

"I read somewhere that everybody on this planet is separated by only six other people. I am bound to everyone on this planet by a trail of six people."

JOHN GUARE'S PLAY (and movie) serves to remind us that we live in a smaller world than we may realize. The Russian Federation is often thought of as a cold and forbidding country with a strange language and an alien culture. Press accounts often leave us with the impression that much of Russia is like Dodge City, the Land of Oz, or simply another Third-World backwater with little hope for success. Nothing could be further from the truth.

The modern Russian insurance industry, which celebrated its 10th anniversary last year, is connected to the West not simply through exchange programs and technical assistance from the European Union but more importantly through direct investment and reinsurance. The American International Group has been in Russia for more than a decade; the Allianz Group in 2001 purchased a

surance and \$260 for property/casualty. Equally important, expenditures on insurance products and services will increase, from current levels, to 2.54 percent of gross domestic product (GDP) for life insurance and 2.41 percent for property/casualty.

The rapid development of the Russian insurance market is also coming from legislative changes that reflect economic and social pressure from the population to turn rising incomes into organized savings and the protection that insurance can provide, rather than pressure from the top to mold a civil society.

As Russia enters this next phase of dramatic growth, its insurance companies will, of necessity, morph into more modern organizations—and this will require Western partnerships, more sophisticated management, technology transfer, and perhaps another \$2 billion to \$3.0 billion in fresh

Six Degrees of Separation

It is a profound thought. How every person is a new door, opening up into other worlds. Six degrees of separation between me and everyone else."

—John Guare

Six Degrees of Separation

stake in ROSNO, Russia's third largest insurer; Conventium (formerly Zurich Re) and Munich Re are active in Moscow and St. Petersburg. A number of international groups are also currently "kicking the tires." There are only a few degrees of separation between Russia and the West and the business of insurance.

Russia's burgeoning insurance industry was recently valued at \$3.3 billion by the United Financial Group (UFG), one of Moscow's leading investment banks. Both the life and non-life sectors are poised for expansion propelled by an accelerating economy, rising disposable income, and improving political and social stability.

UFG's projections for the life and property/casualty insurance markets cover the period through 2016. The life insurance sector is projected to grow 45.0 percent per year to \$36.6 billion in 2016. Moreover, the property/casualty insurance sector is expected to grow at 14.5 percent annually from \$4.6 billion in 2002 to \$35.0 billion during the same period. UFG will write an update later this year, once the Goskomstat (Russia's state statistics and information system) 2002 market figures are released, but the message is unlikely to change.

Spending levels for insurance are projected to increase dramatically to \$273 per capita for life in-

capital through 2005.

The expected growth is supported by legislative and regulatory "drivers" that include the introduction of automobile third-party liability insurance (TPL), substantial pension reforms, the removal of certain investment restrictions faced by insurance companies, and Russia's entry into the World Trade Organization.

Compulsory automobile third-party liability insurance begins this July and will introduce most Russians to insurance for the first time in recent memory. TPL will expand customer databases and provide valuable marketing information and cross-selling opportunities.

The size of the auto TPL market will be a factor of both automobile ownership and premium guidelines. TPL may generate \$600 million in 2003 and then increase in proportion to the number of cars in circulation, along with premium rate adjustments over the period. (The government can modify rates every six months.) However, much will depend on the compliance rate, which has varied from 20 percent in Ukraine to more than 80 percent in the Baltics and Poland.

The impact of TPL may well be far greater than its size alone. Most ordinary Russians simply don't know much about insurance products, and TPL



ROSGOSSTRAKH INSURANCE GROUP | AMERICAN INTERNATIONAL GROUP | INGOSSTRAKH INSURANCE GROUP

6 5 4 3 2 1
ROSNA | ALLIANZ GROUP | ALL RUSSIA INSURANCE ASSOCIATION | CONVERIUM | MUNICH RE

Investing in Russia today isn't what it was a few years ago. The economy continues to grow and settle down, and the insurance business is one of the most promising parts of the Russian Renaissance

will serve to introduce them to the concept and the language of insurance. TPL will necessarily expand insurance distribution since insurers must offer it across the Russian Federation through local sales branches. As a result, insurers need to be forming national alliances, and these expanding distribution networks represent a significant and developing asset.

In addition to the rise of a middle class along with its increasing disposable income, Russians are developing confidence in their financial institutions as witnessed in the steadily increasing retail bank deposits to GDP. Russia's retail deposits-to-GDP ratio, a measure of Russian financial literacy, has increased from 6.3 percent at the end of 1999 to 9.6 percent at the end of 2002, and is forecast by UFG to reach 18.0 percent by 2007.

Given the growing level of activity in Russia, it's helpful to make a comparison to Central Europe (the Czech Republic, Poland, and Hungary). These countries have seen their insurance industries develop several years in advance of Russia. An "insurance culture" is now well established for life and property/casualty products, and both sectors enjoy healthy competition. This experience also serves to indicate that insurance in Russia will expand rapidly over the next decade.

Poland, the Czech Republic, and Hungary advanced as a result of great interest and activity by foreign carriers, a more recent mercantile tradition, and a head start after the fall of the Iron Curtain. And, as expected, personal income levels have been a key element in insurance premium growth in Central Europe.

While Russia's insurance market, as a whole, is moving forward quickly, it will be a challenge for capacity to meet demand. Many of Russia's 1,400 registered insurance companies will probably not survive in this rapidly expanding market. They're smaller, under-capitalized, and have not had the advantage of Western expertise.

The number of companies that will stay in business is far from clear, but there are now more licensed insurance companies in Russia than in all the rest of Europe. It's quite likely that

there will be a 75 percent contraction in the number of active companies and that eventually a "Top 30" will emerge to control around 80 percent of the market. There's also a good opportunity for regional companies to remain meaningful, given Russia's huge geographical expanse.

On a national scale, most of the "Top 30" companies should do quite well provided they accommodate consumer demand. Adaptation will require an embrace of Western insurance technique and technology, along with a healthy measure of growth capital. Indeed, some of them have already adapted or are in the process of doing so, including the highly regarded Ingosstrakh Insurance Group, ROSNO, and the huge Rosgosstrakh Insurance Group (which has some 2,000 branch offices, 40,000 employees, and more than 20 million policyholders).

Structural change, Western strategic partnerships, and private equity will be three of the components necessary for this changing market. The Russian companies with the most likely chance for success are those that enter into foreign partnerships and share the benefits of the predicted rapid growth. They must also perform some housecleaning.

First, Russian insurers need to streamline their distribution networks, install agent selection and retention techniques, and emphasize training and communications.

Second, they should organize national alliances that will enable them to participate carefully in auto TPL, and without which they'll lose a major opportunity to acquire a larger policyholder base and gain experience in personal lines sales.

Third, Russian insurers must meet Western auditing requirements and quickly adapt their accounting practices to international standards. This should be accomplished sooner rather than later if the industry is to be successful in attracting Western partners and investors.

Fourth, they should develop and install professional standards and procedures for the actuarial sciences, pricing, underwriting, claims, investment management, information technology, and professional training and development.

Insurance Market in Russia, 2002-2016

	2002	2004	2006	2008	2010	2012	2014	2016
Annual GDP Russia, \$-mn	334,291	391,497	509,019	625,712	756,570	946,457	1,185,084	1,442,501
Annual GDP/capita, \$	2,321	2,757	3,610	4,469	5,443	6,908	8,714	10,765
Non-life insurance, \$-mn	4,574	6,180	9,384	12,565	16,128	21,316	27,789	34,800
Non-life spend/capita, \$	32.0	44.0	67.0	90.0	116.0	156.0	204.0	260.0
Non-life spend as % of GDP	1.37	1.58	1.84	2.01	2.13	2.25	2.34	2.41
Life insurance, \$-mn	72	173	522	1,571	4,733	14,154	28,589	36,622
Life spend/capita, \$	0.5	1.2	4.0	11.0	34.0	103.0	210.0	273.0
Life spend as % of GDP	0.02	0.04	0.10	0.25	0.63	1.50	2.41	2.54

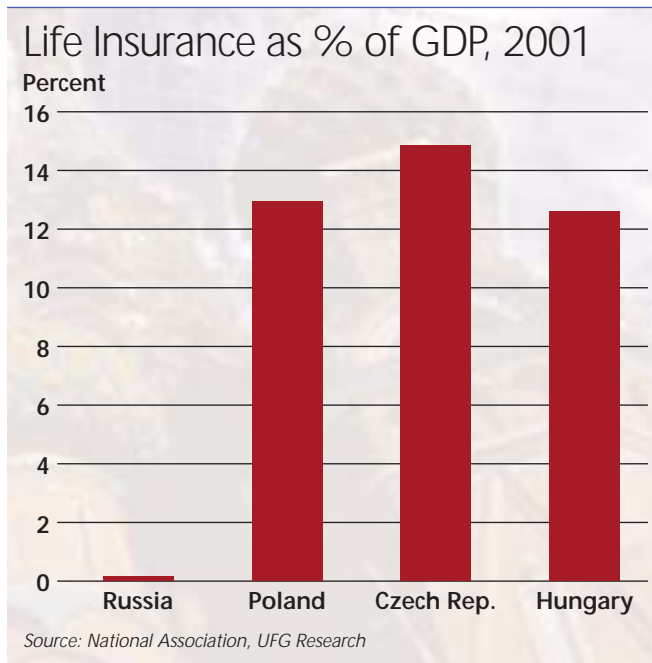
Source: UFG Research

Finally, business plans and a business planning process must become integral to the management of Russian insurance companies.

While insurers sort out what they must do to remain competitive, the Russian government is developing measures to ensure a free market for insurance products. In addition, the government will be monitoring companies so they don't dominate local markets while ensuring that state organizations conduct open and equitable tenders when awarding insurance contracts.

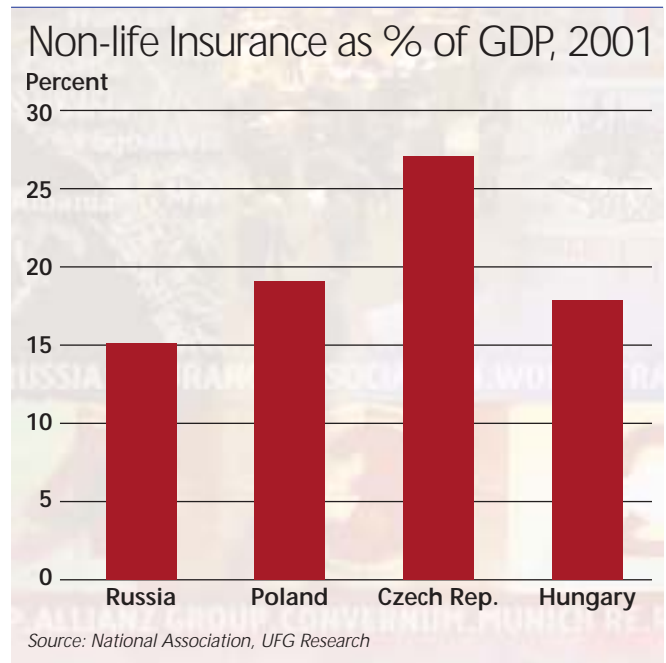
After more than three years of discussion among the government, the Russian Duma, and the All Russia Insurance Association, a planning document was approved by the government this past September. It's intended to provide the basis for legislation necessary to accommodate WTO entry terms. The main components of the plan include:

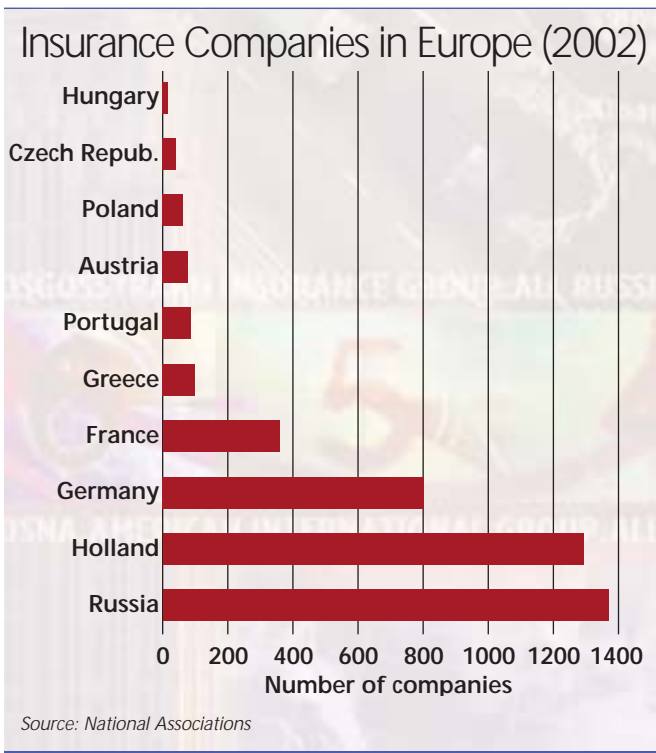
- Establishment of a guarantee fund to protect long-term life insurance policyholders.
- Separation of companies offering life and property/casualty insurance and establishing separate investment regulations for both.
- Expanding compulsory insurance and reducing the government's participation in accident and disaster compensation, along with the establishment of central reserves for this purpose.
- Recognition of actuaries and actuarial science, and establishment of education and qualification standards.
- Incorporating insurance companies in the compulsory pension market on an equal basis with private pension funds.
- Increasing the minimum capital requirements for insurance companies by July 2007 over the course of the next four years.
- Encouraging the expansion of the reinsurance industry.
- Providing that more insurance payments will be tax-deductible for both personal and commercial lines.



- Requiring insurers to provide more statistical information on their performance and solvency consistent with international standards.

The Russian government has plans to reduce various barriers to market entry and to support a healthy and competitive insurance industry. As the state continues to pull away from the





cradle-to-grave control of society that was all too familiar in Soviet times, it finds it important to encourage private-sector alternatives.

Over the next few years there will be substantial opportunity for cooperation between the West and Russian companies. The West can best enter this market with a local connection. Russian companies have good experience and understand the specific peculiarities of their country and of their domestic insurance market. They're eager to learn and to grow their industry and would be very effective partners. The more successful partnerships will occur as Western insurance companies are able to act as "coaches," improving the competitive capability of their newly acquired partner.

The process of market entry and the search for an appropriate local partner can be a tricky undertaking, but in contrast to other emerging insurance markets, Russia offers far fewer impediments. As one of the largest countries in the world, with a highly educated and consumption-motivated population of 145 million, Russia is poised to achieve phenomenal growth. While market-entry timing can be problematic, the opportunity set in Russia is far more advantageous at this earlier stage.

The Russian Federation is making a rapid transition to a Western-style market economy. Progress has been made through structural reforms under President Vladimir V. Putin and has led to improving corporate governance and investment climate. This structural reform program has seen flagship changes to the ownership of major corporations as well as in pension reform, an opening of the land market, tax law changes, customs, and other beneficial reforms. Moreover, President Putin's programs have several more years to run, and he's willing to wield political strength to stamp out corruption in the state bureaucracy and judiciary as well as in regional administrations.

In addition to being the home of a noteworthy and accelerating insurance market, Russia was one the world's best performing stock markets in 2001 and 2002. GDP grew 4.2 percent last year, there was a 17.4 percent increase in real wages, Central Bank reserves have grown to \$60 billion, and inflation was down to 15 percent. The progress has been substantial, the degree of separation is now only minimal, and it would be a mistake to allow this potential to go unnoticed. ●

MARK D. MARISKA OF STAMFORD, CONN., IS A FORMER CHIEF DEPUTY INSURANCE COMMISSIONER FOR CALIFORNIA WITH 31 YEARS' INSURANCE INDUSTRY EXPERIENCE. HE HAS BEEN A LEADER IN THE DEVELOPMENT OF THE RUSSIAN INSURANCE INDUSTRY SINCE 1988. (E-MAIL: MDMARISKA@AOL.COM)

ILAN M. RUBIN IS THE PRINCIPAL INSURANCE ANALYST FOR THE UNITED FINANCIAL GROUP, BASED IN MOSCOW, RUSSIAN FEDERATION. MR. RUBIN IS FROM THE UNITED KINGDOM AND IS OF RUSSIAN HERITAGE. (E-MAIL: IRUBIN@UFG.COM)

**DISTINGUISH
YOURSELF IN THE
MARKETPLACE!**

STEWART SEARCH
Actuarial recruitment specialists

Call us at 888-JOB-OPEN
Search Jobs at www.StewartSearch.com
Sign up with www.ActuarialFutures.com

**Life, health, annuities, P&C,
pension, investment, and reinsurance
opportunities at all levels.**

fax 603 430-7339/e-mail careers@StewartSearch.com