take the effort to provide additional on-going training to their employees:

*“I have always been amazed and worried of how little attention the insurance society pays to education. Education in the broad sense: not only university degree, but also the*

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<sup>41</sup> <http://www.insur-info.ru/interviews/548/>

<sup>42</sup> <http://www.insur-info.ru/analysis/587>

*extended education ...The insurance companies are simply passive.” (Mikhail Eskindarov, Finance Academy under the Government of the Russian Federation)<sup>43</sup>*

Furthermore, due to the economic crisis the overall insurers’ spending on additional training of their staff is decreasing even more, and only the market leaders are increasing their spending on training:

*“In the last three months our recruiting and education expenses have gone up by more than 20 %. And I am sure that these investments will pay off. In 2009 we also make provisions for the increase of financial consultants’ budget rather than decrease.” (Maksim Tchernin, Allianz ROSNO Life)<sup>44</sup>*

Moreover, university professors claim that very few insurance companies partner with academia in order to achieve better results, and those who do, are usually market leaders who aim at achieving tailored programs:

*“Unfortunately, the scale of cooperative work with the insurers is not as significant as one would hope. Mostly it is tailored programs for specific companies like RESO-Garantia, Ingosstrakh [both in the top 5 insurance companies according to Expert RA rating agency]<sup>45</sup> etc.” (Mikhail Eskindarov, Finance Academy under the Government of the Russian Federation)<sup>46</sup>*

Moreover, the institutions training insurance agents are concentrated in Moscow, whereas educational institutions located in St. Petersburg do not have any programs for insurance agents. Here, the insurers have to largely rely on their own training programs. The representatives of leading insurance companies do not share the view of university professors as being passive in this respect:

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<sup>43</sup> <http://www.insur-info.ru/interviews/451/>

<sup>44</sup> <http://www.insur-info.ru/interviews/548/>

<sup>45</sup> <http://raexpert.ru/ratings/insurance/>

<sup>46</sup> <http://www.insur-info.ru/interviews/451/>



*“So during the crisis we have once again appraised the importance of quality agent network. We, more than other companies, work with the agent network teaching and informing them. We have the so-called RESO School. We have it in St. Petersburg as well. Here we perform the selection, teaching and further extended teaching..”* (Sergei Brovko, RESO-Garantia 27.02.2009)

Furthermore, although it is understood and mutually agreed by all market participants that well qualified sales agents contribute to an increase in sales, there are obstacles to achieving the necessary quality. One of the main issues here is the overall cost and organizational challenge of efficient training programs. Very few insurance companies can afford constant training of their staff. This luxury is limited only to the top players on the market and those who possess the necessary financial support from their owners:

*“Recently we had a very good trainer visiting from Canada. Unique trainer. One of the world’s best trainers in life insurance...Not every company can afford to invite a highly paid trainer.”* (Evgeniy Egorushkin, Allianz ROSNO Life 28.02.2009)

Another important issue is the education of agents who are specialized in corporate sales:

*“Our agent network is aimed at retail sales. And corporate as well of course. But the [corporate sales] agent has to be educated better. Because a regular [retail] agent has the following statistics: if he conducts many meetings, eventually after 10–20 meetings he will find at least two clients. But if we take corporate sales, one must work in a more narrow fashion and have a different qualification. It doesn’t work so that many meetings lead to sales – one must be qualified.”* (Evgeniy Egorushkin, Allianz ROSNO Life 28.02.2009)

In addition, the insurers point out to the shortage of professionals who could make a quality evaluation of construction and development risks, which in turn has an adverse effect on the quality of setting the liability insurance tariffs. (Basova 2009)

In general, the market leaders are increasing their investments into their sales agents' qualification, and are also using the current job market situation to expand their sales networks:

*“This year Rosgosstrakh intends to increase its agent network by hiring new insurance agents. They will all be educated at the expense of the company and will be well motivated to sell any products including the insurance of property, health and life. Even further we will fight for client service and invest.” (Sergei Rabtsun, Rosgosstrakh)<sup>47</sup>*

All respondents indicate the importance of qualified sales agents especially under the incumbent financial crisis.

*“Our practice shows that in the regions where there is qualified staff, i.e. qualified management and qualified and well-trained agents – the sales are good in such regions. For example we have one agent in Vladimir who collects the same amount of premiums as a whole agency in St. Petersburg!” (Evgeniy Egorushkin, Allianz ROSNO Life 28.02.2009)*

In addition to the ability to sell, the trustworthiness and skills of agents are crucial as insurance fraud becomes more common in economically difficult times.

Nevertheless, despite the challenges related to staff quality there is a common belief in the market that the overall level of management of the St. Petersburg-based insurance companies is rather high:

*“St. Petersburg still has some insurers that are interesting and are confident in their future. The market is highly attractive in terms of its employees: the top-managers have always been in the position of crisis managers aiming to resist the pressure of federal players. St. Petersburg innovations are the key competencies that allow the local insurers*

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<sup>47</sup> [http://www.expert.ru/printissues/siberia/2009/10/qa\\_rubcun/](http://www.expert.ru/printissues/siberia/2009/10/qa_rubcun/)

*not only to survive, but successfully compete with federal monsters.”* (Sergei Safronov, Avesta)<sup>48</sup>

#### **4.2.4 Changes in the competitive landscape**

The financial crisis has affected and will further affect the competitive landscape in the St. Petersburg insurance sector. Beyond the financial crisis the insurance market is believed to follow the development of the banking sector and continue consolidation (Tarasenko 2008). Also the FSIS has implemented similar measures such as increasing solvency requirements for companies as the Central Bank of Russia has imposed on the banking sector.

The interviewed insurance professionals, both Russians and Finns, see consolidation as a ‘natural’ development path. It is perceived as a positive development in the long-term as it will make the market less volatile and increase insurance know-how in the companies.

*“In the long term the situation is unbearable with that many small companies specialized in some niche-segment. It’s not going to carry.”* (Katriina Tala, Pohjola Insurance Ltd/5.3.2009)

It is expected that many companies in distress will be acquired by bigger insurers, as they can be acquired relatively ‘cheaply’. However, most insurers take a cautious position when it comes to M&A deals due to the overall unpredictability of the market and the non-transparency of most small insurance companies that are the main potential acquisition targets:

*“Most likely the M&A deals activity will decrease substantially. First, almost all the largest international players are present on the Russian market this way or another. Secondly, financial assets’ prices are objectively falling right now and all the potential*

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<sup>48</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7RDC2C230409790?OpenDocument>

*acquirers will be patient. This is so for attractive and healthy assets. As for the companies which, by their financial state, will be forced to leave the market and sell for minimal price, the process of acquiring such companies will take place by the end of the year [2009] when all the consequences of the crisis for them are evident. If we talk of who will be the buyer and who – the seller, the acquirers may be the organizations that have maintained the access to relatively cheap financing: that is either international financial institutions or companies close to the government.” (Bulad Subanov, Generali PPF Strakhovanie Zhizni)<sup>49</sup>*

Furthermore, despite offers from the market, new foreign insurance companies are not expected to enter the Russian market, and existing companies are not likely to expand aggressively. Already before the crisis Russia was considered as risky market and during the crisis risks have increased further. There are already accounts of foreign companies diminishing share in the markets in the first quarter of 2009. Experts from the Russian auditing company Marillion claim that foreign owned insurers are ceding their existing shares from insurance segments focused on insuring individuals, but that they are increasing their share in corporate insurance.<sup>50</sup>

Instead of getting acquired, it is expected that liquidity-constrained small will simply exit the market. It is a common belief of professional insurers that the crisis will improve the competitive climate in the insurance industry. In addition to companies, people who do not possess the necessary qualifications and skills and who entered the industry during the wave of ever growing demand are likely to leave. As a result of such ‘natural selection’ the overall professional level on the market will increase substantially:

*“I hope, more like I am sure, that the financial crisis will have a huge influence on the Russian market in the coming one-two years. The crisis will force the companies to reconsider their strategies and abandon risky means of development. [...] Players who*

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<sup>49</sup> Yanin, A. (2009b) Последний тучный год. «Эксперт» № 17-18, 2009

<sup>50</sup> <http://www.insur-info.ru/press/34319/>

*were developing based on price dumping will have a rough time and, most likely, most of them will be forced to exit the market. But those companies that learn how to develop under a falling market will gain priceless experience and will become even stronger.”* (Bulad Subanov, Generali PPF Strakhovanie Zhizni)<sup>51</sup>

Severe challenges remain in the current worsening economic situation. Even though many companies will go out of business during the financial crisis, customers also need to economize and consequently buy fewer policies. Competitive climate will remain fierce.

*“In the coming couple of years insurance companies will have two major goals. First – maintain and not lose the client base. Second and not less important, learn to fully account for interest of insurance service consumers under the circumstances of constantly worsening deficit of financial recourses. The goal of finding the balance of insurers and policy-holders is becoming relevant as ever.”* (Sergei Almazov, BSK)<sup>52</sup>

As for the St. Petersburg market, it is generally believed that eventually there will be no significant local players left on the market. Those that are currently present will either exit the market or merge with larger federal or foreign players:

*“In fact I am expecting that 3–4 St. Petersburg companies will be acquired in the coming 1.5–2 years. After that the history of St. Petersburg insurance will take the next step when there will only be network companies. In the long term there will be 3–5 leading companies left. There will be others too, but they only occupy niches. All others will be sold. [...] It will be so that the first five companies will control 70 % of the market. The other 40 companies will occupy the remaining 30 %. But each with a share of not more than 2 %.”* (Sergei Brovko, RESO-Garantia/27.02.2009)

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<sup>51</sup> Yanin, A. (2009b) Последний тучный год. «Эксперт» № 17-18, 2009

<sup>52</sup> Rubchenko, M. (2009) В поисках баланса интересов. «Эксперт» № 21, 2009

The general view based on the interviews and literature is that the number of insurance companies will diminish drastically either through M&A-activity or due to solvency problems. However, the list of main players in the market is not likely to change.

In the long-term, consolidation is believed by interviewees to make the competitive environment less fierce. Currently, however, only few companies have funds for acquisitions and as the market is currently still severely fragmented, the effect of mergers and acquisitions in short and medium-term on the competitive environment is ambiguous.

#### **4.3 Insurance companies' adaptation to legislative changes and the economic crisis**

The development of the insurance market and its regulation has naturally challenged the insurance companies to adapt to the changes. This includes re-thinking the competitive advantages and streamlining the procedures to meet the new requirements. This process has been accelerated by the economic crisis as well.

In general, there are different strategies that insurance companies have taken to survive the crisis. Especially companies specialized in motor insurance are forced to make heavy restructuring and downsize their operations. In addition, some companies more carefully select the most profitable customer segments:

*“Companies are cutting down on personnel, all the big companies have announced reductions of 200, 50, 10 employees. They cut down on everything; drivers, accounting and only keep the sales department. [...] There are different directions that a company can take during the crisis. Some cut down on prices and keep their customers. And others don't want many customers now and they do market research, look at statistics and find out what's going on with motor insurance and car sales. They then offer policies for the most expensive cars only. They take a small share but expensive cars.” (Igor Panfilov, A24/27.2.2009)*

Furthermore, some insurance companies have started to develop new incentives to increase the profitability of existing products. This includes, for example, offering 50–50 insurance policies, where the customer pays only 50 % of insurance payment if he or she goes one year without accidents. (Igor Panfilov, A24/27.2.2007) Moreover, many insurance companies have seized issuing new policies or called off the existing policies for financial risk insurance. These policies are usually prerequisite in projects with government funding, which are large construction projects. Many of them have been discontinued due to the crisis. (Igor Panfilov, A24/27.2.2007)

Finally, most market participants have observed an increase in dumping as a response to the crisis. This definitely suggests a close collapse of many insurers, mostly those who have been imprudent in their pricing policy:

*“There will be problems among those who were dumping... Yes, there will be a loss, but the honest ones will bear it through. Because reserves are created in insurance! Reserves are created for future claims to be paid. Absolutely shady companies that were paying high commissions – they will not stand. People will suffer, of course. The exit [of some companies] will accelerate. We will stand. Those who were dumping will have a harder time.”* (Sergei Brovko, RESO-Garantia 27.02.2009)

In the following sections we illustrate how insurance companies view the current challenges and ways to respond to them in different insurance segments.

#### 4.3.1 Automobile insurance

As illustrated earlier in this report, the automobile insurance, consisting of the mandatory OSAGO system and voluntary KASKO insurance, has experienced considerable changes in the recent years. The legislative changes have influenced first, the basis for competitive advantage in the OSAGO segment. According to experts, the introduction of the direct refund system into the OSAGO system increased the importance of service quality, whereas before that the OSAGO portfolio was mainly won by those insurers who sold their policies at the lowest price and highest convenience for the client. After that the relations between the insurer and its customer were practically over. Now, in order to maintain the customer loyalty the insurer needs to demonstrate the ability to swiftly transfer the payments to the client, and also be able to repair the damaged car on time and with decent quality. (Denisenko 2009a)

It is also pointed out that the direct refund system also increases the technical load on the staff of the insurance companies. The volumes of data that insurers will have to interchange will increase significantly. Consequently, the probability of mistakes in the process will grow and lead to further increase of the workload for the insurers. Leading companies in St. Petersburg have started solving this potential problem well in advance:

*“We have a very reliable center [in St. Petersburg] for refunds in automobile insurance – a separate modern building for processing personal requests of the clients. The capacity, I think, is up to 600–800 clients per day. We never have more than 500. Earlier the OSAGO clients were only the victims, now all the participants of the accident will be our clients. Only we and another company have such centers [in St. Petersburg]. Others just have little departments and are overloaded with processing of requests.” (Sergei Brovko, RESO-Garantia/27.02.2009)*



Furthermore, there is a fear that as a consequence of the direct refund system, additional risks will not be equally allocated among market participants. Eventually, the responsible ones will be the most reliable and responsible insurance companies. This is, however, viewed as an inevitable part of the development of the OSAGO market:

*“...Actually, nowadays everyone says that the market will be purified in terms of the amount of insurance companies in general and the OSAGO market in particular. Naturally we, the honest insurers, can be harmed, i.e. take losses in greater scale. But on the other hand for every system problem the one responsible will suffer. I mean here the dishonest insurance companies, dishonest management. So we will accelerate this process [of market purification and consolidation]. (Sergei Brovko, RESO-Garantia/27.02.2009)*

In contrast to the mandatory automobile insurance, which has been affected mainly by changes in the state regulation, the voluntary automobile insurance (KASKO) segment is vulnerable to fluctuating demand due to the economic crisis. The KASKO volumes in St. Petersburg have shrunk both due to the drop in sales of passenger cars and because of the decline of market for transportation services. The cross-border transit of goods and sea imports has suffered the most serious blow due to shrinking import volumes. (Stankovskaya 2009) Since their trucks are idle, transportation companies do not see any need to purchase neither KASKO, nor even OSAGO at least for some of the freighters:

*“Right now things are worst for developers and transporters. Some don’t even have the cash to pay for OSAGO – the vehicles are idle. When they drive out of their garages in a couple of months, they will need the KASKO and OSAGO.” (Sergei Brovko, RESO-Garantia 27.02.2009)*

The crisis has had an adverse effect on the already low levels of voluntary automobile insuring:

*“Before the crisis only 30 % of corporate auto vehicles in St. Petersburg were insured with KASKO. Now many companies cut their budgets; the share of insured cars has dropped to 25 % or even less.”* (Evgeniy Dubenskiy, Union of insurers of St.-Petersburg and North-West Russia)<sup>53</sup>

In addition to dropping sales volumes, the KASKO insurers face a problem on the other side – claims to be covered. The reasons for the growth of the latter are several. First of all, due to the depreciation of the ruble, the prices for spare parts have increased dramatically as most of these are imported to Russia. Exception here are Russian automobiles, however, these are rarely insured and constitute a rather small part of car sales. In addition, the amount of car hijackings is expected to increase, especially in St. Petersburg. This problem is fought against through collaboration of the insurance community:

*“The intensity of car hijackings in St. Petersburg is greater than that in Moscow. We had a problem in 2005–2006 with the growth of hijacking and huge loss ratio of KASKO. But we have overcome this problem by mobilizing resources including those of the insurance community.”* (Sergei Brovko, RESO-Garantia 27.02.2009)

Moreover, according to industry experts, the major problem of the whole KASKO market is inadequate pricing. Price dumping was fairly common for some market players even during the ‘good’ years.

*“If we take St. Petersburg, we see: every year one or two insurance companies attempt to aggressively increase their market share and they find out in a year or two that their share decreases dramatically and they end up with a huge loss. This situation took place 2 – 2.5 years ago with ROSNO. They ended up with a huge loss after which they had to increase their tariffs, lower their market share.”* (Sergei Brovko, RESO-Garantia/27.02.2009)

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<sup>53</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7SAB6S220509497?OpenDocument>

For many players dumping is a way to accumulate customer base, and the inevitable losses are supposed to be covered by the new incoming clients' premiums – classic pyramid scheme. The strategic aim of such insurers is to have a good portfolio of clients and then sell the portfolio or the whole insurance company to large national or foreign players. (Yanin 2009a) A well-known example is the above-mentioned ROSNO, which was acquired earlier this year by the German Allianz.

However, the insurers view that the financial crisis could have a very important purifying effect on the KASKO market. The insurance companies that survive through the crisis will be stronger and will have less of small 'random noise' competitors who give the KASKO insurance a bad name.

#### **4.3.2 Life and medical insurance**

As the automobile insurance market, the life and medical insurance market consists of mandatory and voluntary sub-segments. Consistent with the statistics presented in the earlier sections of this report, the industry professionals view the life insurance sector as resisting both positive and negative market tendencies that have affected other insurance segments.

*“The 1998 crisis showed that life insurance didn't get harmed in any way. Right now one can say that the market is developing. But of course its development has halted in terms of long-term perspective and particular attention to it... So the market is developing, but it is not a reason for the entry of foreign companies. Though not a reason not to enter either.”* (Sergei Brovko, RESO-Garantia 27.02.2009)

Overall, due to its small size, the life insurance market has not yet attracted too many players. As a result, competition is not considered to be very tough:

*“I wouldn’t say there is any rivalry at all [in the segment of life insurance]. Well, imagine how many companies sell non-life in St. Petersburg? 200–300 companies. And life insurance is done by 5–10 companies. More like five! Imagine: three hundred against five. We have a catastrophic lack of staff. We are willing to recruit hundreds of agents! The only question is whether the people are willing to earn money... There is absolutely no competition!” (Evgeniy Egorushkin, Allianz ROSNO Life 28.02.2009)*

In contrast, the voluntary medical insurance segment is more subject to fluctuations in the economic situation. In this segment the insurance companies have faced challenges regarding how to adapt their products and pricing to the decreasing demand due to the crisis, as described by one of our interviewees:

*“Premiums collected in the corporate segment now are barely maintained on the same level with significant efforts... There is hardly any reduction [of insurance programs by existing clients]. However, as the cost level is increasing and we have been trying to maintain the prices at the same level for the last several years, we are forced to adopt a certain shrinkage of the content of the insurance programs. This is not only our approach – other enterprises do the same. However, the pause which the corporations took in the first month or two of the year – it is now over. Companies see that they have survived.” (Sergei Brovko, RESO-Garantia 27.02.2009)*

Moreover, the interviewees confirm the tendency that insurance companies are increasingly investing to their own medical facilities in the lack of proper quality and reasonably-priced medical services available on the market. In addition, it is criticized that medical centers often try to include a number of unnecessary medical proceedings into the service charge. *“It is well known that medical facilities add up to 30 % of unnecessary manipulations.” (Igor Akulin, SOGAZ)*<sup>54</sup> Moreover, the purchase of medical services from third parties increase the risk of insurance fraud:

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<sup>54</sup> Denisenko, E. (2009b) Парад медцентров. «Эксперт Северо-Запад» №15, 2009

*“The intensity of fraud in the medical insurance sector is increasing. Fraud as the confederacy of the doctor and the patient, or by the patient him- or herself. But that has to be monitored and controlled. This is a somewhat market factor. It can be tracked and taken care of.”* (Sergei Brovko, RESO-Garantia/27.02.2009)

In order to be able to control the costs and quality, to supply their medical centers with clients and to decrease the final price of their product, insurance companies offer their clients medical insurance policies that tie the insured person partly or solely to their own medical center. This is especially important in times of crisis, when the inflow of third-party customers is at minimal level:

*“So far the market finds it difficult to get used to programs with the attachment to a pre-specified medical entity. We ourselves have formed the stereotype of taking DMS<sup>55</sup> as with the freedom of choice. But during the crisis when the employer has the choice between the abandonment of insurance or choosing a program with limitations, but 20 % cheaper – I believe this product will be considered attractive.”* (Aleksei Kuznetsov, Kapital-Polis)<sup>56</sup>

Apparently, the price factor is very important for the purpose of attaching the DMS policy owner to the insurer’s medical center. For example Ingosstrakh plans to fill up to 70 % of their new clinic’s capacity with people insured in the company. The policy with the attachment will cost 8–10 thousand rubles as opposed to the product with the full freedom of choice being 2–3 times as expensive. (Denisenko 2009a)

Despite the optimism of some market participants, total DMS premiums collected in 2009 are expected to be 15–20 % lower than that in 2008.<sup>57</sup> However, the optimism is understandable for the market leaders due to the market re-structuring that is taking place

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<sup>55</sup> Voluntary Health Insurance.

<sup>56</sup> Denisenko, E. (2009b) Парад медцентров. «Эксперт Северо-Запад» №15, 2009

<sup>57</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7S898Q200509120?OpenDocument>

right now. The crisis has made visible the hidden problems which earlier were not as critical for the insurers:

*“It is particularly hard for those, who were operating in the DMS segment on a pyramid principle by offering their clients low tariffs and covering the losses with new policy sales, also at dumping prices. These insurance companies encountered the problem of paying the clinics for their medical services.”* (Marina Trofimova, RESO-Garantia)<sup>58</sup>

Currently companies with a large customer base and their own medical facilities have started taking away both the clients and sales agents along with their portfolio from the less prudent competitors. Moreover, the clients themselves have revised their approach to choosing the insurance company preferring those that are more reliable and well-known.

#### **4.3.3 Real estate and corporate property insurance**

As illustrated in this report the economic crisis has had a major effect on the property insurance market, not only for the automobile insurance segment that was discussed previously but also for the real estate and corporate property insurance. The recent years' growth in real estate insurance was largely fostered by the credit boom in mortgage. With the current credit crunch companies and households can no longer afford to take as much credit and so the market for insuring this property is expected to decline as well. (Sologub 2009)

On the other hand, industry professionals view that more and more retail customers come to the understanding of the benefits of real estate insurance. Insurance companies report growing demand for products of insuring personal apartments, summer cottages and other property items in cases not related to loan financing:

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<sup>58</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7S898Q200509120?OpenDocument>

*“For household property insurance the market may show a growth of up to 20 %. Corporate property insurance is not likely to grow more than 5 %. The difference is largely due to the fact that the majority of contracts with commercial firms are signed as part of credit and leasing agreements the amount of which is shrinking. The prospects of this direction are positive: according to our estimates, only 10–20 % of potential market for property insurance that is not related to loan agreements is currently insured.”* (Aleksei Rozhnev, ROSNO)<sup>59</sup>

Furthermore, industry experts note that although the demand for corporate property insurance is not increasing as to premiums collected, it is transforming in terms of quality. More and more companies adopt risk management practices and utilize production equipment insurance as one of the instruments. Earlier a significant part of nominal corporate property insurance was allocated to captive insurance companies affiliated with their clients. That was especially so for the large Russian corporations (e.g. the natural gas giant Gazprom insured most of its property and risks with its own insurance company – SOGAZ). Currently their role is continuously decreasing with a consequent increase in competition, quality and the range of insurance products offered. (Komleva 2008d)

*“Today almost all insurance companies when insuring corporate property offer a standard package of risks: fire, explosion, natural disasters, flood, unlawful activities of third parties. In addition, insurance against the disruption in production activity is gaining popularity. When operating expensive equipment, insurance against malfunctions is demanded. For large and medium enterprises policies that account for their specificities are usually developed.”* (Lyudmila Chertovskikh, Russkaya Strakhovaya Kompaniya)<sup>60</sup>

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<sup>59</sup> Sologub, A. (2009) Зона рискованного страхования. «Эксперт Северо-Запад» № 7, 2009

<sup>60</sup> Komleva, N.(2008d) На пороге большого скачка. «Эксперт» № 10, 2008

Further development of the market for corporate property insurance is expected to take place mostly due to widening coverage of large and medium enterprises. The major factors of sales growth will be the investments of enterprises and the improvement of their corporate governance systems. In addition the growing internationalization of the Russian economy will play a significant factor:

*“The development of inter-state economic relations and the penetration of the Russian market by Western business calls for the need to provide insurance protection based on products that correspond to international standards and that are more typical for foreign companies.”* (Rustem Garaev, MSK)<sup>61</sup>

#### **4.3.4. Liability Insurance**

The liability insurance is one of those segments that have been subject to changes in state regulation in the recent years. This includes new requirements for liability insurance for tourism and construction companies.

The market for tourism insurance is particularly important for St. Petersburg due to its proximity to the national border and its relative importance as a travel hub for Russian citizens and travel destination for incoming foreign tourists. Currently, the Russian tourism market is largely controlled by small business, but there is a consolidation process going on. This is fostered by the new legislative requirements concerning tour operators' liability, which are too high for the smallest players.<sup>62</sup>

Moreover, another sub-segment of tourism insurance is travel insurance purchased by the traveler. For Russians travel insurance is often mandatory in order to get a foreign visa. As a result of the implied mandatory nature of the policy, the industry professionals view that many clients choose their insurer without proper consideration basing their decision

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<sup>61</sup> Komleva, N.(2008d) На пороге большого скачка. «Эксперт» № 10, 2008

<sup>62</sup> <http://www.insur-info.ru/press/33258/>



mostly on the price. (Terskiy 2008) Consequently, many insurance companies engage into dumping and cutting the features offered in the policy implying the coverage of minimal amount of risks. Consequently, when the accident happens, people either do not get what they have expected (which could well be overcome by simply reading the insurance agreement) or – in the case of dishonest insurer – do not even receive the services spelled out in the contract. This in turn decreases the overall level of trust towards the insurance industry.<sup>63</sup>

Traveler's insurance is also associated with higher share of fraud. Often some issues of the accidents are concealed (e.g. alcohol influence). A very common thing is tourists demanding services they are not entitled to according to the agreement. There are even cases of staging casualties in a conspiracy with the doctor, medical bills frauds and even death statements' fraud. Insurance companies do everything in their power to prevent such cases with detailed inspections and direct requests to the hospitals where the patient was treated. However, this routine is extremely laborious both in terms of process and cost. (Terskiy 2008)

Another segment of liability insurance that has recently been subject to changes is the construction insurance. The implications of the new law on self-regulating organizations are difficult to predict, but according to the industry experts the construction insurance has already become more popular in the recent years. This development has been mainly fostered by requests by the clients or financiers, which demand that the development project is insured. In addition, the largest Russian companies have recently adopted the practice of requiring their construction sites to be insured. However, even in the good times the development companies were not too keen on insuring their projects seeing this as simply another expense. As a result, most of the insurance was bought without truly looking into the potential benefits it would bring and the main decisive factor usually was the price. (Basova 2009)

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<sup>63</sup> <http://www.insur-info.ru/press/34058/>

Under the incumbent financial crisis, the problem of under-insurance has become even more severe. It is even worse now that the risks of the projects not being completed on time have increased. In addition, industry experts point out to the overall low professional level of insurers' and developers' staff that has problems with objective evaluation of all potential risks. Moreover, as the insurance companies are experiencing liquidity problems, they tend to engage into price dumping. This is partly explained by the comparatively low payout ratio for construction risks insurance. (Tikhonov 2009) However, it is well known that if a development project goes bust, the losses for the insurance company can be fatal:

*“The crisis evidently has an influence on the market for development insurance. The rivalry among insurance companies is getting tougher – this leads to almost all-round tariff decreases and dumping. If earlier joint -insurance agreements [when several insurance companies share the risks of one project] were not rare, now everyone seeks to take it all for oneself.”* (Anton Stcherbatchenko, Kapital Strakhovanie)<sup>64</sup>

In addition to the above mentioned sub-segments of liability insurance, there are a few distinct types that are in the attention focus of some insurance companies. More and more enterprises make attempts to insure against *force majeure*, i.e. risks of natural disasters or third-party actions that may lead to the company not being able to fulfill its contractual liabilities before its clients.

*“According to statistics, force majeure events occur to every enterprise at least every 5 years. As a result of significant financial losses around 40 % of firms are forced to leave the market. For small business taking money out of turnover to create “emergency funds” is unacceptable – they simply don’t have any extra cash and the access to credits is extremely difficult nowadays. Eventually only insurance is left. It is the cheapest and*

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<sup>64</sup> Basova, O. (2009) Страхование СМР продолжается. «Эксперт» № 9, 2009

*most reliable instrument of protection against unforeseen losses.” (Konstantin Gorodetskiy, Renessans Strakhovanie)<sup>65</sup>*

However, although this insurance type can be very attractive to potential clients, few firms have understood this and the market size is negligible. (Kotchetova 2009) Liability insurance, however, is also very important for the companies that perform commissions for the government:

*“Another highly demanded insurance types this year are programs of insuring the liability of contractual breach when performing government of municipal commission. Due to the Federal act on contract management for the state, the contract can only be signed after the executor provides guarantees of him or her fulfilling the obligations. And an insurance agreement allows to compensate the forfeit penalty in case of a risk.” (Evgeniy Tchereminin, AlfaStrakhovanie)<sup>66</sup>*

Finally, another liability insurance sub-segment that has been growing at impressive rates of 30–40 % per year before the crisis is the directors’ and officers’ liability insurance (D&O). This product implies the protection of top-managers before third parties against the former causing losses to the latter due to wrong actions or inaction or even incorrect and imprudent public statements. The D&O insurance is rather common in the West for the senior executives of commercial enterprises, especially those listed on public stock exchanges.

In fact, it was the boom of Russian companies’ public share offerings (IPO) before the crisis that led to the rapid increase in the demand for D&O. It is recommended that the listed company’s top-management’s liability be insured. According to Expert RA rating agency, many companies see this as the only reason to purchase the product without fully understanding the benefits it brings. (Maloletnev 2007)

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<sup>65</sup> Kotchetova E. (2009) Всё-таки скорее жив. «Эксперт Юг» № 15-16, 2009.

<sup>66</sup> Kotchetova E. (2009) Всё-таки скорее жив. «Эксперт Юг» № 15-16, 2009.

Due to the crisis the IPO activity in Russia is negligible. This has a major negative effect on the growth rate of the D&O insurance market. In addition, many companies refuse to insure their directors' liability due to the high disclosure and transparency requirements it imposes. Lastly, Russian companies have little experience of law suits against their executives and even less experience of incurring any legal penalties. Due to this few firms actually even know of D&O, especially those that are not planning to go public in any near future. (Maloletnev 2007)

#### **4.4 Challenges and opportunities for foreign companies**

This section focuses on the potential problems and advantages of the St. Petersburg market from the view point of a foreign insurer. The section is organized under thematic headings, which are derived from the interviews with Finnish insurance professionals. According to them, the biggest problem in Russia is not necessarily a direct threat to business from a single source, but the general uncertainty of the business environment that stems from a number of sources unexpectedly and possibly simultaneously. These threats can arise from different government officials (tax, legislation, courts), unreliable business partners or from inside the company. At the same time, there is business potential that can not be ignored.

##### **4.4.1 Market potential**

The Russian insurance market may still be underdeveloped in its legal and regulatory framework, in insurance expertise and consumer awareness, but it can offer unlimited potential in the long-term when insuring property becomes more common. According to Katriina Tala from Pohjola Insurance Ltd., Russian insurance market's long-term potential stems from the simple fact that *"there is inconceivable amounts of uninsured property that will come to be insured in the coming decades"* (5.3.2009).

The St. Petersburg market in particular has major potential both in individual and corporate insurance as it is the second most developed region after Moscow. In other parts of Russia the insurance market potential is still very limited. According to Ville Haapalinna from IF P&C Insurance (23.2.2009), the St. Petersburg markets fulfilled all the projected expectations regarding profit and growth until the financial crisis.

Furthermore, as Russia and St. Petersburg as an important business hub have potential for growth in many areas, the interviewees view that insurance companies from potential investor countries must keep track of Russia.

*“The number of Finnish companies in Russia from all industries is increasing and therefore insurance companies of Pohjola’s size simply cannot afford to stay out of Russia.”* (Katriina Tala, Pohjola Insurance Ltd./5.3.2009)

However, the interviewees perceive that the development of the insurance in Russia has been slow compared to other countries in Central and Eastern Europe (CEE). Despite market potential, negative factors such as the small size of the voluntary insurance market, Russian bureaucracy and corruption, backward insurance legislation and unexpected and swift changes in the legislation that can be enforced even in retrospect reduce the attractiveness of the market for foreign insurers. Though, these factors are very similar to problems faced by Russian insurers.

Furthermore, in corporate insurance a Nordic or Western company can have significant advantages over Russian insurance companies due to better reputation, more transparency in procedures, long experience in insurance and usually better degree of solvency. However, this advantage is reduced somewhat by the requirement in the related legislation of different licenses for even very insignificant categories of insurance products. This hinders the possibility to tailor insurance products for customers.

Also from the Russian managers' point of view, foreigners are said to have certain advantages over their Russian peers especially in life insurance:

*“Well, I suppose one can spot an advantage: financial support on the initial stage. The start in life insurance is always with a loss. I remember when I came into this business, we were told that the break-even point takes place during the sixth year of operations. So the foreigners have surplus, a safety bag when they can afford to invest...In addition the experience of foreign companies is also important. Technologies. Also these companies can invite top-paying trainers, book a hotel, gather the people...In addition, foreigners can afford better office accommodation. Russian companies, as far as I know, have more modest premises.”* (Evgeniy Egorushkin, Allianz ROSNO Life 28.02.2009)

However, all the respondents acknowledge that as an emerging market, Russia has significant potential in remarkably many industries for foreign companies, but entering Russian markets requires good preparatory work and it is difficult without reliable local partners (Finnish banking and insurance professional employed in St. Petersburg/26.2.2009).

#### **4.4.2 Alternative entry modes**

The experts see two basic options for foreign insurance companies willing to enter the Russian insurance market. Firstly there is the option of using international networks of insurance companies, such as Pohjola Ltd., through which they can focus on insuring their Finnish customers' property in Russia through reinsurance. Secondly, foreign companies can apply for their own license and set up a company through acquisition or as a green field investment, such as the strategy of the Nordic IF P&C Insurance, and thrive for a broader customer base in Russia.

Working through an international network of insurance companies has many benefits, which are significant for the foreign corporate customer. This way, internationally

operating enterprise can insure its subsidiary in Russia through a domestic insurance company with policy conditions that it is already acquainted with. The risk is insured in Russia through a local partner, which in turn is reinsured in the insurance company's home country. Also a significant benefit for Pohjola Insurance Ltd., according to Vice-president Katriina Tala, is the fact that with regard to the network it has contractual liability to a British trustworthy insurer.

*"If we would take credit risk from a Russian insurance company, it should first of all have a certificate from an international rating agency which none of the Russian insurance companies have gotten yet, which is mainly due to the fact that they operate in Russia which is a risk in itself. They should also open up their accountancy procedures so that for example their degree of solvency could be judged by Western standards"* (Katriina Tala, Pohjola Insurance Ltd./5.3.2009)

As mentioned above, most of the global insurance companies are already present on the Russian market. If other foreign insurers wish to enter the market, Russian experts predict they would have to do so via acquisitions:

*"A foreign company that initially comes from abroad has virtually no chances. The only way is to buy small local companies. There are some present. Acquiring a network is risky because there may be complicated situation concerning integration. The entry should be very soft"* (Sergei Brovko, RESO-Garantia/27.02.2009).

Finnish insurance experts, however, see acquisitions as challenging. There are, for example, major challenges in finding out if a company is 'clean' and if not – how to manage the situation (Ville Haapalinna, IF P&C Insurance / 23.2.2009).

*"I heard from an advisor in relation to acquisitions that the problem often is not whether there is parallel accounting in the company, but where it is."* (Ville Haapalinna, IF P&C Insurance / 23.2.2009).

Furthermore, when buying a Russian insurance company it is hard to review the existing claims when no proper registers are available and there is no reliable method to verify their source. In insurance company acquisitions the new consolidated company can at best receive 50–60 % of the customer base from the acquired company as personnel resistance is traditionally very strong (Igor Panfilov, A24/27.2.2009).

Due to this problem, foreign insurance companies wishing to enter the Russian markets by acquisitions find it difficult to verify the financial situation of insurance companies in Russia and still prefer to engage in green field investment.

*“If I think about these big international insurance companies like AIG & co that have gone there, almost all of them have started their own company from scratch and started from zero instead of buying something. This is only because it’s hard to know what’s at the base there because they are not measured with the same criteria and there is no legislation concerning transfer of customer base or terminating old liabilities”* (Katriina Tala, Pohjola Insurance Ltd./5.3.2009)

In addition to above-mentioned challenges, there are features in the Russian business and management culture that make the post-acquisition integration very challenging for Nordic companies. These include the lack of transparency in making decisions inside the company and strong hierarchy (Ville Haapalinna IF P&C Insurance/23.2.2009). The office culture is also very different to Western or Nordic way of working. Organizational atmosphere in the office is found to be hierarchic and secretive.

*“There is also that the CEO’s position is very strong. He is like a sovereign ruler that has to approve and sign all the decisions himself.”* (Ville Haapalinna, IF P&C Insurance/23.2.2009)



In addition, the communication culture in Russian firms is found to be underdeveloped and shadowy. Working in an executive group in a transparent way is strange to Russian directors.

Furthermore, outside the company, in general, the idea of a consolidated company or a group of companies is not understood by Russian business partners or government officials. *“Tax authorities deal with only one company at a time and business partners look at companies as separate. They just look at that one and don’t see the legal entity behind it”* (Ville Haapalinna, IF P&C Insurance/23.2.2009)

Despite all the threats and difficulties in operating in the Russian insurance markets, business in Russia is facilitated significantly by experience and understanding of the conditions in the country.

*“Our experience of operating there and risks is that it’s not such an impossible place to operate after all. If there are belongings of great value or something that thieves might want automatically there are armed guards around these buildings. They take surveillance pretty seriously over there. In that sense, criminal action is not such a threat you might expect. But in transport insurance there are challenges as stuff goes missing quite a lot. These are the kind of issues that...need precision in pricing if the density of occurring damage is something else than in here [Finland].”* (Katriina Tala, Pohjola Insurance Ltd/5.3.2009)

The Finnish respondents share the view that recruiting qualified staff has been a problem in the past in St. Petersburg and Russia, but due to the crisis this problem has disappeared. Moreover, qualified staff and premises can be expensive in St. Petersburg due to fast growing inflation in the recent years and the overall deficit of quality supply.

#### **4.5 Promising insurance segments and segments in distress**

This chapter concludes with the industry professionals' views of the development perspectives in different segments of the St. Petersburg insurance market. The current trends and the look out for the near future on the insurance market are largely influenced by the on-going global financial crisis. Many insurance market professionals see the year 2009 as a watershed that will form the structure of the young insurance market for the years to come (Tarasenko 2008). In 2009, motor and bank insurance are expected to be hit the hardest and all in all insurers are expecting a general reduction of up to 25 % in sales of these segments in the whole country. In 2008, the markets were estimated by insurance professionals to reach the bottom of the depression in the summer of 2009 (Savelyeva 2008). As the negative tendencies continue in the markets, the total growth in 2009 in the St. Petersburg insurance market will not exceed 10 % based on the estimations of insurance company managers in St. Petersburg (Aleynikova 2008). According to the Russian rating agency Expert RA, at least a hundred insurance companies are going to leave the market in Russia (Gaydash 2009).

However, according to the Finnish insurance experts interviewed, the financial crisis could have a good impact on the insurance market development and the Russian economy as a whole. This, however, depends on how committed the political leadership is to reform and how much it abstains from protectionist action.

In the long-term, the potential of the Russian and St. Petersburg insurance market is enormous. The same segments, namely voluntary motor insurance, which generated the highest growth before the crisis as well as greatest losses during the crisis, are expected to give big revenues also after the crisis. In short, KASKO-segment is "*fast and big money*" (Igor Panfilov, A24/27.2.2009). Less volatile but also profitable is expected to be the property insurance segment that has great potential (Ville Haapalinna, IF P&C Insurance/23.2.2009).

In addition to former strong areas of growth like property insurance, the boost for growth is foreseen to come from new compulsory insurances, which are expected to be introduced by the Duma. These could include the compulsory insurance for dangerous objects and compulsory insurance for lodgings. The latter is currently required only when applying for credit (Sologub 2008).

Some insurers also expect compulsory insurance of some professions to come in the near future:

*“In Moscow our company is fighting for the insuring of doctors [professional liability]... But even if something comes up, it is not significant for the market, but it disciplines the insurers.”* (Sergei Brovko, RESO-Garantiya 27.02.2009)

In addition, the Ministry of Finance has recently announced it will come up with several amendments to the OSAGO act in the near future. The major theme of these alterations will be to increase the content of the motor liability. OSAGO policies will cover more possible injuries and more damage. As a result, however, the price of insurance is expected to grow 2–3-fold.<sup>67</sup> However, the amendments will go into force earliest in 2010.

As a result of these changes, market participants expect a sharp decline especially in the number of OSAGO market participants in Russia as well as in St. Petersburg:

*“The innovations in OSAGO on top of the crisis will truly alter the number of market participants. This will not be competition, but rather transformation of market, its structure. It could even be so that out of one hundred players that have the OSAGO license in the city [of St. Petersburg], only 15–20 will be left. 15 of those that really work and 5 – of those who have an office here. Like in insurance in general, 8 leaders define the market and the other exist only in name. Currently the structuring into leaders,*

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<sup>67</sup> <http://www.allinsurance.ru/biser.nsf/AllDocs/OMIN-7SE7WT260509299?OpenDocument>

*second category and “random noise” is growing stronger.”* (Sergei Brovko, RESO-Garantia/27.02.2009)

Some analysts, however, say that the insurers are not likely to quit the OSAGO.

*“Having cancelled the OSAGO license, a company loses its clients in the other segments because many people wish to receive combined service at one insurance company.”* (Kachalova 2008)

Overall, however, the sales in OSAGO market are expected to grow after the crisis:

*“In OSAGO the sales will be increasing partly due to the increased tariffs and regional coefficients. There won’t be fewer cars. By at least half a percent [during 2009], but there will be growth. The tariff will be increased because it is significantly lagging behind inflation. In six years there hasn’t been an indexation. There will be an adjustment in half a year... Profitability-wise there will be alterations. For OSAGO it will get near 5–10 %, but we hope that eventually it will not go below zero.”* (Sergei Brovko, RESO-Garantia/27.02.2009)

Experts claim that if the government does not increase the pricing tariffs, some insurers may simple exit this market. This opinion is shared by the former head of FSIS Ilya Lomakin-Rumyantsev: *“If the [tariff] coefficients for territories and vehicle types are not corrected next year, the process of insurance companies exiting regional markets will accelerate”*(Vilenskiy 2008).

Some segments are believed to be sheltered from the crisis due to more developed customer awareness of insuring during recent years:

*“The income from personal property insurance – apartments, houses – will increase. Surely, the people will protect the assets they have earned during the “fertile” years...*

*Premiums collected from mortgage insurance will decline; banking [collateral] insurance and the one related to leasing insurance will decrease.” (Dmitry Bolshakov, RESO-Garantiya)<sup>68</sup>*

In the near future corporate risk and property insurance sub-segments are facing contradictory challenges. On the one hand, companies strive to cut down costs and hence buy fewer insurance policies. On the other hand, with the credit crisis on hand some analysts expect an increase in demand for these products. Before the crisis, banks accepted uninsured corporate property as collateral for credits. During the crisis with the risks higher, the banks will demand guarantees of the borrower’s creditworthiness in the form of insurance (Ingosstrakh 2008). However, companies may choose to insure their property at the lowest rate possible using the services of small and inexperienced insurance companies. This may lead to even bigger losses in the future for companies, banks and insurers.

Government-based insurance, including obligatory health insurance, is expected to grow at the previous years’ pace. The reason here is simple. Most of the insurance policies for the government and its institutions are compulsory. Moreover, state organizations are not likely to cut down their costs in this area. All this implies that the current growth rates will be maintained in the year 2009<sup>69</sup>.

With regard to other insurance segments, in times of crisis people are likely to resort to more conservative forms of insurance like life insurance. Some experts believe that life insurance markets will not experience such a heavy decline in 2009 as for example property insurance (Tarasenko 2008). This is already seen in the markets:

*“However, if we talk about household insurance sales, the situation is slightly different. We have clearly seen that during the financial crisis the role of life insurance increases*

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<sup>68</sup> Sologub A. (2009) Зона рискованного страхования. «Эксперт Северо-Запад» №7, 2009

<sup>69</sup> <http://www.insur-info.ru/interviews/534>

*for retail customers. It becomes more called for as means of long-term and guaranteed (though not highly profitable) savings. However, while the amount of policies sold grows, the average premium paid declines and the client expectations are growing. Customers want to have a better understanding of the particular benefits they get by buying the policy of accumulative life insurance.” (Bulad Subanov, Generali PPF Strakhovanie Zhizni)<sup>70</sup>*

Furthermore, this view is backed by the first quarter sales results of 2009 with property insurance declining with a staggering rate of 50 % and life insurance with a mere 5 % in St. Petersburg from a the same quarter from the previous year. Also, the sales for corporate clients is likely to decline by 20–30 %, but sales to private persons are not expected to change as rapidly (Grigoryeva 2008).

In the liability insurance segment the insurers’ hopes for market development are largely related to the SROs and to the multiple government-funded infrastructure projects currently launched all around the country. In St. Petersburg examples of such are the construction of ring road around the city, the construction of Western high-speed diameter highway, restoration of historical buildings and other large projects.<sup>71</sup>

*“In 2009 the reduction of construction investment programs will affect the construction risks’ insurance market. However, this segment will suffer less from the crisis as compared to the insurance market as a whole. Major part of the volume of construction risks’ insurance market come from the insurance hedging of budget-financed infrastructure projects the financing of which will see a less significant reduction than that in investment development including housing development. According to current data one can expect that the growth of the market for construction risks’ insurance will amount to 5 % in 2009.” (Anatoly Kuznetsov, Gefest)<sup>72</sup>*

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<sup>70</sup> Yanin, A. (2009) Последний тучный год. «Эксперт» № 17-18, 2009

<sup>71</sup> More information: <http://www.st-petersburg.ru/investments/projects/>

<sup>72</sup> Sologub, A. (2009) Зона рискованного страхования. «Эксперт Северо-Запад» № 7, 2009.

In sum, the crisis will force companies to restructure and rethink their strategies. For example, the director of marketing at ROSNO Insurance sees that the crisis will force the insurance companies to specialize in more profitable niche markets as they are forced to rationalize their operations (Tarasenko 2008).

## **5 Summary and Conclusions**

This report examined the development of the Russian insurance market in general and the St. Petersburg market in particular. We looked into the history and the current situation in the insurance industry in Russia. The report analyzed the recent developments in the different segments of the insurance market of Russia and St. Petersburg based on statistics and industry reports. In addition, professionals from Russian and Finnish insurance companies were interviewed to identify the major challenges of the St. Petersburg insurance market as well the opportunities there are, particularly for the foreign insurers. We concluded with the analysis of the future prospects of the insurance industry in St. Petersburg.

Although insurance as such was present both in the Imperial Russia and in the Soviet Union, the true development of a competitive insurance industry in Russia began in 1992 with the adoption of the Law on Insurance. In the chaos of the 1990s the insurance industry's influence was negligible and most of the market players were involved in tax evasion schemes and other “grey” activities.

The 1998 financial crisis gave the insurance industry in Russia a boost. Since then the market was constantly on the rise – until the new crisis of 2008. The growth was fostered with the adoption of the Law on mandatory third party motor liability insurance in 2003. Other factors accelerating the market growth were the credit boom of the 2000s and the introduction of new compulsory insurances such as the tour operator insurance and the construction risks insurance.

The market was growing in terms of quality as well. The industry regulator has been successfully fighting illegal schemes and recalling the licenses of unfair insurers. In addition, the legislation has been gradually improving towards a more transparent market. However, the Russian insurance market is still largely closed for foreign entrants: foreign



insurers can not establish their direct subsidiaries, and the maximum share of foreign insurers in terms of market volume and total capital of the insurance industry is still legally limited. Never the less, the market was recently successfully penetrated by such Western insurance companies as Allianz, Groupe AXA and AIG.

However, the Russian market is still considered to be underdeveloped when compared to developed countries. In 2008 total insurance premiums collected amounted to 946 billion rubles, which corresponds 2.3 % of the country's gross domestic product. In the 15 "old" EU member states the corresponding figure is 9.3 %, which shows that the Russian insurance market has a lot to go. The market is still highly fragmented: 10 of the largest companies together control less than half of the total market. In addition, the 2008 financial crisis disrupted the growth of the insurance market both in Russia and St. Petersburg. With the economy on the downfall and the unemployment growing, the demand for insurance products has diminished. Although it is not yet clear when the economic situation will improve, many insurers are facing difficulties and some have already left or will soon be leaving the market.

The St. Petersburg insurance market has largely been developing in line with the Russian market. **Mandatory insurances** played a great role in fostering initial market growth. Mandatory health insurance largely allowed the insurance companies to live through the 1990s and gave them the opportunity to learn the basics of the insurance business. Mandatory third party motor liability insurance (OSAGO) became the first truly mass and competitive insurance type in Russian and St. Petersburg.

The **voluntary insurance** of life, health, property and liability constitutes almost two thirds of the total insurance premiums in St. Petersburg. In the life insurance segment, there has been a sharp decline in the overall volume of the market in the past years. This was, however, largely due to the success of the scheme fighting actions manifested by the authorities – the real life insurance has been growing steadily. Personal insurance grew due to the inferior quality of state healthcare system and also due to the shortage of good

office workers, which induced employers to offer their employees health and accident insurance. Furthermore, property insurance amounts to almost half of the market. Due to the growing awareness of Russians about the benefits of insurance, rapid expansion of retail and corporate credit sales of automobiles and real estate which implies the insurance of the property in question, property insurance was in large demand until the crisis. Finally, liability insurance is still underdeveloped holding only 2 % of the market, but its importance will be growing.

In terms of **market structure**, the St. Petersburg insurance market is still very fragmented: the five top players generated only 36.5 % of all revenues in 2008. However, a concentration is taking place. Recently the largest St. Petersburg-based insurance company Russkiy Mir was acquired by Russia's largest insurer Rosgosstrakh. Particularly before the crisis, foreign insurers like Allianz were active in acquiring small and large local insurance companies (e.g. ROSNO, Medekspress etc.)

**Bureaucracy and legislation** are seen as an obstacle to insurance market development. Our Finnish interviewees pointed out to the burdensome bureaucracy of the interaction with the government agencies. On the other hand, the conduct of the insurance supervising authority has received appraisal especially in terms of its success in fighting illegal schemes. Interviewees, however, pointed out that there still is a considerable room for improvement in the insurance legislation per se.

A recent innovation for the St. Petersburg insurance market is the introduction of on-line **direct sales** of insurance products. This is seen by many as a new sales channel that would partly substitute agent and broker sales. It is also seen as very perspective in the long run. However, there is skepticism whether direct sales can become popular among the people and be profitable for the insurers due to high advertisement and software development costs associated with them.

The importance of the **quality of labor** concerned most of our interviewees. The insurers point out to the lack of insurance education on behalf of third-party educational facilities. As a result, the leading insurance companies adopt their own programs of personnel training and development. Sometimes these programs are carried out in partnership with a higher education institution. Overall, the leading insurers plan to increase their investment into human capital seeing the staff qualifications as a critical success factor.

Our interviewees see many challenges and opportunities in the future development of different insurance segments in St. Petersburg. The **obligatory health insurance** sector (OMS) recently became more competitive in the city as now the people can choose their insurer (previously the choice was made by the state). This will induce insurers to compete for their clients quality-wise since prices are determined by the government. However, the OMS segment is still unprofitable and can be attractive only in terms of increasing volumes and attracting clients.

The **mandatory third party motor liability insurance** segment has recently seen several innovations. The Europrotocol and direct settlement procedures have been introduced by the regulator. This is expected to increase competition and the quality of service. However, since these amendments have not been properly prepared for, market participants expect a lot of uncertainty in the near future. Moreover, the legislative innovations will decrease the profitability of this sector which is very close to the break-even point at this moment. Small companies, which specialize in this segment only, are expected to go out of business due to this. The aggregate market volume is expected to grow slowly, yet steadily.

**Life insurance** segment, due to its conservative nature, is expected to grow even under the crisis. Our interviewees point out to virtually non-existent competition in this sector. Yet it is not seen as too attractive due to the small size and the overall unawareness of the people about the benefits of this product.

**Personal insurance** segment has somewhat suffered from the crisis. Many corporate clients have recalled the medical and injury insurance programs for their employees. On the other hand, the insurers wishing to retain customers have been decreasing the prices of medical policies while cutting some of the features offered. Due to the inferior quality of existing medical facilities and the inadequate pricing of medical services in St. Petersburg, many insurers are forced to invest into their own clinics.

**Property insurance**, the largest segment in terms of revenue, has suffered the most from the crisis. With the household and corporate incomes sharply decreasing, credit products being largely unavailable and the overall urge to economize, many citizens and companies have decided not to insure their automobiles. On the other hand, our interviewees expect the volume of claims in the voluntary motor insurance sector to increase, partly due to increased crime rate (more car jacking) and insurance fraud. Professional insurers are also concerned with the price dumping of many players. It is seen as a sign of deep liquidity problems of the latter. On the other hand, this will accelerate the exit of these imprudent players. Moreover, the real estate insurance sub-segment is expected to maintain its aggregate volumes as more and more households seek to insure their houses. In addition, a growing amount of companies find it prudent to hedge their risks by insuring their real estate and equipment.

**Liability insurance** segment is expected to grow. Insurers expect a growing demand for liability insurance on behalf of the construction companies due to the recently adopted law that prescribes developers to insure their risks. In addition, the amount of government-funded projects, which require the contractors to insure their liability, is expected to increase. Moreover, the recently adopted legislation on the compulsory insurance of tour operators' liability will also foster market growth.

**Credit insurance** or bancassurance was an important sales channel for the insurance companies during the pre-crisis credit boom. However, currently this channel lost its importance due to the credit crunch. Although the insurers would like to deepen their

cooperation with the banks, the latter are not that interested since their benefits from this partnership are not clear.

Overall, the global financial crisis has caused a serious blow to the Russian and St. Petersburg insurance markets. The demand for insurance products has decreased substantially. The prices, and hence profitability, have also gone down. Several insurers tried to ask for government refinancing, which was rejected though the authorities assured that they would not let the industry collapse. Several companies either already have or are soon expected to exit the market or be acquired by their peers. On the positive side, the financial crisis made the issue of shortage of skilled personnel somewhat less urgent, although there is still a lack of niche specialists (e.g. construction risks' assessors).

**Foreign companies' challenges and opportunities** are somewhat different from those of local companies. St. Petersburg is a large rapidly developing city with ca. 5 million people population. Our foreign respondents point out that they simply can not afford not to be present in St. Petersburg: they are here both to service their Nordic clients which enter the Russian market, and to sell insurance products to local clients. In addition, they expect the market to grow further and the demand for tailored products, especially in the corporate segment, to increase. Our Nordic respondents believe to have a competitive advantage in this niche. On the other hand, there are several obstacles to doing insurance business in St. Petersburg. Our interviewees point out to the general uncertainty of the business environment, which comes from various sources: government agencies, business partners and from inside the company. Also it was noted that the overall development of the market is still far behind that of the Central and Eastern European countries.

When discussing the foreign insurance companies' options for **entering the insurance market** of St. Petersburg, it is agreed by both Russian and Finnish insurers that it is preferable to be done via acquiring a local company. Although there still are many small local players present and the price of the assets has gone down sharply due to the crisis, there are issues of concern here. Our respondents point out that buying a small company

can bring “surprises”, as it is hard to establish the true financial status of such. With big companies there is the problem of post-merger integration. Due to this issue, many foreign companies still prefer to make Greenfield investments despite the long pay back time. Here too foreigners have an advantage over their Russian peers in the form of cheaper and longer financial support on the first stage.

As for the **long-term prospects** of the St. Petersburg insurance market, our interviewees seemed rather optimistic. They all pointed out that the market will become cleaner, more transparent and civilized. Market concentration is expected to increase substantially: weak and imprudent companies with sound customer base will be acquired; small insurers with shady history will leave the market partly due to increasingly strict supervision of the authorities. Leading companies will strengthen their positions and gain new clients and reputation. New foreign insurance companies are not likely to enter into the Russian markets or already existing companies are not likely to expand aggressively in the medium term. It is generally believed that eventually there will be no significant local players left on the St. Petersburg market – only foreign and national players.

In terms of different **segments**, our interviewees see a lot of potential in all of them. The mandatory health insurance will be stable due to its national coverage and government-regulated tariffs. Mandatory third party motor liability segment’s development largely depends on the actions of the legislator: if the tariffs are increased and the filing procedures are improved, this segment will be attractive to insurers. If not, it will soon start yielding losses to the insurance companies. Yet even so the insurers can not afford to exit the OSAGO segment as it is an important way to attract new clients. Life insurance segment is expected to grow steadily, and judging from the experience of the 1998 financial crisis, it will not be affected by the incumbent crisis. Property insurance segment’s growth is expected to resume along with the revival of the banking and leasing financing. There is still a lot of potential here since the citizens of St. Petersburg have only started getting used to insuring their real estate.

**Customer preferences** are expected to change. The crisis will show the clients that price of a policy is not the main decisive factor as the cheapest insurance companies are usually those that do not pay on time or do not pay at all having gone bankrupt. Instead, companies and retail clients are expected to pay more attention to insurers' reputation and service level. On the other hand, the insurance companies will have to try harder to prove their worth to the clients since the latter are expected to become more aware of the features of insurance and demand better service. As for the corporate clients, their preferences will switch to bundled products, i.e. one insurance company providing the whole insurance coverage: from mandatory health insurance to risk hedging.

Overall, our interviewees as well as other experts expect the Russian insurance market to move towards the standards and practices adopted in developed countries. The legislation is expected to move towards the best international practices as well. Our respondents are quite optimistic about the future of the insurance market and are confident in their ability to see it through the crisis and beyond.

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