

ALBANIA

INSURANCE MARKET DEVELOPMENT

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**From Examples of
World Bank Projects**



PREAMBLE: The insurance industry is regulated and supervised as part of the financial system. It supports broader economic and general well-being in developed economies in a way that is so entrenched and accepted that it is not widely recognized. In less-developed markets, insurance can remain nascent for many years and then pick up through a dynamic development phase and reach a more mature phase. Many actors contribute to this development. This report is part of a larger effort to understand the key drivers of development in insurance sectors in a range of jurisdictions, especially the role of policy and project interventions.

The Finance, Competitiveness, and Innovation Global Practice of the World Bank Group, specifically Inna Remizova (Financial Sector Consultant) and Peter Wrede (former Senior Financial Sector Specialist) under the guidance of Fiona Stewart (Project Leader, Lead Financial Sector Specialist), prepared this report.

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Insurance for Resilience and Inclusive Growth

The goal of the overall project is to partner with countries to support development of their insurance markets by investigating the experiences of several selected countries. It incorporates assessments of regulatory and supervisory settings in comparison with a range of international standards as well as market circumstances to identify how these settings and contextual elements have contributed to growth and development. The analysis examined the insurance supply chain and considered demand and outcome-based metrics.

A parallel effort that includes quantitative analyses of a range of cross-country data sets and a review of observance of the International Association of Insurance Supervisors' Insurance Core Principles in comparison with developmental metrics with a view to identifying priority Insurance Core Principles for development complements the country studies.

Overall learning is distilled from the deep-dive studies to present broader conclusions in a synthesis report.

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List of Abbreviations

AFSA	Albanian Financial Supervisory Authority
ALL	Albanian lek
ATM	Automated teller machine
CAGR	Compound annual growth rate
DPL	Development policy loan
FIRST	Financial Sector Reform and Strengthening Initiative
FSAP	Financial Sector Assessment Program
GDP	Gross domestic product
GWP	Gross written premiums
HHI	Herfindahl-Hirschman Index
IAIS	International Association of Insurance Supervisors
INSIG	Insurance Institute of Albania
MTPL	Motor third-party liability
NAIC	National Association of Insurance Commissioners
NBFI	Nonbank financial institution
NPL	Nonperforming loan
RBS	Risk-based supervision
VAT	Value-added tax

Currency: All amounts are in local currency unless specified. At the time the report was prepared, the exchange rate was USD1 to Albanian lek (ALL)110

The insurance industry in Albania is relatively new. Before 1991, there were no insurance companies operating in the country. Today, the Albanian insurance industry¹ is professionally regulated, with a comprehensive insurance law in place. Since the World Bank and the Financial Sector Reform and Strengthening (FIRST) Initiative first funded insurance projects in 2008, insurance penetration (defined as premiums as a percentage of gross domestic product (GDP)) grew from 0.65 percent to 1.04 percent in 2017 and twice as fast between 2008 and 2016 (9.8 percent compound annual growth rate (CAGR)) as nominal growth of GDP (4 percent CAGR). Macroeconomic factors are favorable for further growth in insurance demand. Nevertheless, the insurance sector in Albania remains small in absolute terms (USD135 million written premiums in 2017) and in comparison with peer countries in the region (Croatia - USD1,368 million, Serbia - USD864 million, Bosnia and Herzegovina - USD394 million).

The insurance industry has been undergoing critical changes over the last decade. The independent Albanian Financial Supervisory Authority (AFSA) was established in 2006 to regulate and supervise nonbank financial institutions (NBFIs), namely, the insurance, private pension, and securities sectors. In response to AFSA requests, FIRST provided three consecutive grants worth more than USD1 million between 2008 and 2017.

The efforts of insurance interventions have come to fruition: strengthened prudential frameworks for insurance supervision, steady and increasing penetration of the insurance market. FIRST's assistance has been instrumental, as recognized throughout AFSA annual reports, in helping the authority upgrade the legal framework in line with international standards and to implement risk-based supervision (RBS). Important legal enactments that FIRST has supported include the Insurance and Reinsurance Law (effective July 2014) and subsequent regulations, the amendment to the Motor Third-Party Liability (MTPL) insurance law; support for the Law on Natural Disaster Property Insurance, regulation of actuarial principles, the market liberalization strategy in line with European Union directives, independence of the insurance supervisor (AFSA), and training of new staff.

The legislative upgrade of the insurance market in Albania encouraged its development. In recent years, the focus of insurance legislation has been on updating and making the insurance market more stable and more pertinent in a country applying for EU membership. The Albanian insurance market needs more time to achieve its full potential, but it is important that the country has strong legal fundamentals and supervisory tools in place to regulate and develop the market as the country progresses toward EU membership.

Albania, like all candidates for EU membership, must establish a liberalized market for MTPL. MTPL, the largest line of business in the insurance industry, was based on Albania's centrally managed tariff-based pricing regime. The new MTPL law liberalized premium rates in July 2011.

In 2017, 11 companies were in the Albanian insurance market, eight of which were non-life insurers and three were life insurers. The first state-owned company, INSIG, was privatized in 2016. Market shares of voluntary and compulsory insurance were 33.2 percent and 66.8 percent, respectively, of total gross written premiums (GWPs) in 2017. In Albania, like elsewhere, insurance is often bought for the first time when it is compulsory according to law or a condition of a bank

¹ "Insurance" means insurance provided by (private) insurance companies, so "insurance industry" and "insurance sector" exclude social security unless otherwise stated.

loan. Compulsory MTPL dominates the insurance market (with 71.7 percent of premiums coming from motor lines of business).

The life insurance market in Albania is small and still dominated by credit life insurance. Life insurance was introduced in 1997 and accounted for approximately 7 percent of GWPs. The life insurance market in Albania is less developed than Western European countries, but also peer countries in southeastern and central Europe. With annual insurance consumption of USD46 per capita, Albania lags behind Kosovo, where per capita premiums are USD52, Macedonia (USD79), and Croatia (USD327). Historically, Albanian's low level of life insurance penetration was due to low demand (including the absence of personal insurance during the postwar communist period) and supply (state monopoly INSIG had little incentive to expand its product range beyond the compulsory motor liability class). Today, banks are the leading distribution channel for life insurance because of the requirement for credit life or credit personal accident protection.

RBS was introduced in 2016, starting with comprehensive on-site inspections in three non-life insurance companies using the risk-focused methodology. The RBS method led to a market database that helps evaluate the risk profile of each insurance company, as well as the risk level of the insurance market as a whole. Early warning tests started to be used for the non-life insurance market in Albania in 2016, indicating the increasing professionalization of insurance supervision. These financial indicators serve to identify problems of market operators. Technical provisions have increased over the years, reflecting not only market growth, but also the ongoing efforts of the AFSA to developing better reserving standards.

The country's good economic development in the last two decades has contributed to the insurance market's development, but so have good policy choices informed by technical assistance projects and other interventions by the World Bank Group and the FIRST trust fund. The following lessons, discussed in more detail in section 5, could be replicable for other countries with a nascent insurance industry and provide guidance for market development:

Lesson 1 – Technical assistance is beneficial to development of insurance markets, but it is particularly effective when coordinated with other interventions.

Albania's insurance sector could not have arrived at where it is today without outside help. Insurance markets develop differently in different countries, and technical support requires appropriate diagnostics of the markets to be fully effective. Interventions to develop insurance markets need policy support. World Bank insurance-related development policy loans (DPLs) and other technical assistance interventions made insurance policy reforms more effective. Albania is a good example of how coordinating technical assistance projects with other World Bank operations reinforces the effect.

Lesson 2 – Independence of the supervisor is paramount for healthy insurance market development.

The most important task of any insurance supervisor is to police the insurance market. Albania took an important step toward independence of the supervisor in 2006, but sufficient independence was not achieved until 2014. Even a very independent insurance supervisor tends to be part of the public sector and can be constrained by civil service rules that have nothing to do with insurance.

Lesson 3 – Market development requires that supervision and regulation go together and that regulation is informed by international good practices but takes national realities into consideration.

A rigorous assessment of a jurisdiction's compliance with the Insurance Core Principles (ICPs) is an excellent window into priorities for updating the regulatory framework. An ICP compliance assessment or other comparison with international standards and trends reveals weaknesses in valuation of assets and liabilities, investment, risk management, internal control, and corporate governance, as well as capital requirements in many countries. If done intelligently, the mutually reinforcing evolution of regulation and supervision will benefit insurance market development, as Albania evidences.

Lesson 4 – Insurance develops in the context of the wider financial sector. The bancassurance channel has the potential to increase insurance penetration beyond life insurance.

Life insurance is purchased when loans are taken out. Access to more loans not only develop life insurance, but can also boost non-life products, for example property insurance for assets bought on credit. Bancassurance can help drive growth in most lines of business. The bank's customer base can provide sizable pools of potential buyers for insurance products.

Lesson 5 – Compliance with international standards is an important element of strong insurance market oversight.

AFSA gradually improved standards for the industry. Requirements that are too stringent threaten to stifle market development, whereas setting standards too low risks an overcrowded market of weak players, whose failure can wreck market confidence. The necessity of harmonizing national legislation with EU requirements was an important driver for the Albanian insurance market. Liberalization of tariffs in Albania became necessary to comply with the European Motor Insurance Directives. It would have been more advisable for Albania to liberalize gradually, with preparation.

Lesson 6 – MTPL is complex, and de-tariffication needs to be managed when trying to steer markets toward stable development.

MTPL is significantly different from most other lines of insurance business and needs a more comprehensive ecosystem beyond insurers and products. The general experience is that liberalization leads to a major drop in premium rates due to the onset of fierce market competition. The sustainability of products, financial stability of insurers, and health of ecosystem structures need to be coordinated. To address premium erosion and substantial differences in technical provisioning, it is necessary to consider key elements of the ecosystem (in the case of Albania, introduction of MTPL reserve standards, the Compensation Fund) and manage them in coordination with products. For example, requesting insurers to introduce an additional special claim reserve led to the considerable increase in premium rates that resulted in strong growth of the insurance market. This shows how, in MTPL (unlike most other lines of business), not only premiums and reserves, but numerous elements have to be managed simultaneously.

Lesson 7 – Monopolies are detrimental to insurance market development, and it takes a long time to overcome their adverse effects (even as the market share of the former monopolist plummets).

Albania chose to move from the total absence of insurance to a functioning insurance market via a state monopoly. Given the previous role of the government as the sole provider of risk management via social security, this choice is understandable, but it constrained development of a thriving insurance market for a long time. State monopolies with inadequate service reinforce consumers' impression that insurance is of no interest to them and the expectation that social security will better address their risks, even when it no longer covers more than a fraction of the population. This stifled demand has led insurers to focus on compulsory insurance, notably MTPL. This, in turn, led to price wars for market share in this line of business after demonopolization was eventually achieved, threatening market stability and consumer service and challenging the supervisor's technical proficiency.

Several factors are holding back development of Albania's insurance market. Although lack of awareness and understanding is a universal explanation for lack of demand, it is justified in Albania in view of its communist decades without any insurance and its postcommunist insurance monopoly, but it is not the only explanation for the insurance market's lag behind its potential and possibly not the principal one either. A country with a small (and shrinking) population with a low degree of urbanization and weak digital and regulatory infrastructure to serve rural areas, translates into poor economies of scale, which in turn result in poor client value with respect to operating and administrative expenses, claim turnaround times, and product development and diversification. Albanians' lack of enthusiasm may result as much from a rational choice as from ignorance.

Any project has to be put in the context of a longer-term, institution-wide change management effort by the relevant agency and keep possible follow-up work streams in mind as necessary to consolidate and strengthen progress and maintain momentum. Supervisory tools, for example, need to be calibrated, market-tested, and fine-tuned after their initial development, requiring not only training of the users, but also several reporting cycles to allow for that. A strong supervisory approach has to be coordinated not only with the legal framework, but also with the technical capacity of the supervisory staff, because absorption capacity is critical to success.

Without aspiring to the impossible task of attributing causal relationships between these interventions and specific market developments, the following pages will nonetheless suggest what role these interventions may have played in developing Albania's insurance market, so as to guide the way forward in this country and future developmental strategies of other countries.

1. COUNTRY CONTEXT

Macroeconomic Development

Albania has transformed from one of the poorest countries in Europe in the early 1990s to an upper-middle-income country with a per capita gross national income of USD4,300 by 2015.

Albania received EU candidate status in June 2014 and is implementing important reforms on advancing the EU integration agenda. Albania is a Balkan country of approximately 2.9 million people and has a considerably smaller economy than other European states but is highly integrated into international trade and markets (table 1). It has undertaken significant reforms of many aspects of its economy in recent years, including improvement of the business environment and, as a result, attracted USD6 billion in net foreign direct investment from 2007 to 2017.

Table 1: Macroeconomic Indicators

	2013	2014	2015	2016	2017
Real GDP growth (%)	1.1	1.8	2.6	3.5	3.8
Nominal GDP (USD billion)	13	13	11	12	14
Nominal GDP in local currency (billion)	1,351	1,394	1,435	1,481	1,555
GDP per capita (USD)	4,379	4,526	3,896	4,076	4,785
Population (year-end, million)	2.9	2.9	2.9	2.9	2.9
Exchange rate (year average, USD/ALL)	105.7	105.5	126.0	124.1	110.9
Current account (USD billion)	-1.4	-1.7	-1.2	-1.1	-1.0
Current account (% of GDP)	-10.9	-12.9	-10.7	-7.6	-6.9
Foreign exchange reserves (year end, USD billion)	2.7	2.6	3.1	3.1	3.1
Import cover (months)	5.4	5.0	7.3	6.7	6.5
Inflation (annual average, %)	1.9	1.6	1.9	1.3	2.0
Government balance (% GDP)	-5.0	-5.2	-4.1	0.5	-1.0

Source: World Development Indicators, World Bank, IMF.

Note: GDP, gross domestic product.

Albania's development achievements are substantial. Real GDP grew by 3.8 percent in 2017 and 3.7 percent in 2018, reflecting strong domestic demand driven by a revival of construction and tourism services, recovery in the labor market and household credit, and large energy-related foreign direct investment projects (figure 1). Inflation is low. The Consumer Price Index was 2 percent in 2017 and reached the lower end of the Central Bank's informal target band of 3 percent (± 1 percentage point) (figure 2). Interest rates have hit historic lows, and lending requirements have eased for households and small and medium-sized enterprises. Credit growth has been channeled mainly to the household segment, although overall credit growth remains moderate (average 2.9 percent annually) because of lack of solid demand and tight credit requirements for the corporate sector. Economic growth, financial stability, and credit to the private sector have been shown to correlate positively with insurance market growth.

Figure 1: Real GDP growth, average 2011-2017, %

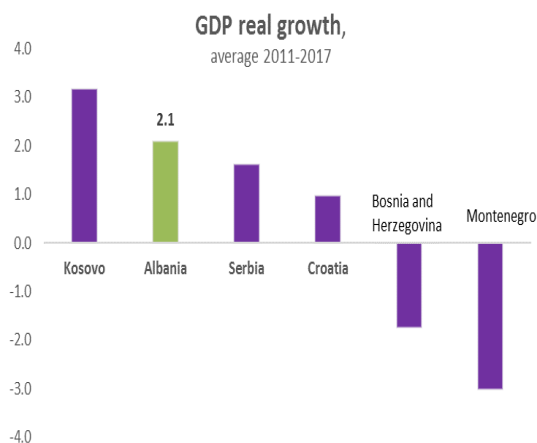
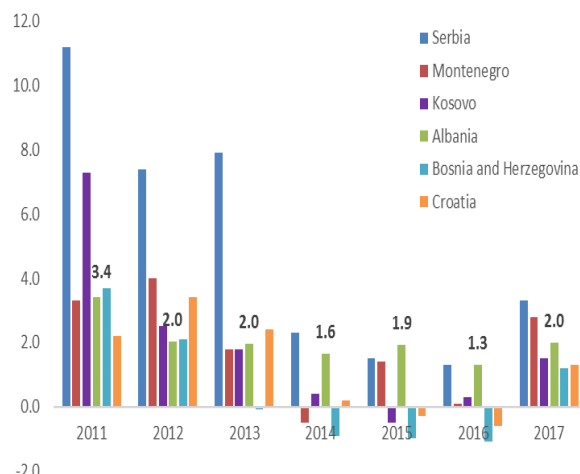


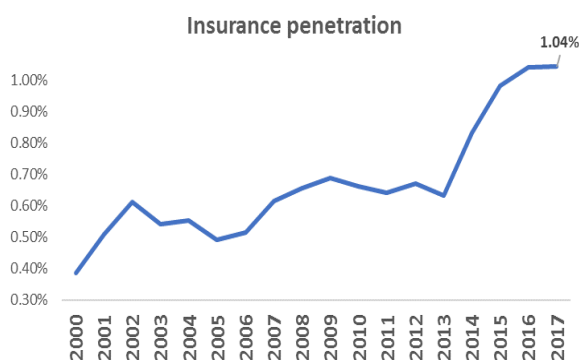
Figure 2: Consumer Price Index, average, %



Source: Eurostat and national statistical offices, Authors' calculations.

Insurance penetration grew from 0.65 percent in 2008 to 1.04 percent in 2017 (figure 3).

Figure 3: Insurance Penetration, %



Source: AXCO.

The ALL continued to appreciate in 2017, reflecting improvement in the external sector of the economy—narrowing of the current account deficit (6.9 percent of GDP in 2017 from 7.6 percent in 2016 and higher foreign inflows, after its significant depreciation against the US dollar in 2014-2015). The level of foreign exchange reserves remains comfortable, covering 6.5 months of imports of goods and services. Albania has a relatively narrow production base, resulting in a large deficit in its trade balance for goods, although the current account benefits from a large volume of remittances, reflecting the recovery in Italy and Greece (the two largest sources of inward remittances).

The fiscal revenue in Albania relies heavily on indirect taxes, as well as direct taxes and social contributions. The value-added tax (VAT) accounts for nearly 33 percent of government revenue and 9.1 percent of GDP. In 2013, the VAT was removed from insurance policies. VAT accounts for approximately half of the revenue of all taxes collected from tax offices and customs. In addition, excise tax revenues account for 11 percent of total revenue and 3.1 percent of GDP. An insurance premium tax was introduced at a rate of 3 percent on all insurance premiums (other than for life, international health, foreign travel, and international motor (Green Card) and increased to 10 percent in 2016.

Social security and health contributions are paid from employment income (minimum and maximum gross salary boundaries, ALL22,000 and ALL97,030, respectively). The employee's contribution rate is 9.5 percent, and the employer pays 15 percent. The contribution rate for health care insurance is 3.4 percent of monthly gross salary, with the employer and the employee paying equal shares--1.7 percent each. Self-employed people pay 23 percent for social security and 3.4 percent for health insurance, but for the latter, the contribution is calculated based on double the minimum wage. These contributions are compulsory for all economically active persons resident in Albania, and other economically inactive persons can voluntarily pay the social and health contribution.

Growth stimulated job creation. Labor force participation increased to 58.3 percent, 0.8 percentage points higher than in 2016. The unemployment rate continued its downward trend to 14.1 percent in 2017 from 15.6 percent in 2016. According to national statistics, the average monthly wage in the fourth quarter of 2017 was ALL61,600 (USD555) in the public sector; it is about 60 percent higher for jobs in financial intermediation. The monthly minimum wage was ALL24,000 (USD216).

An equally impressive decline in poverty has accompanied rapid GDP growth and increases in employment in Albania. The poverty rate (measured as USD5.5/day, 2011 purchasing power parity) is estimated to have decreased in 2017 to 32.8 percent from 33.9 percent in 2016. Extreme poverty is very low. Wage growth, poverty reduction, and evolution of the regulatory framework will continue to push total insurance premiums higher.

The comparatively high degree of informality in Albania is likely to hinder development of the insurance market. According to estimates from the International Labour Organization (2018), informal employment accounts for 61 percent of total employment in Albania, compared with 30 percent in Bosnia and Herzegovina and 22 percent in Serbia. High degrees of informality are detrimental to insurance demand because workers in the informal economy are excluded from mandatory insurance related to employment, such as group life insurance, and because they are beyond the reach of tax incentives for voluntary insurance. Workers in the informal economy are generally excluded from social security schemes that provide health care financing, for example, so in theory, their need for private insurance is even greater. Lastly, it is suspected that high degrees of informality are related to low demand for insurance in some countries because consumers have less motivation to buy insurance related to third-party damages, compulsory or not, because the risk of being held accountable is perceived to be low.

Demographics

Albania's population declined in 2017 by 0.2 percent from 2016. The number of births fell by 2.3 percent to 30,869, and the number of deaths increased by 3.9 percent to 22,232. There was massive emigration: 39,905 people in 2017, driven by poverty, lack of professional opportunities, and disillusionment with life in Albania. This is having several effects, including a shortage of skilled labor and a growing strain on Albania's public finances as the dependency ratio shifts. According to the latest World Health Organization data published in 2018, life expectancy in Albania is 74.3 for males and 78.6 for females, and total life expectancy is 76.4, which gives Albania a World Life Expectancy ranking of 53. By 2030, Albania will have 6.2 dependents for every 10 workers, one of the highest ratios in Europe.

Most of the population is subsistence farmers with little cash income. Although Albania's inner-city and major highways have been vastly improved in recent years, the wide dispersal of the rural population and appalling state of country roads make it challenging to distribute insurance on an individual basis to many Albanians.

Banks dominate the financial system in Albania, accounting for financial sector assets amounting to 90 percent of GDP, whereas assets held by NBFIs, which have grown rapidly since 2012, still amount to only 10 percent of GDP. Approximately 85 percent of total assets in the banking system are under foreign ownership; EU banks hold 63 percent (IMF 2017). The Albanian NBF sector is relatively underdeveloped and smaller than in other new EU member states. The small size of the economy and a business climate less favorable than that of its neighbors have also hindered private capital market development. There is a need for Albania to diversify its financial system by stimulating development of NBFs and the capital markets, starting with the secondary market of government securities, and expanding the insurance and private pension sectors.

The banking sector is stable, liquid, and profitable. Banks are well capitalized and highly liquid, but their lending remains subdued. The ratio of nonperforming loans (NPLs) to total gross loans declined from 18.3 percent in 2016 to 13.2 percent in 2017, mainly as a result of mandatory write-offs. The high level of informality and weaknesses in contract enforcement and collateral recovery constrains financial intermediation. Overall, the banking system maintains adequate buffers to absorb shocks, with capital adequacy and liquidity ratios exceeding regulatory requirements and profitability improving. Banks also do not rely on foreign-based parents for funding because the loan-to-deposit ratio is low and declining (table 2).

Table 2: Financial Sector Indicators

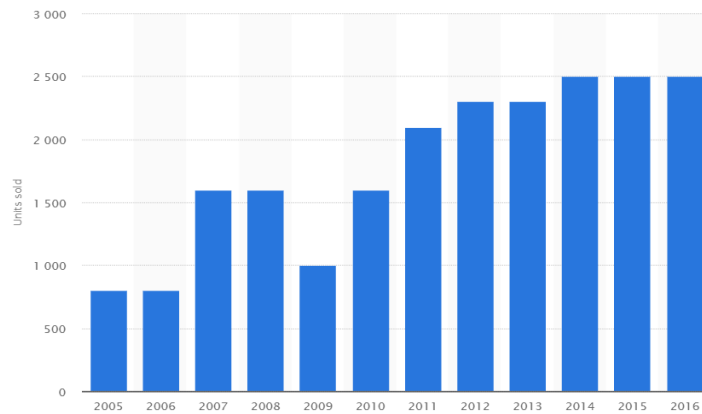
	2013	2014	2015	2016	2017
Total assets of the banking system, million Euros	9,877	10,872	10,728	11,906	11,873
Credit growth, %	-0.2	0.2	0.3	-0.7	-0.2
Deposit growth, %	3.7	1.5	1.9	1.1	1.0
Loan-to-deposit ratio	58.4	57.7	56.8	55.8	54.8
Financial soundness indicators, %					
Nonperforming to total loans	23.2	22.8	18.2	18.3	13.2
Core capital to risk-weighted assets	18.0	16.8	16.0	15.7	16.6
Liquid assets to total assets	27.6	31.9	32.3	31.3	30.2
Return on equity	6.4	10.5	13.2	7.1	15.7
Foreign exchange loans to total loans	63.0	62.4	60.8	58.6	55.9

Source: 2018 Economic Reform Program, Bank of Albania.

Of 16 banks operating in Albania, two dominate the market, with a cumulative 46.3 percent market share. Banking services are fairly modern but skewed toward urban areas. In recent years, there has been a significant increase in bank branches, and 14 banks offer electronic banking transactions through a variety of instruments such as debit and credit cards, automated teller machines (ATMs), point-of-service terminals, internet banking, phone banking, mobile and short message service banking, and prepaid cards, although most branches and ATMs are in urban areas.

With the increase in consumer wealth and the growth of household loans, the demand for cars has increased (figure 4). The private car market recorded a positive trend in Albania. Figure 4 shows an estimate of annual sales of private cars in Albania from 2005 to 2016. This is relevant for insurance because mandatory MTPL insurance is often the first insurance that households buy and because MTPL often determines the insurance experience and opinion of wide parts of the population (even those who do not own a car). In many countries, this leads to fierce competition for MTPL market share to the detriment of efforts to serve consumers well with other lines of insurance.

Figure 4: New Passenger Car Sales Figures in Albania from 2005 to 2016, Units Sold



Source: *statista.com*

<https://www.statista.com/statistics/557536/sales-new-vehicles-albania/>

Financial Inclusion

Financial inclusion is low. Global Findex data reveal that 39 percent of adults had a bank account in Albania in 2017 (compared with 67 percent for the world’s total population) (figure 5 and table 3). Although this is growing, 61 percent of adults remain unbanked (without an account at a financial institution or through a mobile money provider) in Albania for self-declared reasons that include cost and geographical ease of access, lack of documentation, and distrust in the financial system (figure 6).

Figure 5: Account Ownership, 2017

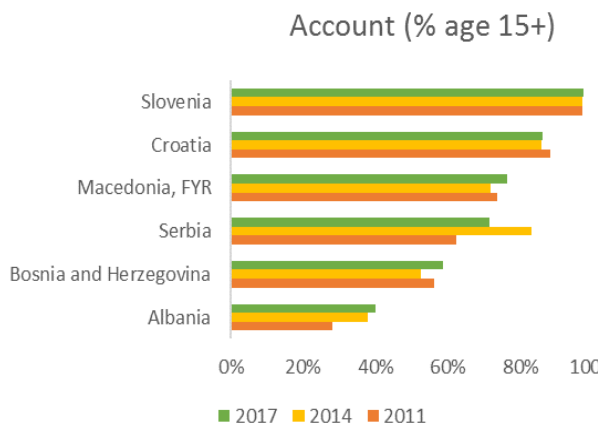
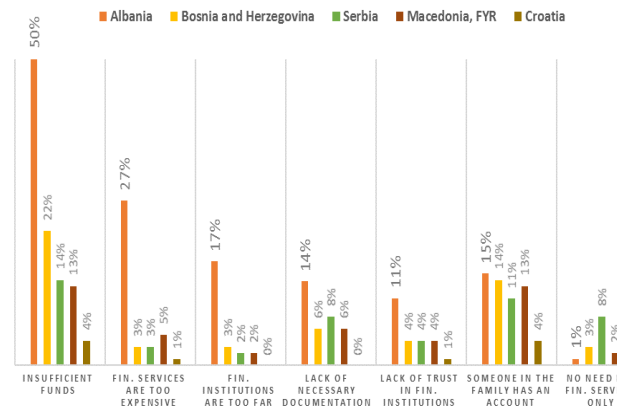


Figure 6: Reasons of Unbanked Population, % Aged 15+, 2017



Source: *Global Findex Database*;

https://globalfindex.worldbank.org/#data_sec_focus

Table 3: Financial Inclusion Indicators, 2017

	Albania	Bosnia and Herzegovina	Croatia	Kosovo	Montenegro	Serbia
Financial Institution Account - All adults	39%	59%	86%	52%	68%	71%
Financial Institution Account - Adults living in rural areas	30%	59%	88%	50%	68%	68%
Used an account to receive wages	16%	24%	40%	11%	31%	31%
Used a financial institution account to pay utility bills (past year)	5%	12%	41%	8%	23%	26%
Saved at a financial institution (past year)	9%	10%	36%	9%	10%	12%
Saved any money (past year)	26%	21%	47%	39%	29%	30%
Borrowed from a financial institution	9%	9%	13%	10%	15%	12%
Borrowed any money (past year)	43%	24%	51%	44%	45%	41%
Saving formality gap	17%	11%	11%	31%	19%	18%
Borrowing formality gap	34%	15%	38%	34%	30%	28%

Source: The Global Findex Database 2017.

Annual cash-in and cash-out activities are significant for Albania. Albanian consumers make and receive day to-day payments overwhelmingly in cash – 96 percent of payments initiated and 90 percent of payments received (World Bank 2018). For all business sizes surveyed, 99.2 percent of all payments in volume terms were received in cash. Businesses accepting electronic payments through a point-of-sale device are limited to 15 percent of the business sample.

E-money, which was recently introduced to the Albanian market, reached 177,000 accounts in 2016. In terms of access points, during 2015–16, the net growth rate of bank branches and ATMs per 100,000 adults was negative (–4.2 percent and –3.2 percent, respectively), whereas the net growth rate of e-money agents and POS terminals was positive (+25.7 percent and +6.3 percent, respectively).

E-money products are demonstrating potential. After groceries and necessity goods, Albanians make the most payments for periodic bills and services; of these, 90 percent are made in cash. Similarly, 95 percent of person-to-person transfers are cash-based. Although government disbursements to a great extent are paid directly to the beneficiary’s bank account, old-age pensions are channeled mostly through physical service channels and paid in cash. In 2016, there were approximately 22.5 million cash withdrawals in the country, 59 percent of which were made via debit card at an ATM and 32 percent at bank branches. Another 19 percent of cash withdrawals represent cash-out at an e-money agent. Moreover, there were approximately 10.5 million cash deposits, 85 percent of which were at bank branches and 15 percent at (e-money) agents.

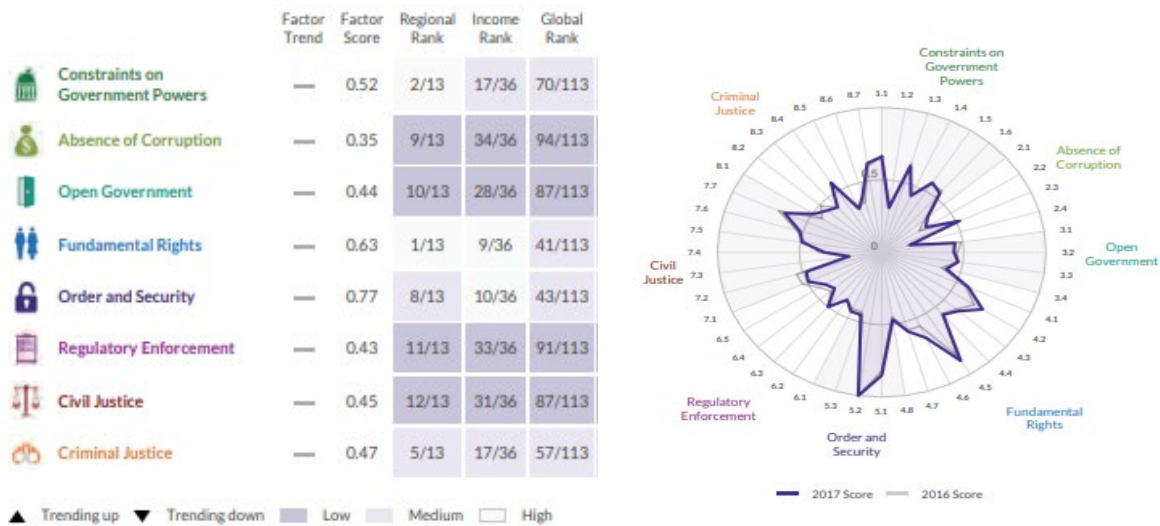
Economies that are heavily cash based pose particular challenges to development of insurance markets, especially in countries where the road infrastructure does not favor serving rural populations face to face. Transfer of money in the form of premiums and claims payments is at the core of insurance and can add considerable cost and hassle to the overall client experience when relying primarily on cash transactions or checks that claimants need to cash at a bank branch. Furthermore, banks and microfinance institutions have some advantages when it comes to expansion of the use of insurance among first time buyers.

The Rule of Law

The Albanian government is continuing to prepare the country for integration within the European Union and is committed to the eradication of corruption and organized crime. Governance and rule of law is an area where Albania is lagging, with a rank of 68 out of 113 countries in the 2017-18 World Justice Project Rule of Law Index (figure 7). Absence of corruption, regulatory enforcement, open government, and civil justice in Albania are very low in global rankings, although some important business-relevant reforms have been launched, such as a comprehensive overhaul of the justice system. A weak judiciary, insufficient enforcement of property rights, and burdensome administrative procedures are institutional weaknesses that have been only partially addressed.

This is relevant for insurance because governance indicators such as the rule of law, indicative of insurable certainty, have been shown to correlate with insurance market development (Gine, Barboza, and Wrede 2019). When people have doubts as to whether their entitlements toward insurance companies can be enforced by law if necessary, buying insurance may not appear to be a safe bet; and when people do not need to worry that they will be held legally accountable for damages they cause to others, their motivation to buy liability insurance tends to be lower.

Figure 7: Rule of Law Index in Albania, 2017-2018



Source: WJP 2018.

The World Bank 2019 Doing Business report ranks Albania’s business environment 63 out of 190 countries in the world. Although this was a rise of two places from last year, Albania is still ranked far behind neighboring Macedonia (10), as well as regional peers such as Kosovo, Serbia, and Montenegro. The indicators on which Albania performs best are trading across borders (24), protecting minority investors (26), and resolving insolvency (39), and the process of enforcing contracts has eased since the procedure for making small claims was simplified, although many problems remain. Most interactions with the state are slow and costly, including paying business taxes (the highest in the region), enforcing contracts, getting electricity, and obtaining a construction permit, despite attempts to put some government services online.

Natural Disaster Impact

Albania is highly vulnerable to natural disasters and climate change. According to the Emergency Events Database, from 1974 to 2016, floods accounted for the major share of disaster events. Occurrence of different disasters over these years shows that the large majority of them are of hydro-meteorological origin. Incidence of catastrophic events in Albania has resulted in a steady increase in number and economic losses brought on by disasters. A September 2002 flood alone affected 16,971 families, inundated 30,000 hectares of agricultural land, and damaged 494 houses, with reported economic losses of USD17.5 million. The most recent flooding was in December 2017, when more than half the country was inundated after days of torrential rain, affecting 3,500 houses and 10,000 hectares of farmland; destroying more than 60 bridges; closing main roads, including the Durres-Tirana highway, causing widespread interruptions to power and freshwater supplies; suspending flights and ferry services; and leading to several fatalities. Landslides are also a major problem given that many roads, rail networks, and settlements are built along unstable slopes.

Extreme temperatures can result in drought and wildfires. In summer 2017, more than 600 fires broke out in multiple locations, especially in the south of Albania, and the agricultural sector suffered heavy losses because of the absence of irrigation water, a serious shock to a country where farming contributes to one-fifth of GDP and half the population works on the land.

Earthquake hazard is classified as high in Albania.² Seismic activity is frequent, and massive earthquakes occur occasionally. Poor infrastructure and uncontrolled land use worsen the effect of natural disasters. Thus, there is earthquake risk accumulation in insurers' balance sheets. Such risk accumulations require proper risk management to ensure that claims are paid in full and insurers remain solvent after an earthquake.

Insurance penetration for catastrophe perils is in the low single digits. An earthquake microinsurance product was designed under the World Bank Insurance Program for Southeast Europe and the Southeast Europe Catastrophe Risk Insurance Facility, supported by the Swiss State Secretariat for Economic Affairs.³ To increase awareness of the danger of earthquakes and promote insurance coverage available to homeowners to protect their housing investment, one insurance company purportedly provided the first 300 clients with earthquake microinsurance coverage free of charge in September 2017. The insurance policies are designed to provide the insured with immediate payouts of up to ALL300,000 in the case of total damage to their dwellings caused by earthquake.

The Albanian Financial Supervisory Authority (AFSA) and the government have announced an initiative to make reasonably priced insurance against natural disasters (flooding and earthquakes) compulsory for every business and household. Meanwhile, insurance against fire and natural perils increased to approximately ALL1.4 billion (10.6 million Euro) in 2017. Insufficient growth in a country being regularly hit by natural disasters such as flash floods leaves business and households completely uncovered.

2. INSURANCE MARKET DEVELOPMENT

Premium Growth and Development

Since the World Bank started implementing FIRST-funded insurance projects in Albania in 2008, insurance penetration has been continuously growing, from 0.65 percent in 2008 to 1.04 percent in 2017. This indicator shows that economic growth alone does not drive insurance premium volume; insurance premiums grew twice as fast between 2008 and 2016 (9.8 percent CAGR) as nominal GDP growth (4 percent CAGR) (figure 9). Despite this healthy growth in premiums, the insurance sector in Albania remains small in absolute terms and in comparison with peer countries in the region (figure 8, table 4). At 1.04 percent of insurance penetration, the market is in an early stage of development. With insurance consumption of USD46 per capita, Albania lags behind peer countries of southeastern and central Europe. For example, this figure is lower than in Kosovo, where per capita premiums are USD52, Macedonia (USD79), and Croatia (USD327). Albania ranked 130th in total premiums (USD135 million) of the world's 181 insurance markets in 2017 according to AXCO Global Statistics.

² See <http://thinkhazard.org/en/report/3-albania/EQ>

³ See http://www.europa-re.com/uploads/news/Press%20release_Promotion%20of%20catastrophe%20insurance%20products%20in%20Albania_Societe%20Generale%20Bank_FINAL.pdf

Figure 8: Insurance Penetration, % GDP

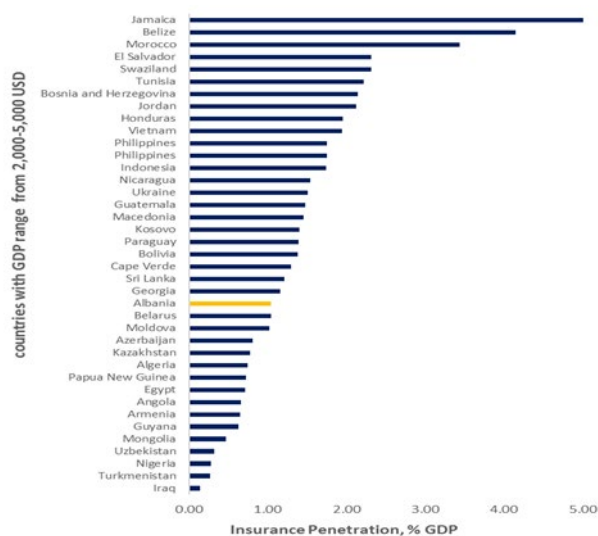


Figure 9: Growth of GDP and Gross Written Premiums in Local Currency, %

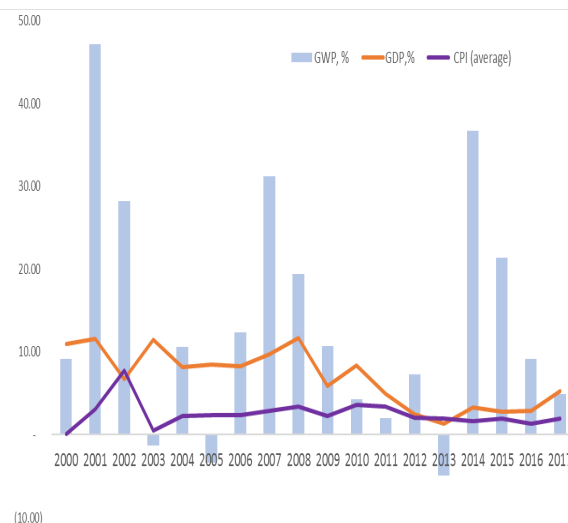


Table 4: Insurance Premiums and Penetration

Country	Population (2017)	GDP per Capita (2017)	2015			2016			2017		
			Written Premiums (mn)	Penetration %	Density	Written Premiums (mn)	Penetration %	Density	Written Premiums (mn)	Penetration %	Density
Albania	2.93	4,450	112	0.98	38.66	121	1.00	41.92	135	1.04	46.17
Bosnia and Herzegovina	3.51	5,181	338	2.02	95.55	359	2.14	101.97	394	2.17	112.27
Croatia	4.19	13,100	1,272	2.60	300.31	1,287	2.54	305.53	1,368	2.49	326.53
Kosovo	1.89	3,816	90	1.42	50.98	90	1.42	50.98	99	1.36	52.03
Montenegro	0.62	7,671	85	2.12	135.83	89	2.12	141.06	92	1.93	148.06
Serbia	8.79	4,713	744	2.00	84.02	801	2.12	90.82	864	2.09	98.28

Source: AXCO.

Between 2007 and 2017, the Albanian insurance market grew in all segments in terms of GWPs and paid claims (table 5). All insurance segments recorded a positive trend throughout the period. Non-life insurance maintained its share of approximately 92 percent of all written premiums (figure 11). The value of gross paid claims increased in annual terms to ALL4.8 billion. Although life insurance GWP almost tripled over this period, it remains an underdeveloped segment in Albania.

The non-life insurance market followed a similar trend, with GWPs doubling, keeping the same proportions in the market structure. Since 2008, the MTPL line has strongly influenced the market. The Albanian insurance market has not changed much in portfolio terms in the past 10 years.

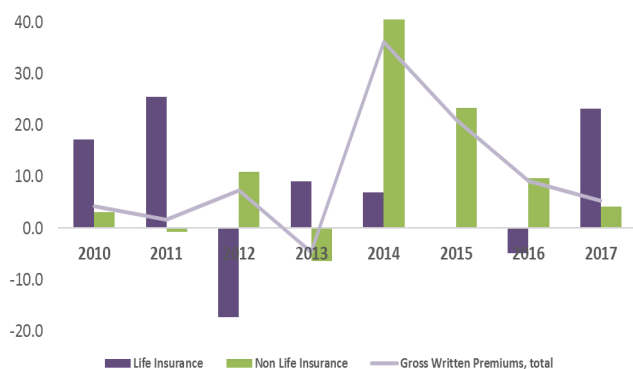
Table 5: Insurance Market in 2007 and 2017

	2007	2017	Growth (%)
Gross insurance premiums (value in thousands ALL, annual)	5,935,377	16,193,678	173
Life	409,526	1,204,267	194
Non-life	5,525,851	14,907,715	170
Gross paid claims	1,311,160	4,808,678	267
Life	41,580	269,302	548
Non-life	1,269,579	4,539,376	258
Insurance policies (n)	543,743	1,261,238	132
Life	40,933	173,917	325
Non-life	502,810	1,087,274	116

Source: AFSA, authors' calculations.

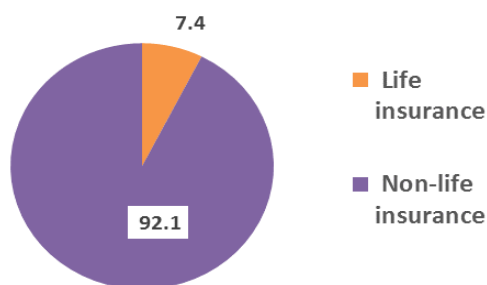
In emerging economies, motor insurance tends to develop early because third-party liability insurance is usually compulsory. Life insurance markets typically develop later, because the life insurance sector is more dependent on the rise of the professional class and capital markets. This is also true in Albania, where motor classes, especially MTPL, make the largest contribution to the total market. The strong increase in GWPs in 2014 was mainly due to the increased level of compulsory MTPL premiums after a period of stagnation (figure 10). This development resulted from the measures that were undertaken to stabilize MTPL rates in the market and prevent the fierce competition from affecting them. The stabilization measures that AFSA took that year were related to tighter rules for payment discipline for motor insurance claims and a considerable strengthening of the Compensation Fund, which compensates victims of uninsured and unidentified drivers, as well as claims against insolvent insurers, and had been carrying forward substantial amounts of pending claims payments (AFSA 2014).

Figure 10: Change in Gross Written Premiums, 2010-2017, %



Source: AXCO.

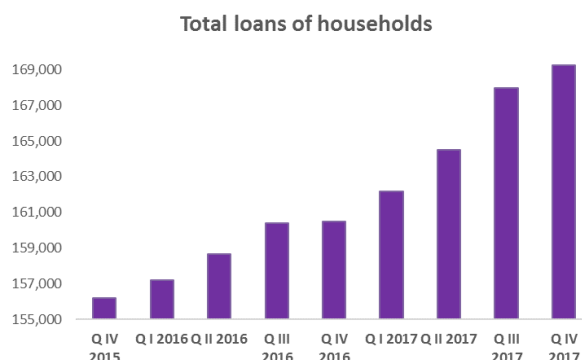
Figure 11: Insurance Market Structure, 2017, %



Source: AFSA.

Life insurance premiums increased approximately two times between 2008 and 2011, followed by a five-year period of stagnation with minor fluctuations. The life insurance market in Albania is dominated by credit life insurance, which depends on credit growth in the country. The modest credit dynamic in 2015-16 hampered the development of the life insurance market. Credit to households in Albania generates not only life insurance, but also usually property insurance for assets bought. Household loans have grown again since 2017 (figure 12), after the NPL ratio dropped to 13.2 percent in 2017. Consumer credit expanded by 8 percent and mortgage credit by 2 percent. Mortgage loans accounted for approximately 63 percent of outstanding loans that resident households received in 2017 (BOA 2017).

Figure 12: Household Loans, ALL billion



Source: Bank of Albania.

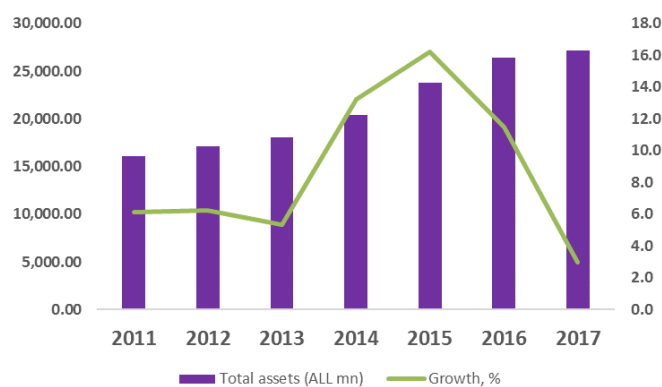
The insurance market performed relatively well financially in 2017. GWPs increased by 5.4 percent, reaching ALL16.2 billion in 2017. Non-life premiums increased by 4.2 percent and life premiums by 23.2 percent. The market was oriented toward non-life insurance, which accounted for 92.1 percent of total volume of GWPs in this market, with life insurance accounting for 7.4 percent. In 2017, the number of insurance contracts reached 1,261,238, an increase of 12 percent over 2016, showing not only that premium growth reflected the general growth of insured values (e.g., newer cars), but also that more people and businesses bought more new insurance.

MTPL insurance constitutes the largest share of the total non-life premium (66.8 percent). Albanian insurers have reported GWPs worth ALL12.46 billion (EUR98.7 million) in the third quarter of 2018, up by 9.73 percent year on year. For the same period, paid claims decreased by 3.1 percent, to ALL3.39 billion (EUR26.86 million). The local subsidiaries of the Austrian group UNIQA lead the life and non-life insurance segments.

Total Assets

Although total assets under management of non-life insurers grew steadily, the proportion of total insurance assets as a percentage of GDP (2 percent in 2016, up from 1.4-1.9 percent for 2007-2015) continues to be lower than in peer countries – Croatia (11.4 percent), Bosnia and Hercegovina (7.1 percent), Serbia (5.1 percent), Macedonia (3.1 percent). Despite the expansion of the insurance market, its share in the financial markets remained roughly at 30 percent from 2013 to 2016. The modest expansion came as a result of increased volume of GWPs, mainly in products of compulsory motor insurance. Total assets managed by life insurers are small, because life insurance in Albania is barely developed and mostly short term. Total insurance market assets grew by 4 percent in 2017, reaching ALL30.6 billion, an increase that the non-life insurance sector drove almost entirely (figure 13).

Figure 13: Total Assets of Non-Life Market



Source: Axco, AFSA.

The capital market is underdeveloped, making it difficult for life insurers to offer attractive products with long-term capital accumulation. Some progress was made on financial market infrastructure with the licensing of Albania’s first private stock exchange, which became operational in February 2018. Investments of insurance companies are focused on deposits with banks, treasury bills, and bonds. Deposits account for the main share (50.5 percent), followed by land and buildings (18.1 percent) and treasury bills and bonds (12.5 percent).

Market Structure

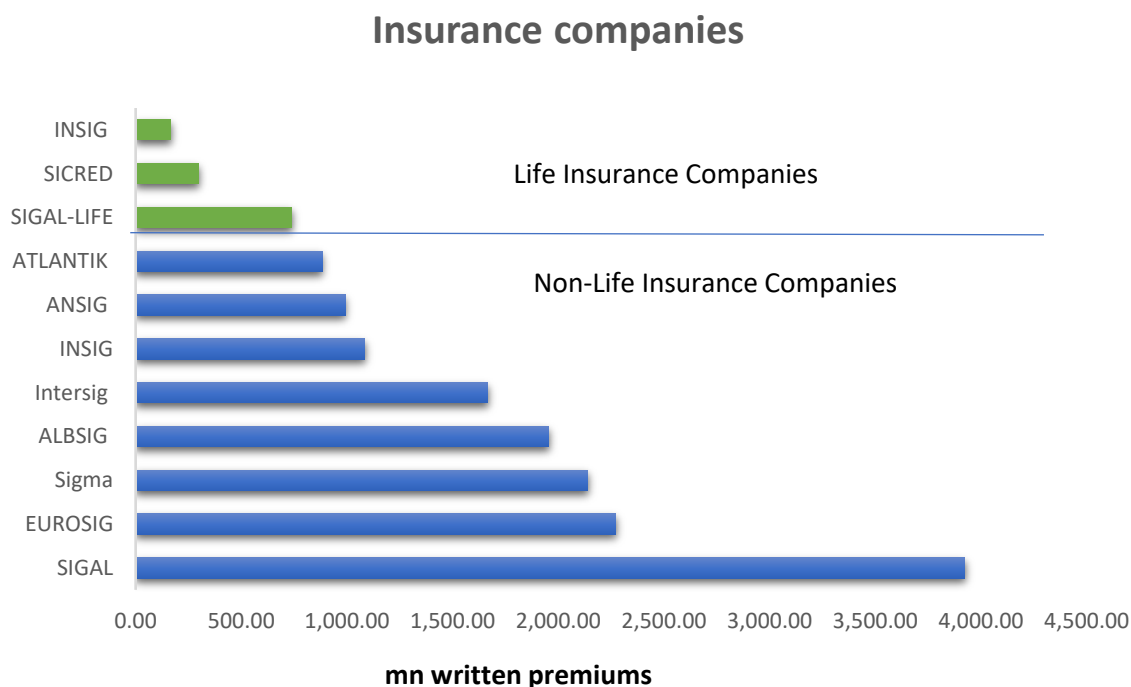
In 2017, 11 companies were in the Albanian insurance market, eight of which were non-life insurers, and three were life insurers (figure 14). The first insurance company, established in 1991 as a state-owned company, was **INSIG**. From 1991 to 1999, the insurance market in Albania was a monopoly, because **INSIG** was the only provider. In 1996, the regulatory framework for market liberalization created the conditions for private life or non-life insurance companies, although it was not until 1999 that two new insurance companies, **Sigal** and **Sigma**, started competing with **INSIG**. These two private companies broke **INSIG**'s eight-year monopoly and gave a new dimension to the sector, creating a new spirit and a competitive environment (Sherifi 2015). Two more non-life insurers (**Intersig** and **Atlantic**) entered the market in 2001. In fall 2004, five new insurance companies received licenses, and two of them offered life insurance products: **Interalbanian**, **Albsig**, **Eurosig**, **Sigal Life**, and **Sicred Life**. In 2007, the Austrian Group **UNIQA** completed its partial acquisition of the **SIGAL** group companies. The **SIGAL UNIQA** companies remain the clear market leader in life and non-life insurance.

Sigal Uniqa Group Austria leads the life and non-life markets. On the life insurance side, Sigal Life Uniqa Group Austria holds a 61.3 percent market share in GWPs (third quarter 2018), whereas its sister company, Sigal Uniqa Group Austria, accounts for 26.3 percent of the non-life insurance business. **SIGAL** was founded in 1999. In 2010, **UNIQA** bought the right to buy a majority share of the company after having acquired a share in 2007. **SIGAL** was the first company in the Albanian market to acquire a reinsurance license, approved in March 2006, which it uses largely to reinsure group companies in Kosovo and Macedonia.

The second-ranked company was **Eurosig**, with a market share of 15.2 percent in 2017. **Sigma Inter-albanian Vienna Insurance Group** was the third-ranked company, with a 14.4 percent market share. The Vienna Insurance Group acquired a majority share in **Sigma** in September 2007. In October 2010, the Vienna Insurance Group bought **Inter-albanian**, the fourth-ranked non-life company in 2014, and the two companies were merged in 2014. The company has subsidiaries in Kosovo and Macedonia. **Albsig**, ranked fourth with a market share of 13.1 percent, is also licensed in Macedonia. The third company in the Vienna Insurance Group is **Intersig**, acquired in August 2011, with a market share of 11.2 percent. Thus, the aggregated market share of the Vienna Insurance Group in Albania was approximately 25.6 percent in 2017.

INSIG, the ex-state monopoly, had a significant reduction in its share, from 18.6 percent in 2006 to 6.7 percent in 2016. In March 2016, the Albanian government announced the end of its long-running process to privatize **INSIG**. As the first insurance company operating in Albania, **INSIG** played a defining role in the creation, development, and consolidation of this business. The company has expanded its operations outside Albania by opening new subsidiaries in neighboring Kosovo and Macedonia. Non-life insurer **Eurosig**, which outbid three other companies with an offer of USD17.9 million, acquired the company in May 2016. In January 2017, **Eurosig** announced that it had sold 90 percent of the life operation of **INSIG** in equal shares to **Albsig** and an Albanian business entrepreneur, Samir Mane, owner of the **Balfin Group**. The price quoted was USD1.1 million.

Figure 14: Gross Written Premiums of Life Insurance and Non-Life Insurance Companies, 2017



Source: AXCO, AFSA.

Market concentration is high, and the upward trend was interrupted only slightly over the last two years. Combined market share of the five largest non-life insurers was 80.2 percent and of the top three was 55.8 percent in 2017 (table 6). Kramaric (2012) analyzed the market structure as well as the degree of concentration in insurance markets in new EU member states (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovakia, Slovenia). The results of the analysis showed that, in all countries analyzed, the level of concentration decreased, although with significantly different intensity. The fact that these countries were centrally planned economies, where one state-owned company provided most insurance services, explained this. After the collapse of communism, some countries adopted free-market policies more quickly, increasing the proportion of insurance companies operating in insurance markets, especially those with foreign capital, which resulted in greater competition. In the case of Albania, competition was a positive factor, given the size and development of the market.

Table 6: Market Concentration

	2012	2013	2014	2015	2016	2017
Top 3 companies	54.1	58.1	54.4	60.3	57.5	55.8
Top 5 companies	73.3	76.1	72.0	82.2	80.7	80.2

Source: Axco Global Statistics / Industry Associations and Regulatory Bodies, authors' calculations.

Competition in the insurance market is measured according to several indicators. The Herfindahl-Hirschman index⁴ (HHI) measures the size of insurance companies in comparison to the industry and is used as an indicator of the degree of competition as well. A decline in the HHI index is viewed as a reduction in market power, whereas an increase is perceived as a strengthening. The HHI index ranges from 0 (in case of perfect competition) to 10,000 (for monopoly). It is calculated using life and non-life insurance activity.

⁴ HHI is the squared sum of the market share of all insurance companies operating in the industry times 10,000 (to avoid decimals).

Figure 15: Herfindahl-Hirschman Index for Life and Non-Life Insurance, 1999-2017



Source: authors' calculations based on AXCO statistics.

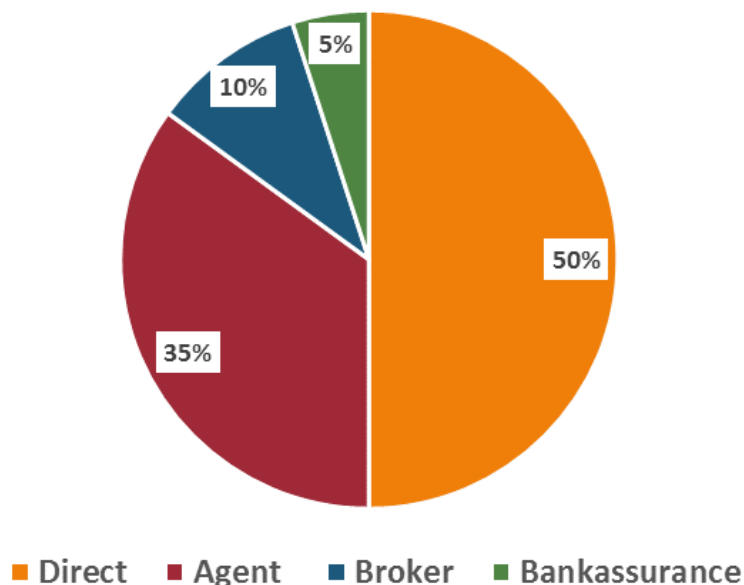
Trends over the last 18 years in terms of the HHI and industry measures show that the structure of the insurance market has changed from the state monopoly (until 1999) to monopolistic competition and moderate concentration in Albania (figure 15), although the degree of competition varies according to class and activity. The level for the life and non-life sectors for the index is different. Overall, the average for the data set suggests that a “natural level” is closer to the data set averages of approximately 2,000 to 2,200 for life insurers and 1,200 to 1,500 for non-life insurers (Thorburn 2008). Life insurance activity is more concentrated than non-life insurance because of the small number of insurance companies operating in the life insurance market. The HHI for life insurance activity is approximately triple the HHI index for non-life insurance and has been increasing, with a value of 4,571 in 2017 (versus 3,411 in 2007). The HHI for non-life insurance of 1,558 is in the normal range for competition.

All companies are locally established joint stock companies. Foreign companies are free to enter the Albanian insurance market, where they may establish wholly owned subsidiaries and branches. Insurance law requires the separation of life from non-life insurance. All insurance companies operate through branch offices in the provinces, many of which operate as independent units, issuing policies and settling claims.

Distribution Channels

A lack of skilled distribution channels characterizes the Albanian insurance market. Insurance knowledge is virtually nonexistent in banks (which act simply as referral agents) and low among agents, so the skills necessary for the active marketing of products are largely missing (AXCO 2019). There were 16 brokerage companies, 224 insurance agents (of which 165 whom licensed for the first time), 36 brokers, and 14 agent companies in 2017 (AFSA 2017). Agents are the main source of MTPL insurance. One recent trend in Albania is that banks have formed their own broking operations after years of operating as agents for insurance companies. Banks are becoming an increasingly important source of loan-related small to medium-sized enterprise accounts, but strict lending criteria limit the amount of insurance that such loans can generate. Figure 16 shows the percentage of premiums written through various distribution channels for the overall non-life and life market in 2016.

Figure 16: Distribution Channels, %



Source: AXCO.

Agents, agent companies, brokers, and brokerage companies perform insurance intermediation activity:

- **Insurance agents.** Insurance agents act on behalf of insurance companies including the presentation, proposal, and other preparatory activities related to insurance contracts and their signing by the insured. Banks, branches of foreign banks, and nonbank financial entities may also operate as agents after they have received prior approval from the Bank of Albania.
- **Agent companies.** Insurance agent companies are legal entities licensed by AFSA. Non-life and life agency activity must be conducted separately. An insurance agent company must always have financial resources equal to 4 percent of its cumulative annual premiums but no less than ALL500,000 (USD3,922). The funds must be deposited in a bank or a branch of a foreign bank operating in Albania. Agent companies must have minimum capital paid in cash of ALL1 million (USD7,843); employ at least one insurance agent; and not be related parties to an insurance company, another agent company, or an insurance or reinsurance brokerage company.
- **Insurance brokers and brokerage companies.** An insurance broker is a person that AFSA has licensed to perform insurance brokerage activities. All brokers must have professional indemnity insurance for a minimum of ALL30 million (USD235,294) per event and an annual amount of ALL100 million (USD784,314). They are also required to have financial resources of no less than 4 percent of their annual premiums, subject to a minimum of ALL1 million (USD7,843). Insurance brokerage companies should have capital of at least ALL3 million (USD23,529). The money must be deposited in a bank or a branch of a foreign bank operating in Albania. There are 13 brokerage companies and three brokerage banks operating in the market. GWPs intermediated by brokerage companies amounted to ALL7,107 million for 2017. Non-life insurance, driven by compulsory motor insurance, accounts for 92.5 percent of GWPs of brokerage companies, and life insurance accounts for 7.5 percent.
- **The technical difference between a broker and an agent is that the broker represents the client (insured), whereas the agent represents the insurance company.** It is the broker's function to search among the various insurance companies to find the best possible combination of coverage at the most reasonable price for the client. A broker must place the insurance contract through the authorized agent of the insurance company selected. The broker is also an independent contractor who controls the renewal of contracts obtained for clients.

The main distribution channel for commercial and industrial business is direct handling.

Most state-owned enterprise accounts are processed on a direct basis, whereas foreign brokers usually represent foreign companies. All insurance companies work through branch offices located in the provinces, many of which operate as independent units, issuing policies and settling claims. Some of them are strategically located next to the government vehicle registration offices, which makes them the major source of MTPL business.

Insurance companies are aware of the possibilities of e-commerce but have yet to develop coherent internet distribution strategies. Discussions in 2006 among the companies with a view to establishing a common online system to sell MTPL resulted in the creation of the National Data Centre in 2007, and the AFSA has created a common database. Insurers have websites, used to inform and attract clients, but it is not possible to purchase a policy on-line, not least because an insurance policy requires a physical signature from the insured.

Bancassurance in Albania

Bancassurance channel growth could increase insurance penetration in the medium term.

Banks are a leading distribution channel because of their requirement for credit life or credit personal accident protection in connection with a loan. Most banks have agency agreements with a number of insurers, and although some allow their customers a free choice of insurance provider, others insist on the policy being obtained from a specific insurer. Commercial banks require their clients to buy credit life insurance sufficient to cover the unpaid loan balance. Approximately 60 percent of life insurance premiums come from credit life insurance, by far the largest class.

Banks need specific bancassurance licenses, awarded by the Bank of Albania, with the AFSA further ratifying the license. No bank has such a license in practice. Agents of the insurer rather than bank personnel perform all significant transactions. Thus, there are no specialist insurance staff in banks. Banks simply act as referral agents, passing the customer on to their allied insurance companies to arrange the coverage required to secure the loan. The only genuine bancassurer is Credins Bank, which established a subsidiary called SiCRED Life in 2004, which makes use of the distribution potential of bancassurance beyond loan-related mandatory covers; their life and health insurance CASH PLAN provides family financial protection in case of loss of life and at the same time insures against medical expenses, with costs starting at 7 Euro per month per person.

Loan-related insurance policies demanded by Albanian banks:

- ***Property insurance*** is mandatory under any mortgage contract. The premium is calculated based on the building type and the requested loan amount, on the order of 0.07 percent to 0.14 percent of the loan amount⁵. The property insurance that some banks require will at any time at least cover the outstanding balance and accrued interest. That means that, as the loan is amortized, the sum insured is being reduced. That is fine for the bank but not for a borrower. If the property burns down, for example, the borrower would need to rebuild, which is likely to cost more than the outstanding balance of the loan, so it would be advisable to take out a policy covering replacement value. Because this insurance provides protection primarily for lenders, they are the first beneficiaries, but homeowners also benefit from property insurance if there is an event that damages the property (BKT 2017).

- ***Mortgage protection life insurance.*** Life insurance premiums are between 0.45 percent and 0.65 percent of the amount of the mortgage, depending on the age and sex of the applicant and the requested loan amount. The amount insured usually follows the mortgage balance and decreases along with the outstanding loan amount. This coverage is not compulsory, because borrowers can

⁵ Data present mortgage loan conditions of banking sector in Albania as of the end of April 2017.

opt to pay a higher interest rate instead of buying credit life insurance. Still, a decrease in lending usually results in a decrease in life insurance premiums, as was the case in 2012 and 2015.

Voluntary versus Compulsory Insurances

Market shares of voluntary and compulsory insurance were 33.2 percent and 66.8 percent, respectively, of total GWPs in 2017. Most people will not buy insurance unless it is compulsory by law or a condition of a bank loan.

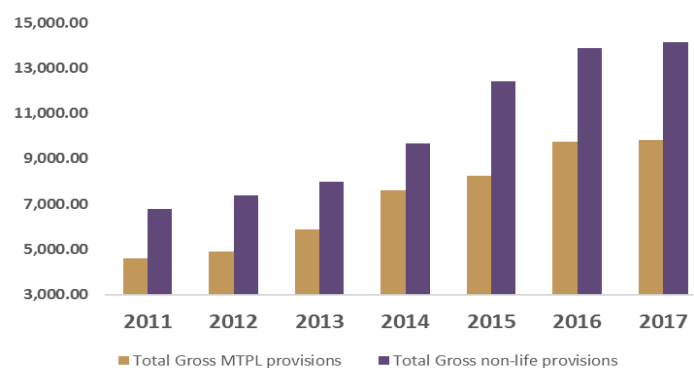
The law on transport sector compulsory insurance⁶ introduced the requirement that passengers using public transport be insured against personal accident and that aviation and marine liabilities be insured against. Lawyers, doctors, accountants, and insurance intermediaries must have professional indemnity insurance. Premiums for general liability insurance accounted for less than 3 percent of non-life insurance premiums.

Technical reserves

Technical provisions have increased over the years. The strong upward trend of technical provisions reflects not only market growth, but also the ongoing efforts of the AFSA to better reserving standards (figure 17), particularly with respect to compulsory insurance, based on analysis of the insurance companies, on-site inspections, and other sources of information such as courts, which provide detailed insights into insurers' liabilities and risks.

The gross technical provision for MTPL constitutes the largest share of the total technical provision of the non-life market. The technical provisions structure reflects the structure of the non-life insurance market, with a high concentration in compulsory insurance.

Figure 17: Technical Provisions, ALL



Source: AFSA.

Insurance Performance Indicators

AFSA started using key performance indicators for the Albanian insurance market (table 7). These financial indicators identify problems that may be due to the deterioration of one or more parameters of market operators. RBS was introduced in 2016, starting with comprehensive on-site inspections of three non-life insurance companies using the risk-focused methodology. Use of the

⁶ List of compulsory insurance: commercial aviation risks; MTPL; personal accident for all passengers using public transport; marine liability; hoteliers' liability; personal accident for workers in mines; general liability of petrol stations; professional indemnity for insurance intermediaries, for notaries; shipowners' liability against marine oil pollution (financial guarantee or insurance); workers' compensation (state social security scheme).

RBS method led to development of a market database that helps evaluate the risk profile of each insurance company and the risk level of the insurance market as a whole.

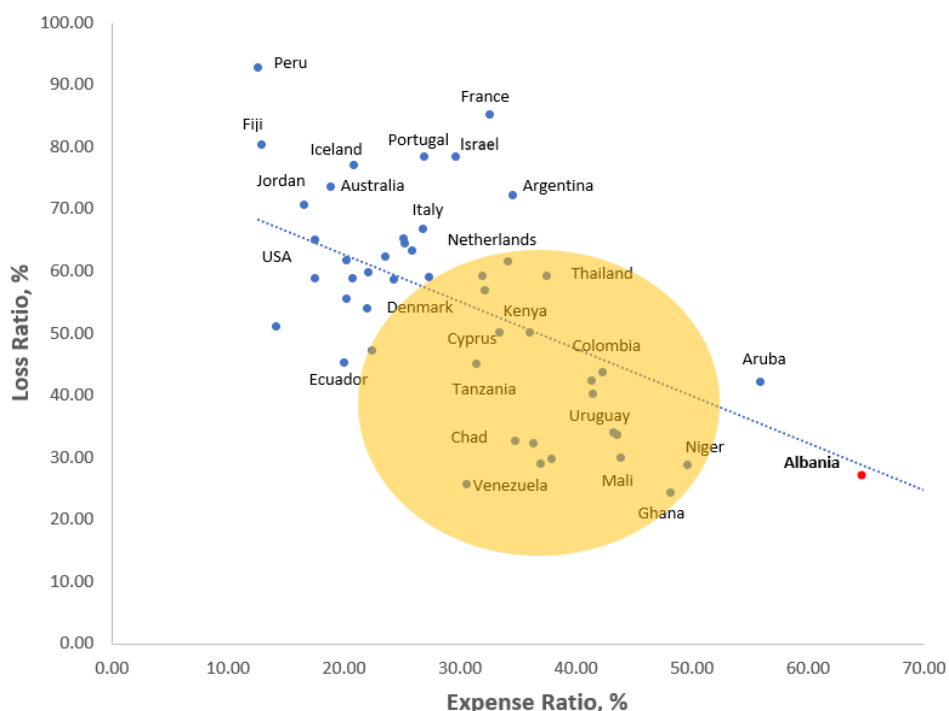
Table 7: Key Performance Indicators

		2012	2013	2014	2015	2016	2017
Claims ratio	Non-life	31.4	42.8	35.8	38.8	29.7	31.1
	Life	20.1	15.5	16.8	16.9	23.6	13.8
Expense ratio	Non-life	68.9	72.9	65.7	62.1	66.9	64.5
	Life	59.7	62.7	51.5	57.6	67.1	69.8
Combined ratio	Non-life	100.3	115.7	101.4	100.8	96.6	95.6
Return on equity	Non-life	4.9	-5.9	6.7	4.4	5.1	9.6
	Life	10.4	9.7	6.9	13.2	5.1	11.7

Source: AFSA 2017.

- **The claims ratio** (*claims/premiums*). The debate about what a reasonable claims ratio is has been going on for a long time. If the claims ratio is too low, the less value for money the customer gets. Claims ratios of less than 50 percent indicate a market that is not working properly, whereas claims ratios that are too high can signal unsustainable levels of competition that threaten financial stability. In Albania, the non-life insurance market claims ratio was 31.1 percent in 2017. This is notably lower than in other European countries, where it fluctuates in the range of 60 percent to 70 percent. Such a low claims ratio in recent years is more likely to indicate poor claims performance and a low level of consumer advocacy.
- **The expenses ratio** (*expenses/premiums*) is a measure of how efficient an insurer is. The premium received should be sufficient to pay expenses and claims in most circumstances and lines of business, because investment income is market driven and not fully under the insurer’s control. If the expense ratio is too high, the insurer will eventually find that it cannot compete for market share against more-efficient operators. Although the trend is improving in Albania, the expense ratio is high and remains above the upper limit of the range generally considered normal (less than 35 percent), the non-life market average being 64.5 percent in 2017 (69.8 percent for life), markedly exceeding those in other European markets. Administrative expenses increased at a higher rate than the net earned premiums, driven by distribution and operational costs. The expense ratio signifies that insurance companies had less money to pay claims and less value for money for consumers. Figure 18 shows how Albania is outside the yellow circle that indicates the “sweet spot” for the most important value-for-money ratios.
- **The combined ratio** (*claims ratio + expense ratio*). The combined ratio measures how much of the premium is being used for claims and expenses. If the combined ratio is greater than 100 percent, the insurer is relying on investment income, and if this is not sufficient, on capital and surplus to cover claims and expenses. The market average combined ratio in Albania was unremarkable in 2017, at 95.6 percent for non-life.

Figure 18: Expense Ratio versus Loss Ratio, %



Source: AXCO, authors' calculations.

Note: Loss ratios (or claims ratios) were taken from AXCO Global Statistics, and the authors calculated expense ratios.

- **Average return on equity** was a healthy 9.6 percent for the non-life insurance market in 2017 and 11.7 percent for life, well above the average of 6.5 percent of the previous years, thanks to good technical results and investment returns.

All these indicators show that the performance of the insurance industry has room for improvement in Albania, where a considerable share of the premium paid by consumers does not benefit them in form of claims payments but is absorbed to finance inefficient administrations. Such averages say nothing about the health and performance of individual insurers, for which no such information is published.

Taxation

Taxation of insurance is not an obstacle to growth. All insurance premiums have been exempt from VAT since January 2015,⁷ when a new insurance premium tax⁸ was introduced instead at the rate of 3 percent, increasing to 10 percent in January 2016. The Motor Guarantee Fund levy is a minimum of 1.5 percent of MTPL income but may be subject to additional amounts if required (table 8). There are no taxes or charges applicable to life insurance.

⁷ Article 53 of Law 92/2014, On value added tax.

⁸ Other than those for life, international health, foreign travel plans, and international motor cover.

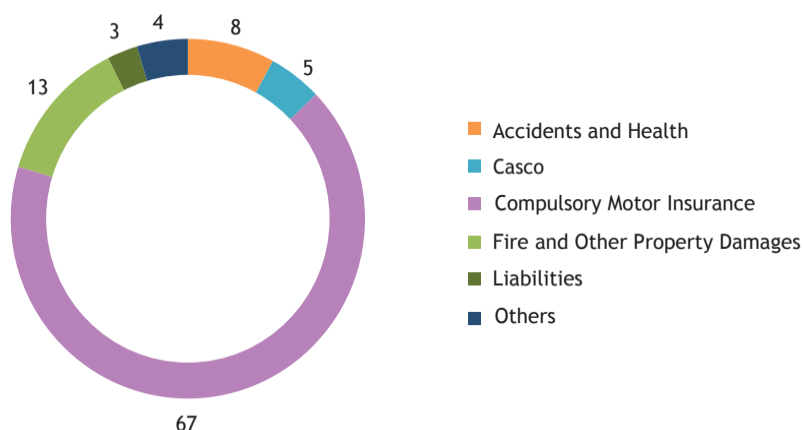
Table 8: Insurance Premium or Policy Taxes and Charges

Insurance class	Description of tax or charge	Rate	Paid by
All non-life (including local private health) except international motor and travel medical	Insurance premium tax	10%	Insured
All non-life (including private health)	Supervisory levy	Up to 1.5 of gross premium	Insurer
Motor	Guarantee fund levy	1.5 of MTPL premium	Insurer

Source: AXCO.

Compulsory MTPL dominates the insurance market. Approximately 72 percent of premiums came from motor lines of business (MTPL, casualty and collision; 13 percent from property; 8 percent from personal accident and health; 3 percent from general liability; and the rest from marine, aviation, transport and financial insurance (table 9, figure 19).

Figure 19: Gross Written Premium Share in Non-Life Market, 2017, %



Source: AFSA.

Table 9: Non-Life Insurance Market by Insurance Portfolio

Portfolios	2013		2014		2015		2016		2017	
	Premiums, millions ALL	%	Premiums, millions ALL	%	Premiums, millions ALL	%	Premiums, millions ALL	%	Premiums, millions ALL	%
Motor insurance	4,383	58.3	7,398	70	9,053	69.4	10,230	71.5	10,689	71.7
Other property and casualty insurance	2,472	32.9	2,366	22.4	2,871	22.0	2,930	20.5	3,029	20.3
Health insurance	669	8.9	807	7.6	1,119	8.6	1,147	8	1,190	8.0
Total	7,524	100	10,570	100	13,043	100	14,307	100	14,908	100

Source: AFSA.

Compulsory MTPL

MTPL is one of the most important lines of insurance business in developed and in developing countries. Motor insurance is the main business line not only in Albania, but also in the region. Compulsory MTPL insurance was introduced in 1992. In most countries where MTPL is mandatory,

it is often the first and sometimes the only insurance a person may have, especially where the degree of informal employment is high. Consumer satisfaction or dissatisfaction with service under this line of business frequently influences perceptions of insurance in general. In Albania, MTPL accounted for 65.5 percent of all premiums in 2014, growing to 66.7 percent in 2017. This dominance contrasts unfavorably with comparable countries in the European Union (table 10).

Table 10: Market Composition Comparison, 2017

	Albania	Bosnia and Herzegovina	Croatia	Kosovo	Macedonia	Montenegro	Serbia	Slovenia
Premium per line as % of non-life insurance premium								
MTPL	77.9	83.0	57.8	86.9	72.9	73.4	64.3	53.7
property	14.0	11.7	23.8	6.2	21.7	18.6	18.1	27.5
liability	2.8	1.6	7.3	1.7	3.1	2.7	3.3	7.3
Premium per line as % of total insurance premium								
MTPL	66.7	59.4	32.4	66.7	53.6	49.4	42.7	22.5
property	11.9	8.4	13.3	4.8	16.0	12.5	12.0	11.6
liability	2.4	1.2	4.1	1.3	2.3	1.8	2.2	3.1

Source: AXCO.

Note: MTPL, motor third-party liability.

An obligation for Albania, as well as for all candidates for EU membership, is to establish a liberalized market for MTPL. Five directives for motor insurance establish the legal framework in EU member states.⁹ Countries aspiring to join the European Union must harmonize their national legislation in accordance with the requirements of these directives.

Liberalization of MTPL tariffs in Europe took place in 1994 under the European Directive on the Freedom to Provide Services and Right of Establishment. European countries have pursued liberalization—meaning insurers’ autonomy to set appropriate premiums at different times and ways. In France, the free tariff regime has been applied since 1986. In Spain, the freedom to set premiums in the insurance sector was established in August 1984. In Germany, tariffs were regulated until full liberalization in 1994. Italy was one of the last Western European countries to move toward liberalization in pursuance of the European Directive of 1994. Austria experienced liberalization in the 1980s and Slovenia in 1997 (Poshnjari 2017).

In Albania, a new MTPL law liberalized premium rates in July 2011 (with amendments to the Law on Compulsory Insurance in the Transport Sector). This law stipulates that "the insurance companies shall determine the insurance premium tariffs themselves, in accordance to the market conditions, and begin to apply them, after informing the Albanian Financial Supervisory Authority. Notwithstanding, the insurance companies should have technical reserves and provisions not below the level of technical reserves and provisions determined by the Authority." AFSA intervenes only when insurance is sold at below risk premium. Until 2011, the law of 1992 regulated premium tariffs for compulsory motor insurance products in Albania, with minimum and maximum tariffs being determined once a year with guidance from the Minister of Finance, following the recommendations of market specialists. Since liberalization of compulsory motor insurance in 2011,

⁹ In all member states, MTPL is mandatory for all users of motor vehicles. This class of insurance in the European Union, as a whole, is regulated under the five directives (72/166/EEC, 84/5/EEC, 90/232/EEC, 2000/26/EC, 2005/14/EC, and changes in 2009/103/EC) that provide guidance on the approximation of the laws of the member states relating to insurance against civil liability with respect to the use of motor vehicles, and three Council directives (73/239/EEC, 88/357/EEC, and 92/49/EEC). Since the early establishment of the European Union, there have been set some basic goals, including two top priorities: creating an open market between EU member states and providing conditions for free movement across national borders. To enable this, there was a need to harmonize the laws of member states and to ensure appropriate regulation that will guarantee long and continual functioning of the system.

insurance companies have determined the risk premium for compulsory motor insurance themselves and much more accurately than before, based on technical models.

Given the dominance of MTPL and competition in this line, the general decrease in motor liability rates after liberalization was so aggressive that overall premiums in the market appeared to be declining fast. A semblance of order was restored in February 2012, but an aggressively competitive price war re-emerged in the summer of 2013, with the standard domestic MTPL price falling from approximately USD129.8 to USD32.4. This was at the root of considerable problems for the Albanian insurance market, given every non-life insurer's reliance on revenue from this line.

Crucially, with significantly reduced income and costs in absolute terms largely constant, companies had considerable problems paying claims and reserving sufficient amounts for unpaid claims. It was symptomatic of this malaise, for example, that the Compensation Fund was more than USD3.37 million in arrears. Premiums rose substantially in 2014 and 2015. At the start of 2015, the average domestic MTPL price was approximately USD114.6, and by early 2016 had risen to USD136.3, although part of this increase resulted from that year's increase in the insurance tax. The average domestic MTPL premium is now approximately USD162.

Table 11: MTPL Dynamics, 2013-2017

MTPL	2013	2014	2015	2016	2017
Gross written premiums, ALL	4,383,490	6,955,252	9,052,804	10,230,479	10,691,506
Gross claims paid, ALL	2,275,457	2,010,587	2,393,586	2,767,806	2,977,750
Net operating expenses, ALL	2,723,187	3,186,424	4,046,444	5,109,862	5,755,084
Net claims ratio, %	62.1	40	35	34.8	32.4
Expense ratio, %	74.5	66.6	61.2	67.9	62.9
Combined ratio, %	136.6	106.6	96.2	102.7	95.2

Source: AFSA 2017.

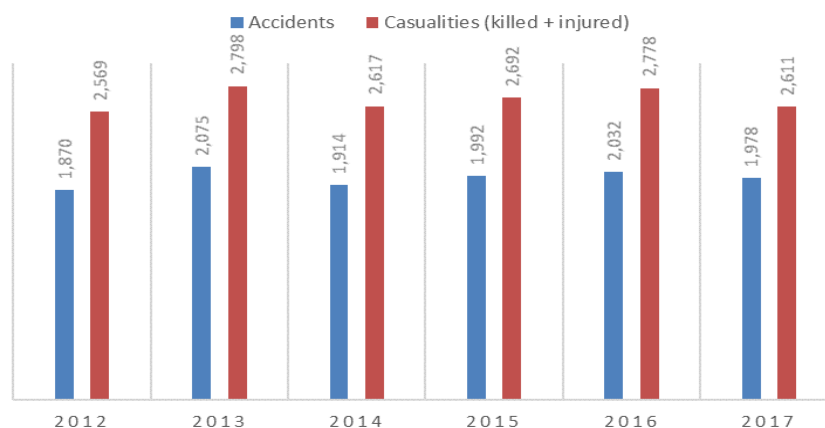
Note: ALL, Albanian lek.

Casualty and Collision

Casualty and collision policies are mainly rated on the type, age, and price of the car, with an adjustment for the age and experience of the driver. Some companies charge lower rates for female drivers. Rate adjustments may also be made for existing clients and those with a large volume of attractive business to offer. Cover for natural perils requires additional premium.

There has been a continuing trend in road accidents as the number of cars sold has grown (figure 20). According to the latest World Health Organization data published in 2017, there were 395 road traffic accident deaths in Albania (2.04 percent of total deaths). Death and permanent disability claims average USD12,000 to USD15,000. Claims in excess of USD50,000 only arise, in theory, if the injured party has to be sent abroad for specialist medical treatment.

Figure 20: Accident Statistics in Albania



Source: INSTAT;

<http://www.instat.gov.al/en/themes/industry-trade-and-services/transport-and-accidents/#tab2>

Personal Accident

Personal accident is a non-life class (3.6 percent of the non-life market in 2017). The individual personal accident market is mainly composed of bank borrowers buying loan protection personal accident policies that cover accidental death only and are thus a cheaper alternative to a credit life that covers death from any cause. Personal accident policies cover death, permanent disability, temporary disability, and medical expenses incurred as a result of an accident but exclude death and injury resulting from earthquake. Normal death benefits range from ALL100,000 (USD784.3) to ALL3 million (USD23,529), and most policies are in the ALL500,000 (USD3,922) to ALL1 million (USD7,843) range.

Life Insurance

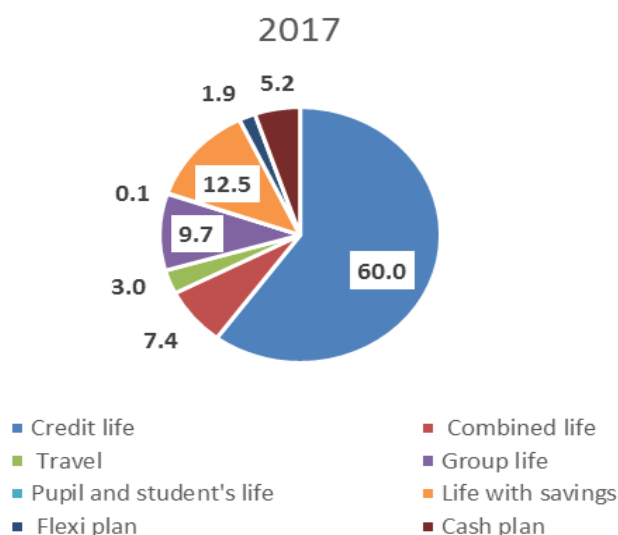
Life insurance accounts for a small share of the insurance market in many developing countries, but it is particularly small in Albania and still dominated by credit life insurance. Although life insurance accounts for the greatest share of premiums in most EU countries, the dominance of non-life insurance is typical for Eastern European countries. The insurance market in Albania is more underdeveloped only than Western European countries, but also than Eastern European countries. Albania has one of the smallest life insurance markets in Europe. In 2016, its life insurance market was ranked 148th in the world, between Dominica and Burundi, which the unusual fact that no life insurance was available in Albania until 1997 may explain. Credit life insurance saw a sharp growth of approximately 276 percent in 2005, albeit from a low base. From 2006 to 2007, most of the growth in life premium was in travel personal accident, written as a rider to an increasing number of life policies. From 2007 to 2011, credit life showed consistently good growth rates. GWPs in life insurance increased by 23.2 percent, and the number of contracts increased by 53 percent over 2016. In 2017, life market penetration and density were still only 0.08 percent of GDP and USD4,449.7, respectively, ranking 147th out of 177 countries.

Insufficient demand and supply explain low life insurance penetration. Albania's low level of life insurance penetration was due to low demand (the absence of personal insurance during the postwar communist period) and supply (until 2006, state monopoly INSIG had little initiative to expand its product range beyond the compulsory motor liability classes). According to research identifying factors affecting the demand for life insurance in Albania, the country's economic growth has not led to increased demand for life insurance because it did not translate into sufficient

increases in household incomes (Madani et al. 2014). Albania is among the lowest income per capita countries in Europe. Other barriers to life insurance development include the absence of supportive capital markets, tax incentives, distribution networks, and product innovation and of national campaigns promoting awareness of financial services in general and in particular of insurance.

Albanian investors have been more interested in short-term investments than long-term insurance contracts. Although life insurers introduced long-term life insurance products with saving elements, this did not bode well for the insurance revenues from such products. They accounted for only 12.5 percent of a small life insurance portfolio of USD9.8 million (figure 21). One of the main structural problems constraining the development of the life market is the lack of investment opportunities, which are limited to government bonds, bank deposits, and real estate. In addition, income and savings of most Albanians are low and have been painfully depleted by financial scams, such as the 1990s Ponzi schemes, which explains why Albanian consumers are slow to embrace life insurance as an investment vehicle, but there are signs that the situation may be changing, with insurers reporting growing appreciation for life insurance and consumers expressing interest in protecting their families against the loss of the breadwinner.

Figure 21: Structure of Business Lines, % of Life Insurance Gross Written Premiums



Source: AFSA.

Box 1: AFSA role is crucial in market oversight and development of insurance

Albania’s transitional period from communism to democracy began in 1990 with a difficult period ensuing in the economic and political arenas that resulted in a long period of transition. Pyramid schemes emerged during this period because of weak controls and instability. As the old social system, which offered free medical treatment, low rents, vacation vouchers, and pensions during communist times, had collapsed, the pyramid schemes became widely considered as a replacement for the social insurance system. The collapse of the pyramid schemes in 1997, when the country was on the brink of civil war, led to the spread of public unrest throughout the country. Two-thirds of the population had invested in the pyramid schemes (Jusufi 2017). By the end of January 1997, the government had almost lost control of the country, as an armed revolt swept away the government’s control over most parts of the country (Biberaj 1999).

The country’s insurance system was reformed and liberalized in 1996. Law N 8081 terminated the monopoly position of INSIG and enabled insurance market liberalization, facilitating new companies’ entrance in the market.

The Albanian Financial Supervisory Authority (AFSA), established in 2006, after the merging of three supervisory authorities,¹ took a lead for the insurance sector. AFSA is responsible for licensing and supervising insurance companies, brokers, agents, loss adjusters, and insurance consultants to promote the sound development of the insurance market and protect consumer interests. Since its inception, AFSA has been involved in an intensive process of strategy development, strengthening its legal and supervisory frameworks to enable more efficient supervision of a fast-growing, rapidly changing market. AFSA has determined to bring the legal and regulatory frameworks in line with international standards and in harmony with EU directives and has approached FIRST for technical assistance. AFSA is a full member of IAIS. AFSA acts as the legal institution authorized to evaluate companies, distribute licenses, and monitor and audit insurance and reinsurance companies.

¹The Insurance Supervisory Authority, the Albanian Securities Commission, and the Inspectorate of Supplementary Private Pensions Institutions.

Three companies offered life insurance in 2017. The life market leader is Sigal Life Uniqa (established in 2004), with 61.4 percent of the market in 2017 (table 12). Sigal Life Uniqa has also built a network of medical facilities in Albania, supporting the health insurance business. Sigal, Sicred, and Insig compete for business in the same market segments, and each of them copies any innovation that either of the others comes up with. With the exception of credit life, all life policies are annual covers, with commission rates ranging from 10 percent to 20 percent. Most healthcare business is written in the non-life market, where it attracts commissions of 10 percent to 20 percent.

Table 12: Gross Written Life Insurance Premiums

	2016, millions ALL	2017, millions ALL	% change	2016 as % of total	2017 as % of total
Sigal Life Uniqa Group					
Austria	586,355	739,339	26.1	60.0	61.4
Sicred	277,208	296,734	7.0	28.3	24.6
Insig	114,287	168,193	47.2	11.7	14.0
Total	977,851	1,204,267	23.2	100.0	100.0

Source: AFSA; authors' calculations.

Albania has low level of life insurance density. Life insurance premium per capita shows how much Albanians spend annually, which is lower than in peer countries (table 13).

Table 13: Life Premiums 2017, USD

	Written premiums (USD million)	Insurance penetration (%)	Premiums per capita (USD)	GDP per capita (USD)	GDP (USD million)	Population (million)	Exchange rate (local currency unit to the US dollar)
Albania	9.8	0.08	3.4	4,450	13,038	2.93	119.1
Croatia	444.1	0.81	106	13,100	54,881	4.19	6.62
Kosovo	2.9	0.04	1.5	3,816	7,228	1.89	0.89
Macedonia	26.5	0.23	12.7	5,442	11,338	2.08	54.7
Serbia	211.2	0.51	24	4,713	41,432	8.79	107.8
Slovenia	736.5	1.51	354	23,447	48,770	2.08	0.89

Source: AXCO.

Note: GDP, gross domestic product.

The healthcare system in Albania is mainly public, with private practice limited to a small niche market sector. The government is the major provider of health services, health promotion, prevention, diagnosis, and treatment for the population of Albania. The private healthcare sector in Albania is still developing, and it covers pharmaceutical and dental services, as well as some clinics for specialized diagnoses, mainly situated in Tirana (USAID 2014). The government of Albania is the main funder of the state healthcare system. Other sources of funding include contributions from some employers, employees, and self-employed individuals, with a percentage of wages or income deducted to contribute to the insurance scheme.

Between 2008 and 2017, there was an increase in the proportion of persons covered by social insurance. According to the Albania Demographic and Health Survey¹⁰ the proportion of women protected by state insurance or social security increased significantly, from 26 percent to 46 percent, whereas for men, the increase was modest, from 34 percent to 37 percent. Thirty-two percent of women aged 15 to 49 are covered by state health insurance, 14 percent are covered under the social security program, and 62 percent report not having any form of insurance. For men of the same age, the coverage is slightly less; 29 percent are covered by the state health insurance, 9 percent are covered under the social security program, and 64 percent report not having any insurance (INSTAT, IPH, and ICF 2018). Although by law all citizens should be covered by health insurance, a huge percentage of the population reported no medical insurance for main reasons: healthcare services requiring out-of-pocket payments, inability to pay for health care, and public health insurance not covering all healthcare expenditures incurred in public institutions (Tomini et al. 2015). There are large geographical differences in health insurance coverage for men and women, with only 13 percent of men and women in Kukës prefecture covered by state health insurance or social security, but 68 percent of women and 50 percent of men in Tirana covered. Eighty-four percent of women and 69 percent of men with a university or postgraduate degree had state-sponsored health insurance, compared with 17 percent of women and men with primary education.

AFSA supervises private medical insurance the same way as any other life or non-life insurance. The only organizations providing private medical insurance are insurance companies. Principal among these is the non-life company, SIGAL UNIQA, the market leader. The main reason for the slow development of private medical insurance was the lack of incentives for people to buy private insurance, because few people could afford regular insurance premiums, and those who were sent to Greece, Turkey, or Italy for major treatments. Gross private medical insurance premiums in 2016 were USD5.6 million (ALL717.5 million), accounting for 5 percent of the total non-life market.

There is also recent growth of supply-side-driven private health insurance products. In addition to travel health insurance, needed by Albanian travelers to obtain visas, different forms of medical insurance are becoming available, such as hospital cash benefit plans, surgical plans, and critical illness coverage, often as a rider to life policies.

3. SUPERVISION AND REGULATION

It is important for the insurance industry to be well regulated. Liberalization of the insurance market, which began in 1999 with the approval of some amendments to Law 8081 “On insurance

¹⁰ A nationally representative study aimed at collecting and providing information on population, demographic, and health characteristics of the country.

and reinsurance activities” enabling the introduction of private insurance companies with domestic or foreign capital, supported development of the sector. Sigma was licensed in 1999; Intersig in 2001; and Interalbani, Albsig, Eurosig, Sigal Life, and Sicred in 2004. Foreign companies began to show interests in the Albanian insurance sector in 2006.

AFSA was established in 2006 to regulate and supervise NBFIs, namely, the insurance, private pension, and securities sectors. After establishment of AFSA and enactment of supporting insurance laws and regulations, supervision of the Albanian insurance market was strengthened gradually between 2006 and 2014, guided by external assessments and technical assistance projects (see section 4) in respect of legal, supervisory framework and capacity building.

Legal framework:

- Insurance Law
- Catastrophe Insurance Law
- MTPL Law
- A set of insurance regulations in the areas of life insurance, reinsurance, and catastrophe insurance

Supervisory framework:

- Risk-Based Supervision Manual
- Life Insurance Supervision Manual
- Reinsurance Manual
- Manuals and instruments for the MTPL claims provisions methodology

Capacity building:

- Workshops, training, and study tours

Law 52 empowers AFSA to develop a functional organizational structure, retain and motivate highly qualified staff, and hire new employees to fill existing and newly created positions. In recent years, the focus of insurance legislation has been on updating and making the insurance market more stable and eligible for EU membership. Following Albania’s application for EU membership, additional legal amendments are expected to adapt local laws to EU laws.

Table 14: Main Insurance Legislative Framework

Legislation	Effective Date	Purpose
Law 9/572 dated 3 July 2006	10 August 2006	Established Albanian Financial Supervisory Authority, which regulates the insurance sector
Law 52/2014 dated 22 May 2014	4 July 2014	Established principles and procedures relating to the organization, management, operation, and supervision of the insurance and reinsurance market, including intermediaries, and strengthens and protects the rights of consumers
Regulation 79 dated 31 August 2015	31 August 2015	Regulates activities of insurance agents and establishes professional and financial requirements
Regulation 85/1 dated 30 September 2015	30 September 2015	Specifies minimum credit ratings and maximum treaty shares for reinsurers
Regulation 87 dated 27 June 2016	27 September 2016	Specifies permitted elements for income and discounts for liabilities for solvency margin calculations

The insurance law and the MTPL insurance law enabled AFSA to bring its regulatory practices and regulatory framework closer in line with the IAIS requirements and introduced risk-based by-laws and regulations to:

- introduce risk-based “early warning” claims performance and solvency requirements, which require companies to meet insurance liabilities arising from insurance contracts in a timely manner and maintain a capital buffer greater than the minimum solvency requirement;
- adopt appropriate requirements with regard to corporate governance and sound risk management practices and adequate management information systems to ensure timely monitoring of insurers’ risk exposures, as well as performance of its senior management;
- develop an internal insurers’ risk rating system for the purposes of efficiently allocating scarce supervisory resources to the most problematic companies and areas of operations;
- develop detailed inspection manuals for thematic regulatory inspections to provide for targeted and quick supervisory action;
- prepare and enact relevant regulations on life insurance;
- introduce a nation-wide earthquake insurance program for homeowners compliant with catastrophe risk management requirements;
- undertake MTPL market stabilization measures by establishing minimum reserving standards based on market-wide claims performance and ensuring proper funding of reserves. These special stabilization measures, designed to address the poor claims payment performance by most insurers immediately, were to be phased out over time in response to visible improvements in market fundamentals;
- conduct a market-wide study of companies’ MTPL reserving practices with a view to understanding the industry historical claims development patterns and drafting a by-law on the minimum regulatory requirement for technical provisions for the MTPL line of business. The reserving requirements and the underlying actuarial methodology shall support implementation of sound claims performance by all insurers in the market and should be supported by a detailed reserving supervision manual and relevant automated IT supervisory tools;
- address the social and fiscal effects of natural disasters and support the growth of the insurance market; and
- introduce a legal mandate for AFSA and provide it with the necessary financial and human resources to supervise compliance of the insurance market with AML and CFT regulations.

4. WORLD BANK GROUP INSURANCE INTERVENTIONS IN ALBANIA

The development of insurance in Albania has benefitted from a number of World Bank interventions over many years. Some had targeted insurance specifically, but others had a broader focus on the financial sector, which helped obtain attention and support from authorities for insurance topics, which in other parts of the financial sector often eclipse. The prospect of joining the European Union also motivated broad support for initiatives that brought the insurance market closer to EU standards, for example regarding effective supervision and the legal framework. Insurance-related objectives of all interventions were well coordinated, and the activities were mutually reinforcing to address weaknesses and vulnerabilities of the insurance sector.

Projects that FIRST has funded have been instrumental. As recognized throughout AFSA annual reports, FIRST projects helped AFSA upgrade the legal framework in line with international standards and to implement RBS. Important legal enactments that FIRST supported include the Insurance and Reinsurance Law with its corresponding subordinate regulations, but also important amendments regarding MTPL, disaster risk insurance, and market liberalization in line with the EU directive. Technical assistance projects that FIRST has funded and the World Bank has implemented are also recognized to have helped with the independence of AFSA and the technical competence of its staff.

The Financial Sector Adjustment Credit, 2002-2004

In 2002, the World Bank Group (WBG) approved a policy-based loan whose objectives included support of the privatization of the state insurance company INSIG, as well as improvement of Albania's regulatory framework. It led to establishment of some budgetary and operational independence of the Insurance Supervisory Agency and to the enactment of a new insurance law, Law 9267, in 2004.

The Financial Sector Assessment Program, 2005

In 2005, a financial system stability assessment (IMF 2005) was prepared for Albania under the Financial Sector Assessment Program (FSAP), which the International Monetary Fund (IMF) and the World Bank designed and conducted to help countries reduce the likelihood and severity of financial sector crises with a comprehensive framework to identify financial system vulnerabilities and develop appropriate policy responses. These assessments usually also contribute to drawing more attention to a country's financial sector in economic policy discussions, indicate obstacles to development and vulnerabilities, and often assess a jurisdiction's compliance with financial sector standards and codes such as the ICP.¹¹

The assessment found the insurance industry to be underdeveloped and fragile, warning that excessive competition for motor insurance through premium discounting (possibly in violation of the tariffs that governed the premium levels of this line of insurance at the time) threatened the financial stability of insurers, as well as their market conduct, for example in the payment of legitimate claims promptly. It also indicated important outstanding secondary regulation to complement the law regulating insurance (Law 9267 of 2004). More importantly, the assessment highlighted the importance of an independent authority equipped with competent management and staff to conduct the supervision required for orderly development of the nascent insurance market. Given the dynamic growth of insurers with weak governance, this was a recommended priority, suggesting specifically that consolidation of the supervisors of NBFIs could achieve economies of scale and improve regulatory efficiency and that the supervisor needed to attract qualified, experienced professionals with appropriate remuneration.

The 2006-2007 Development Policy Loan

World Bank DPLs provide speedy financing to address present or imminent financing requirements related to sustainable development and the necessary policy and institutional actions. They constitute non-earmarked contributions to general budget financing, and although they are subject to the borrower's implementation processes and systems, disbursement is subject to completion of specific policy and institutional "Prior Actions" agreed upon between the World Bank and the client. This is a powerful incentive to prioritize policy action, which in the case of insurance, often fails to attract the sense of urgency from lawmakers facing multiple challenges in the financial sector. In the case of Albania's 2007 DPL, one such prior action required the promulgation of legislation for the establishment of an integrated no-banking financial regulator, what would be known as the Financial Services Authority.

The FSAP Follow-up, 2006-2007

In the two years after the FSAP, WBG experts met repeatedly with Albanian authorities to help advance recommendations on insurance. In that time, AFSA was created, as required according to the DPL, whose mandate included supervision of insurance. By mid-2007, WBG experts

¹¹ The ICPs, which IAIS developed, provide a globally accepted framework for the regulation and supervision of the insurance sector.

recommended increasing its independence and de-coupling its salaries from the Public Administration Law. The experts also pointed to some weaknesses in the legal framework, and the Financial Services Authority requested technical assistance from FIRST in that respect and to strengthen an effective supervisory framework.

This follow-up allowed the WBG experts to gain deeper insights into the Albanian insurance market and uncover further sources of vulnerability, for example insufficient reinsurance protection against natural and man-made disasters. Many technical recommendations to address the weaknesses of the motor insurance market were also shared with the authorities.

FIRST Project for Effective Insurance Supervision and Legal Review (2008-2010)

Following up on the FSAP, this technical assistance project helped AFSA implement effective supervision and review the insurance market's legal framework, with the overall objective of establishing an efficient, fair, safe, stable insurance market for the benefit and protection of policyholders. It helped in designing an effective supervisory methodology including the proper supervisory platform and tools (including the Early Warning Tests mentioned above) and helped increase the capacity of the supervisor to evaluate market participants' risks, to use its resources efficiently, and to prioritize supervisory actions. Specific outputs included supervisory strategy, manuals, action plans and operating guidelines, training of users, and indications for necessary regulatory changes for implementation of strengthened supervision. There was also a review of the legal and regulatory framework for the insurance sector in line with international standards but taking into consideration the development stage of the industry in Albania, with the resulting recommendations and drafting support for new laws and regulations, paying particular attention to areas identified as critical, such as prudential requirements, governance, and asset valuation.

Key lessons learned included that developing a strong supervisory approach has to move in synch not only with the legal framework, but also with the technical capacity of the supervisory staff, because absorption capacity is critical to success. Overall progress may, therefore, be slower than anticipated. The project found that fundamental changes needed in situations such as Albania's at the time require continuous coordinated effort that goes beyond one technical assistance project and that any such project must be put in the context of a long-term, institution-wide change management effort by the relevant agency and keep possible follow-up work streams in mind as necessary to consolidate and strengthen progress and maintain momentum. Supervisory tools, for example, need to be calibrated, market tested, and fine-tuned after their initial development, requiring not only training of users but also several reporting cycles to allow for that.

FIRST Project for Liberalization of MTPL (2011-2013)

Motivated by the outsize weight of MTPL insurance in Albania and by the apparent weaknesses and vulnerabilities of this line, but also by Albania's expectation of joining the European Union and its commitment under the corresponding Stabilization and Association Agreement, AFSA requested another technical support project from FIRST. A crucial element in the transition of the insurance market framework toward compliance with European Union directives was the move away from centrally managed tariff-based MTPL pricing toward fully liberalized risk-based pricing. Based on an in-depth assessment of the state of the MTPL market, company practices, and the architecture of the Compulsory Insurance Information Center system used to determine the prescribed premium levels, the project helped AFSA develop a road map to responsibly liberalize MTPL pricing, including a review of the various relevant legal frameworks (including for the motor accident victims' Guarantee Fund, for trans-border insurance, and for insurance claims adjudicated by the courts). A further important result of the project was the actuarial model and methodology for the calculation of premiums and reserves. Introduction of an effective bonus-malus system, a

tool seen to considerably reduce road traffic accidents elsewhere, was also among the objectives. The project proposal recognized that the previous project had sufficiently developed the necessary technical competence of AFSA and that the project proposal had benefitted from consultation with other international stakeholders who support insurance market development, including the IMF and the U.S. and Swiss aid agencies. The strong ownership of AFSA was among the decisive criteria for approval of the project, as well as the fact that the financial sector development context was part of a broader strategy for growth and development. MTPL pricing that reflected the cost of claims, driven by the anticipated likelihood and expense of claims, was among the motivators to implement risk-based supervision.

Given the ambitious scope of the project, the lessons it generated included that bringing in the right array of experts in their respective fields (IT, claims handling, policy, actuarial) is paramount and that each expert needs to be able to adapt his or her expertise and recommendations to the reality of the target country.

The 2014 FSAP Update

Although FSAPs are conducted in countries with systemically important financial systems every five years, there are no general patterns for when FSAP updates happen in other countries. In Albania, a joint WBG / IMF team assessed the financial sector in late 2013 and documented the findings in early 2014 (World Bank and IMF 2014). This time, a summary assessment of compliance with the ICP was included, taking into consideration AFSA's self-assessment, as well as discussions with market participants, but also the insights gained at previous FIRST projects. It found that Albania's legal and regulatory framework for the insurance industry was only partially compliant with most ICPs. The regulatory framework was too rigidly based on rules as opposed to principles, an approach that had emerged as recommended practice elsewhere because it allows supervisors to direct their attention and resources to intervene effectively and quickly so problems can be prevented from becoming crises. Resources for insurance supervision were found to be insufficient because of AFSA's organizational structure and because remuneration followed civil servant rules, which prevented the hiring of competent professionals from the private sector. It was found that AFSA's having been subject to the Law on Public Administration had compromised its independence, and insurers could easily suspend its corrective and preventive measures by filing appeals in the courts. Although the previous FIRST project had drafted a new regulatory framework for MTPL and other regulations, they had not been enacted by the time of the FSAP update, and this line of business constituted the greatest vulnerability that the FSAP found. Not all insurers seemed to establish sufficient claims reserves to be able to compete more aggressively in the market,¹² and AFSA was ill equipped to police this behavior and assess the capital adequacy of insurers engaged in it. This in turn raised the risk of disorderly market exits, to the detriment of consumers and their trust in the industry, a trust that insufficient funding for the motor vehicle Compensation Fund and the alarming backlog of claims it had to pay to victims of uninsured and unidentified drivers tested further. The FSAP made a number of specific recommendations, all of which AFSA acknowledged, with top priorities being an overhaul of insurance regulation – especially with respect to supervision – and measures to stabilize the MTPL market. Other propositions included mandatory property insurance for natural disasters and waiving the 20 percent VAT on insurance premiums to stimulate demand. Law 92/2014 abolished the VAT on insurance premiums as of 2015 but introduced a 3 percent insurance tax (raised to 10 percent in 2016).

The 2014-2015 Financial Sector Development Policy Loan

¹² Aggressively acquiring MTPL market share before ascension to the European Union, when the insurance company would be sold to European insurance groups, had culminated in market failures in other countries in the region.

The second DPL in Albania was substantially larger and focused specifically on the financial sector. In addition to several prior actions addressing nonperforming loans (see section 1), it contained requirements specific to insurance; disbursement was conditional on the government submitting to Parliament a new insurance law and several other pieces of legislation aiming to strengthen AFSA and AFSA issuing measures to stabilize the MTPL market, including regulation of MTPL reserve standards and replenishment of the Compensation Fund. Parliament approved all the necessary legal amendments that the government put forward, ensuring full financial and operational independence of AFSA, where a new board was granted powers to approve a new organizational structure and salary scale. The newly empowered AFSA requested insurance companies to contribute ALL1,348 million (~EUR10 million) to the Compensation Fund to pay pending insurance claims and recapitalize it to appropriate levels. In addition, a special reserve for insurers was introduced, which led to growth in the insurance market. The World Bank internal evaluation review commended the government's commitment to the policy objectives and the good coordination to implement the prior actions.

FIRST Insurance Market Reform Project for Albania (2014-2017)

Although the DPL addressed some challenges highlighted in the FSAP update, it was not the right instrument to address the further increase in technical capacity of AFSA staff in line with increasing market complexities and the evolution of international good practices, most notably risk-based supervision. The third FIRST-funded insurance project, again executed by the World Bank, continued development of supervisory instruments – now with a focus on risk-based supervision and actuarial tools – and introduced methodologies and tools for the market and AFSA to ensure that MTPL reserve levels are appropriate, including assessment of each insurer's reserves. It continued support for the on-going evolution of the regulatory framework via subordinate regulations (on reinsurance, life insurance contracts, group wide supervision, portfolio transfers and others) and paved the way for a national earthquake insurance program by drafting the corresponding law, supported by technical documentation.

Other FIRSTs

In addition to the three insurance-specific projects discussed above, FIRST has implemented several other technical assistance projects for development of the financial sector in Albania since 2007, a period that saw insurance premiums grow by 173 percent. FIRST projects included Financial Crisis Contingency Planning and Simulation, Strengthening Deposit Insurance and the Resolution Framework, Supervision and Coverage of Pension Funds, Strengthening the Government Bond Market and Management of Related Public Debt, and Safeguarding Stability of the Financial Sector. The value of technical support FIRST has given to Albania adds up to USD2.6 million. This shows how the World Bank remains an important strategic partner supporting AFSA and other financial sector authorities, currently for example by helping AFSA and the Bank of Albania implement a financial reporting based on IFRS.

5. LESSONS LEARNED

Strengthening insurance regulations and supervision assisted with the development of the insurance market in Albania. The following lessons could be replicable in other countries with a new insurance industry or candidates for the European Union with undeveloped insurance legislation and frameworks.

Lesson 1 – Technical assistance is beneficial to development of insurance markets, but it is particularly effective when coordinated with other interventions.

Albania's insurance sector could not have arrived at where it is today without outside help.

Given the complete absence of insurance during communist times and the very slow development after the end of the Soviet Union, Albania had a severe shortage of insurance expertise, not only among insurance companies, but more importantly among policymakers, standard setters, and supervisory authorities. It was not obvious to local stakeholders what weaknesses need to be addressed, in what order of priority, and how. Although an environment of poorly enforced, weak rules may stimulate entrepreneurial spirit, it is not without risk in the area of insurance, which is based on trust, meaning that it is difficult for consumers to assess its value, before or after a purchase. Consumers need more protection in insurance markets than elsewhere to safeguard this trust. Authorities must have the technical competence and political resolve to provide that protection if more insurance than the bare minimum mandatory cover is to be bought.

Insurance markets develop differently in different countries, and technical support requires appropriate diagnostics of the markets to be fully effective. Even though products in nascent insurance markets are often similar (and typically dominated by MTPL), the development path is different in every country, depending on idiosyncrasies such as progress towards de-monopolization, ownership structures, and prospects for joining the European Union. While progressing along the learning curve, local stakeholders may struggle to assess vulnerabilities of the insurance market and obstacles to its development objectively. Although technical assistance projects often include some element of diagnostics, FSAPs are ideal opportunities to allow foreign experts, who can access all the necessary information and people but are detached enough for unprejudiced judgment, to indicate areas where technical assistance will be most effective. Coordinating technical assistance projects with FSAPs or similar evaluations thereby increases their effect, informing, for example, the project concept when funds to make the diagnostics have not yet been approved.

Interventions to develop insurance markets need policy support, and that benefits from some leverage. Newly established insurance supervisors in nascent markets with rules-based regulation often do not have the power to issue many regulations themselves but need ministers or Parliament to approve their proposals, however well informed by technical assistance projects and capacity building. Nevertheless, even when supervisors have the power to issue secondary regulations in a timely manner, there will occasionally be the need to overhaul the legal framework more thoroughly, for example by updating the country's insurance bill, and that normally requires parliamentary decisions. Experience shows, however, that insurance is rarely a top priority of lawmakers, so votes on insurance laws are often postponed, a process that can repeat for years. This threatens the entire outcome of projects: competencies that have been developed will fade, trained staff may leave the supervisor, industry buy-in may erode, and market evolution (new products or distribution channels, for example) may make drafted bills increasingly obsolete after years of waiting to be enacted. None of this happened in the case of Albania, and the DPLs with their prior action requirements contributed notably to this. Making the disbursement of important loan amounts conditional on focused progress by government on specific policy goals helps to coalesce attention and a sense of urgency across ministries and agencies. DPLs do not always require that laws actually be enacted but making sure that the Council of Ministers has submitted drafts of good quality to Parliament in a timely fashion, along with a sense of priority, makes a substantial difference. Albania is a good example of how coordinating technical assistance projects with other World Bank operations reinforces the impact.

Lesson 2 – Independence of the supervisor is paramount for healthy insurance market development.

The most important task of any insurance supervisor is to police the insurance market. Miss-selling, whether intentional or not, can be financially devastating for consumers. It is difficult to avoid this completely, given the complex and intangible nature of insurance and the fact that you may receive the benefit of insurance long after you paid for it. Poor market conduct by even just one insurer can quickly destroy the consumer trust that the industry has built over many years of exemplary service and limit demand and market development for years. Reckless – or even just thoughtless – financial management can result in the disorderly market exit of an insurer, which can threaten the stability of the entire financial sector and wider economy, including government finances. The important line of defense against any of these adversities is the insurance supervisor. That defense can be compromised when the supervisor fails to identify critical developments in time to avoid them causing harm, when they lack the power to impose remedial action, or when particular interests of other stakeholders can influence decisions (e.g., when members of government hold financial interests in, or have family ties with, insurance companies seeking a license). Large insurance companies can have considerable clout, because they provide employment and invest in government bonds, for example. ICP number 2 therefore requires that the supervisor be operationally independent and have adequate resources and appropriate legal protection (among others).

Albania took an important step toward independence of the supervisor in 2006, but sufficient independence was not achieved until 2014. Carving out the function of insurance supervision from a line ministry significantly increases its independence, but in nascent markets, supervisory fees from insurers may not be sufficient to fund competent supervision. In such circumstances, it is therefore a good idea to establish a larger authority in charge of also supervising other areas of the financial sector such as pensions and capital markets for greater economies of scale, and supervisory fees can fully replace funding from the government. This is what Albania did in 2006 by merging three separate supervisory authorities, although one consequence was a lack of specialization that constrained actions. Lacking autonomy with respect to its budget and organizational structure, there was little AFSA could do about this until 2014, when Parliament approved three legal amendments to address this.

Even a very independent insurance supervisor tends to be part of the public sector and can find itself constrained by civil service rules that have nothing to do with insurance. In many countries, salary levels of staff and management at insurance supervisors are lower than at central banks, and much lower than at insurance companies. The temptation to leave the supervisor for a better paid job in the industry can be irresistible for competent staff. As a result, such countries develop an imbalance of intellectual fire power that makes it hard for the supervisor to fully comprehend what the industry is doing, anticipate what risks might entail, prescribe the appropriate corrective action, and defend it convincingly. Such a supervisor is equally ill equipped to drive the evolution of regulation to reflect local market developments and international good practices. Lastly, it is likely that such a supervisor also lacks the wherewithal to design strategies to develop the market and the clout to secure buy-in from the government and the industry. Only after Albania amended its Civil Servant Law, Law on Salaries, Rewards and Structures of Constitutional Independent Institutions and Other Independent Institutions Created by Law, and the law governing AFSA did this authority have sufficient independence to hire and retain the people vital for the success of its mandate.

Change takes time. Although these legal amendments were enacted in 2014, the new operational structure of AFSA did not come into force until 2017. Given the effort that major (and even minor) changes to the laws take, careful consideration is required. Being thoughtful when

designing the appropriate operational structure – one that not only fits the current market reality but will continue to be suitable as the market develops – is equally important. Projects need to be mindful of realistic timelines and estimates of absorption capacity. Major changes may require institution-wide change management efforts (as opposed to an isolated task to complete by a single department), with the attendant confusion, pain, and resistance this can entail. In such situations, well-managed technical assistance projects can be crucial to maintain momentum and perspective, if they can synchronize sensibly with the developments at the supervisor.

Lesson 3 – Market development requires that supervision and regulation go together and that regulation is informed by international good practices but takes national realities into consideration.

An ICP compliance assessment or other comparisons with international standards and trends show weaknesses with respect to valuation of assets and liabilities, investment, risk management, internal control and corporate governance, as well as capital requirements in many countries.

Recent crises or an intention to join the European can be powerful motivators to do something about it. Once a supervisor has realized this, it must obtain more detailed, granular, timely data on what happens inside insurance companies, and new or modified regulation may be necessary to implement this. Some understanding of the risks that insurance companies are exposed to is necessary to draft such regulation sensibly, and it may be necessary to begin building capacity for the supervisor in advance. Only after the new information comes in and the supervisor is in a position to derive deeper insights from it, regulations that specify stricter requirements for internal risk management, reinsurance, valuation of liabilities, and other important areas can be drafted. At the same time, tools and procedures need to be put in place within the supervisor not only to police the new rules, but also to detect deviations that require immediate intervention. New regulations may be needed to grant the supervisor the necessary powers. Most importantly, the transition to risk-based supervision that Albania is engaged in must abandon rules-based compliance approach (which often reduces supervision and inspection to ticking boxes even at the risk of ignoring unforeseen developments if they are not on the checklist) and embrace supervision based on principles, where the intended outcomes go beyond compliance with laws that may be due for update.

If done intelligently, the mutually reinforcing evolution of regulation and supervision will benefit insurance market development, as Albania evidences. Insurance penetration increased from 0.65 percent in 2008 to 1.04 percent in 2017, so premium volume grew at a pace almost twice GDP. Even more encouraging is the increase in the number of insurance policies, showing that more Albanians have entered the insurance market as consumers. The various laws enacted with support of projects and other interventions discussed above have strengthened operations and stability of insurers and increased the value of what clients have paid for. They allowed the supervisor to put in place effective tools such as risk-based early warning tests, risk ratings, and modern inspection manuals and to issue requirements for better corporate governance and sound risk management practices, among others. Lastly, they allowed several weaknesses in MTPL insurance to be addressed, and this is the line of business that most influences consumer attitudes on the path to mature markets.

The benefits of such transformation go well beyond development of insurance markets. An effective bonus-malus system, once implemented, can be expected to lead to safer driving and thus reduce the risk of injuries for pedestrians and drivers.

Lesson 4 – Insurance develops in the context of the wider financial sector. The bancassurance channel has the potential to increase insurance penetration beyond life insurance.

Life insurance is purchased when loans are taken out. Even if credit life insurance is voluntary, it is almost impossible to obtain a mortgage without life insurance on the borrower. More people are becoming aware of the existence of life insurance when obtaining a loan. Use of formal financial institutions, measured for example according to account ownership, has grown considerably—from 28 percent 2011 to 40 percent in 2017—and the number of life insurance policies has increased in parallel. If financial inclusion continues to develop, providing more bank accounts, loans, and the corresponding insurance, life insurance will be more visible in the market, and economies of scale will improve the quality of supply. On the other hand, strict lending criteria limit the amount of insurance driven by loans. Life insurance suffered during financial crisis years, but despite this, credit life has grown since then, although it fell by 25 percent in 2012. In 2017, premiums finally reached, and exceeded, their 2011 level, reaching ALL722.59 million (USD6.84 million).

Bancassurance indicates strong potential for growth in most lines of business. Although agents and brokers are still the main form of insurance distribution, sales through bank branches have good potential to increase market penetration.

Banks' customer base can provide sizable pools of potential buyers for insurance products. One recent trend in Albania is that banks have formed their own broking operations after years of operating as agents for insurance companies. New insurance products and services can establish themselves in the market more quickly using a local bank's existing network. The insurance company often benefits from the trustworthy image and reliability that people are more likely to attribute to banks. Once people experience insurance for the first time, they might buy other products if the experience was positive.

Lesson 5 – Compliance with international standards is an important element of strong insurance market oversight.

AFSA gradually improved standards for industry. Mandatory financial reporting of insurance companies under IFRS was a good starting point. The insurance law and the MTPL insurance law enabled AFSA to bring its regulatory practices and regulatory framework closer in line with IAIS requirements and introduced risk-based by-laws. AFSA has a public responsibility to support effective, efficient communication of financial information via the internet. Such transparency is a strong tool to steer informed consumers toward better performing insurers, thus putting pressure on poor performers to improve or lose market share. The strong upward trend of technical provisions reflected not only market growth but also the ongoing efforts of the AFSA toward better reserving standards.

The necessity of harmonizing national legislation with EU requirements was an important driver for the Albanian insurance market. The Albanian authorities designed the subsequent reforms following the recommendations to upgrade the insurance legal framework in line with the EU approach. The legal review paved the way for the restructuring of the Albanian insurance market legal framework and supervision. The Albanian insurance market and consumers have thus benefitted from the proximity of much more developed markets and the outlook of being able to join their club.

Liberalization of tariffs in Albania became necessary to comply with the European Motor Insurance Directives. The third directive confirms the freedom of insurance companies to set premiums. The main challenge with switching from a regulated tariff system to a liberalized system is correct and prudent pricing of products. The basic principle of insurance is that paid premiums should be sufficient to cover expected claims and expenses and provide a reasonable profit margin. Delays in claims payments and insufficient reserves can mask unsatisfactory premiums for a while but tend to lead to financial difficulties later.

It would have been more advisable for Albania to liberalize gradually, with preparation. The immediate transition from a system in which MTPL premium was prescribed to complete liberalization in 2011 was associated with market instability and premium fluctuations. After the sharp drop in premiums between 2011 and 2013, average premiums went up by 70 percent in 2014 and another 20 percent in 2016. The supervisor was only gradually acquiring the expertise to ascertain that reserve levels were adequate to allow insurers to honor their liabilities without threatening their financial stability. The Competition Authority uncovered a price-fixing agreement between several insurance companies, who were fined in 2012.

Abrupt liberalization has negative consequences for the insurance market. Two countries in the region that illustrate different paths are Croatia and Montenegro. Croatia's need to liberalize MTPL premiums became necessary when it joined the European Union as the 28th member in 2013, and liberalization started in September that year when insurers themselves started determining premium levels. The ensuing fierce competition among insurance companies resulted in considerable erosion in the price of car insurance. In the following two years, the average cost of car insurance dropped 35 percent, the total number of car insurance contracts rose by 84,000, and insurance companies lost USD140 million. Such a dramatic collapse in the price of motor insurance over such a short period of time has not been recorded in any other EU member state. By contrast, Montenegro, another EU candidate, opted for gradual liberalization of the market, with a five-year transition period prescribed in a law stipulating that insurance companies would not be able to price motor insurance themselves until 2017. The transition period was also used to increase liability limits to make insurance better for consumers. Such a gradual transition gives the supervisor and the insurance industry time to develop the expertise, calibrate the tools needed to manage premiums and reserves appropriately, and avoid financial and reputational risk.

Lesson 6 – MTPL is complex, and de-tariffication needs to be managed when trying to steer markets toward stable development.

MTPL is significantly different from most other lines of insurance business. MTPL dominates insurance markets in many countries, because few other insurance types are mandatory for individuals. On the one hand, this means that dynamics observed in insurance markets may be reflective only of that market's MTPL insurance – when this grows, rising insurance penetration is ready to indicate market development. On the other hand, the importance of this line of business motivates insurers to act differently, for example in the hunt for market share, which tends to focus on MTPL. Furthermore, MTPL is unlike other lines of insurance in that it protects the general public as much as the policyholder and that cars and drivers often cross borders into neighboring countries. Because the cost of transportation affects the cost of many other goods, and transportation employs many people, public sensitivity to MTPL premiums is significant, explaining the systems of prescribed tariffs that determine pricing in many countries.

MTPL needs a more comprehensive ecosystem than insurers and products. In nascent insurance markets such as Albania's in the 1990s, some arrangements needed to be established and

managed along with tariffs, insurers, distribution, and their corresponding regulation (for example, the Green Card system, Compensation Funds for victims of uninsured or unidentified motorists). In MTPL, technical reserves are a crucial element to determine the adequacy of premiums, an exercise that requires skills often in short supply at supervisors.

Typically, liberalization leads to a major drop in premium rates because of fierce market competition among companies. Albania was not an exception, with rates quickly dropping from USD130 to approximately USD32 over the two years after liberalization was initiated. DPL was focused on measures to stabilize the MTPL market, including regulation of MTPL reserve standards and replenishment of the Compensation Fund. The World Bank DPL program, in conjunction with follow-up technical assistance, required that AFSA introduce an additional special claim reserve for insurers that could be used only to pay claims. The regulator rigorously policed use of the funds in this reserve account. As a result, the companies could no longer operate their business without adequately funding their reserves. The imposition of special claims reserves for MTPL contributed to the major jump and then stabilization in MTPL premium rates approximately to the level where they were before the liberalization.

The sustainability of products, financial stability of insurers, and the health of the ecosystem need to be coordinated. At the same time as it had to address premium erosion and substantial differences in technical provisioning between insurers, AFSA (itself undergoing structural change) had to fix the shortcomings of the Compensation Fund. Requesting that insurers introduce an additional special claim reserve led to the considerable increase in premium rates that resulted in strong growth of the insurance market. This shows how, in MTPL (unlike most other lines of business), numerous elements must be managed simultaneously, not only premiums and reserves, but also the health of the ecosystem.

Lesson 7 – Monopolies are detrimental to insurance market development, and it takes a long time to overcome their adverse effects (even as the market share of the former monopolist plummets).

Albania was extreme even among communist countries in that virtually no insurance was available to households and businesses. Instead, the state covered the risks of sickness, accidents, death, and old age for everyone, a promise that could not be maintained after the end of communism. Therefore, although the number of people covered is slowly rising, the majority of Albanians still do not have social security protection because they are engaged in informal or rural sectors. Decades of the communist ban on insurance left many people in the habit of looking to the government for help in managing risks instead of buying insurance.

Starting insurance with a state monopoly provided a framework for an orderly transition to liberalized competition but probably delayed market development. After the general demise of communism in Eastern Europe, Albania introduced insurance but in the form of a state-owned monopoly. Allowing people to own cars in 1992 and requiring MTPL created demand, but like monopolies elsewhere, INSIG had little incentive to serve customers well and provide a range of products tailored to consumers' needs. This tarnished Albanians' perception of insurance for years, showing that initiating an insurance market with a state monopoly has downsides. Albania's case also illustrates how long it can take to move from monopoly to a liberalized market; although the legal basis for demonopolization was laid in 1996, it took three more years to establish the first private insurance company. In the meantime, consumers' confidence in financial services were shaken as pyramid schemes proliferated across the country before collapsing, taking with them millions in savings, and threatening to destabilize the government.

Demonopolization usually takes longer than anticipated, because the skills required to regulate market entry do not develop in monopolistic markets. One reason that a diversified insurance market did not emerge immediately after the legal conditions were created is that allowing access to an insurance market – granting an insurance license – is not a straightforward task for an unexperienced supervisor, requiring policy guidance and considerable technical expertise. The early years of demonopolized insurance markets are challenging for authorities and consumers and shape market dynamics for years to come. This can be aggravated when special privilege continues to be granted to the former state monopoly company, for example being allowed (unlike everyone else) to underwrite life and non-life insurance and thus benefit from economies of scale.

Box 2: What is holding back the Albanian insurance market?

Despite considerable efforts by the authorities and support from donors, Albania's insurance market continues to lag behind its potential. A number of factors contribute to this constrained development. Albania continues to have a relatively high percentage of rural population and lacks the infrastructure for insurance to serve it efficiently. Fewer than half of the roads are paved, only half of the population uses mobile broadband, and less than half of employment is formal. The use of formal financial services is lower in Albania than among its peers.

In a country of less than 3 million inhabitants, this difficulty in reaching and serving a considerable proportion of the shrinking population of predominantly low-income people limits economies of scale for insurers, who all focus on the same subset of potential customers and products. Annual premium income for seven of the eight non-life insurers is less than USD20 million and less than USD15 million for half of them. This translates into extremely high administrative expense ratios, which together with long claim turnaround times, results in poor client value. It also indicates fewer resources for development of a diversified range of products that better reflect consumers' needs (which may thus turn into demand) and novel ways to overcome service hurdles. For example, despite the growing importance of agriculture, there is no insurance to address the considerable risks inherent in this economic activity and no insurance to specifically address the other risks of people engaged in agriculture. What is cited as lack of awareness and singled out as the most significant obstacle to demand is in part a reflection of behavioral attitudes shaped by the communist absence of insurance and the post-communist insurance monopoly.

Moreover, under the current circumstances, lack of demand could also reveal a rational choice: when available insurance offers poor value for money, avoiding spending money on it can easily seem the intelligent response. Lack of digital infrastructure and reliable statistics hinders not only product development, but also a more rational approach to claims assessment and fraud policing, critical factors for a mature relationship between consumers and insurers.

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