

# **Financial Services in the Euro-Mediterranean Partnership**

## **A. Banking**

by

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## **B. Insurance**

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# 1. Introduction

## Methodology

Towards the goal to gather a better understanding of the banking structure and the regulatory practices in place, the Working Group on Financial Services in the Euro-Mediterranean Partnership developed a survey. This survey is based on a questionnaire which was addressed to the States of the MEDA region. The questionnaire tackled various topics related to the banking regulation, supervisory institutions in charge and the prevalent market conditions such as current market data. Furthermore the jurisdictions were asked to assess the compliance with the Core Principles for Effective Banking Supervision (BIS 25) in their countries.

The MEDA representatives made a significant effort to provide useful and meaningful answers to the questionnaire. Their answers were compiled during the meeting of the Working Group from October 28 to 30 in Luxembourg.

Answers were provided by the following nine jurisdictions:

- Algeria
- Egypt
- Israel
- Jordan
- Lebanon
- Morocco
- the Palestinian Authority
- Tunisia and
- Turkey

The turnout of responses was very high so the report is in a position to reflect the situation in all the above mentioned jurisdictions appropriately. However, in some exceptional cases the questions have not been an-

swered by all the jurisdictions. If such data was not available in particular countries, the report based its outcome on the answers received indicating the number of responses.

## Context

The European Neighbourhood Policy (ENP) is aiming at substantially deepening the EU's relations with its neighbours. The EU offers the neighbouring countries a privileged relationship, building upon a mutual commitment to common values, such as market economy principles, better governance and sustainable development. The European co-operation and assistance with the southern Mediterranean neighbours is embedded in the MEDA. The mutual interest of the EU and the MEDA is to promote reforms towards prosperity, stability and the rule of law.

The importance of the financial sector to economic growth and development is now well established.

Numerous studies, using various methodologies, have found evidence that greater financial sector development has a positive causal impact on key macroeconomic variables such as growth, productivity, and even poverty reduction.

The past decade has seen a rapid increase in the empirical literature investigating the links between financial development and macroeconomic outcomes. In a comprehensive survey of the literature, three broad conclusions may be drawn from these studies (Levine, 2005)<sup>1</sup>. First, countries with more developed financial sectors grow faster. Through careful use of instrumental variables and sophisticated econometric methods, the evidence suggests that simultaneity bias is not driving this conclusion; finance does seem to have a positive causal effect on growth. Second, the degree to which a country's financial system is bank-based or market-

based does not matter much. This does not necessarily imply that institutional structure does not matter for growth; rather, different institutional structures may be optimal for different countries at different times. Third, industry and firm-level evidence suggests that one mechanism through which finance influences growth is by easing external financing constraints on firms thereby improving the allocation of capital.

Until the 1980s the financial sector was probably one of the sectors where state intervention was most visible both in developing and developed countries. In many countries, banks were owned or controlled by the government, the interest rates they charged were subject to ceilings or other forms of regulation, and the allocation of credit was similarly constrained. Explicit or implicit taxation also weighted on the volume of financial intermediation. Entry restrictions and barriers to foreign capital flows limited competition. Since then, many countries have liberalized and deregulated their financial sector, although the process is by no means complete.

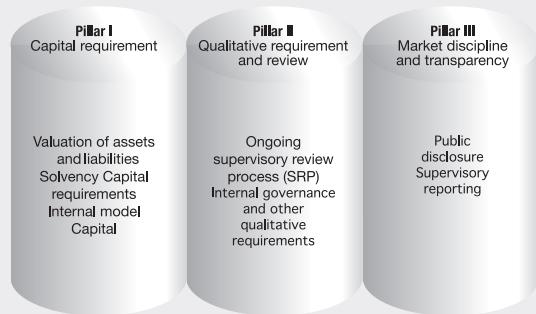
A healthy and dynamic financial sector is essential to achieving high and sustainable economic growth in the Mediterranean region.

## Preliminary Remarks on Banking Supervision and Integration

The regulatory framework of banking supervision is based on various international and cross-border rules. The core elements of banking supervision on an international scale are set out by the **Basel Committee on Banking Supervision**. The most prominent rules are the Basel Accords (Basel I dated 1988 and Basel II dated 2004). Basel II aims to provide an up-to-date regulatory standard for banking supervisors. Basel II stipulates three pillars as stated below. The rework of the European Directive relating to the taking up and

pursuit of the business of credit institutions and the Council Directive on capital adequacy of investment firms and credit institutions are merged under the title “Capital Requirements Directive”, under which the Basel II regulations have been implemented in European legislation and eventually national acts in all Member States

One of the main ideas of Basel II are qualitative aspects in the field of banking supervision. According to Pillar I credit institutions in the European Union are obliged to reasonably value all material business risks. The pillar II of Basel II describes the ongoing supervisory review process (SRP) as a requirement for banking supervision. In Germany for instance, the regulator (BaFin) co-operates closely with the central bank (Bundesbank) to achieve a flexible, risk-oriented and high-quality supervisory process, which allows sufficient latitude for the credit institutions to design their risk management process and supervise the necessary changes to their workflows and methods. Another pillar includes requirements to disclose the banks' qualitative and quantitative information regarding equity capital and all relevant risk indicators. This aims to improve market transparency and thus also to reinforce market discipline and a successful good corporate governance.



Another tool for enhanced and effective banking supervision are the **BIS 25** Core Principles for Effective Banking Supervision originally published by the Basel Committee on Banking Supervision in 1997 and revised in 2006. In an appendix to the questionnaire the MEDA jurisdictions were asked to indicate whether and to which extent their jurisdiction complies with each of the 25 Core Principles. The very large majority of answers to the 248 items (94 %) is positive or "compliant". This point will not be developed further more in this report in this regard.

Within more than five decades the European Community has managed to create an integrated cross-border European market entailing the 27 EU Member States as well as the 3 EEA Member States thus encompassing thirty European States. The Area is based on the so-called "four freedoms", the freedom of goods, persons, services, and capital. The realization of these freedoms was the foundation stone for an integrated market also referred to as Single European Market.

## **European integration**

The Single European Market on banking has been achieved steadily by the implementation of several European directives. National obstacles and barriers have been diminished continuously to allow a free float of banking services. This concept has been institutionalized by the so called "European Passport" basically requiring only one license issued by the competent administrative authority of the Home Member State. Thus the credit institution is in a position to also e.g. open branches or offer banking services in other Member States without going through another authorization or approval procedure by the Host Member State in which the bank envisages to operate. The authority of the Host Member State trusts the licensing procedure undergone in the Home Member State due to a level playing field in place. The implementation of the Euro-

pean banking directives ensures that basically the same requirements and rules are in place across all Member States. Thus one can easily presume that the same set of rules are adhered to no matter which of the European supervisory authority has actually been in charge so there is no need for any other authority to reopen the question of authorization. These circumstances speed up the pan-European process significantly and ensure a higher level of flexibility for the banks.

## **Recent economic developments in MEDA region**

The main characteristics of the financial systems in the Maghreb region are common to the whole region and include the following: (a) bank dominance and heavy public sector presence in most countries; (b) limited financial sector openness in some countries; (c) bank soundness exhibiting significant cross-country variations; (d) public banks burdened with inefficiencies and a high level of nonperforming loans (NPLs) in certain countries; (e) still embryonic fixed-income and equity markets, [...] [in some countries]; (f) nascent institutional investor industry and generally underdeveloped microfinance; (g) shortcomings in the legal, regulatory, and supervisory frameworks despite tangible progress; and (h) a largely cash-based payment systems that is being modernized (Tahari & al., 2007<sup>2</sup>).

The MEDA countries are at various stages of economic development and have different endowments of natural resources. The economic reforms that have been already undertaken over the past two decades have generally achieved macroeconomic stability and contributed to raising growth in some countries. The growth dividend has been dispersed: Growth in GDP per capita in purchasing power parity (PPP) terms in the region has accelerated somewhat during the past decade though the pace of growth varies dramatically (Table 1).

Financial systems have developed substantially in the last decade. Countries to different degrees, have improved their legal and regulatory frameworks, privatized state banks, and enhanced competition in the financial sector.

In quantitative terms, the average domestic credit provided by the banking sector to GDP ratio (except two countries) combined rose from 65 percent in 1995 to 89 percent in 2006, when the domestic credit to private sector to GDP ratio rose in average from 42 to 55 percent for the same period (Table 2).

The volume of credit is not an indicator to be taken as sufficient alone; in some countries of the area, the level of non-performing loans (NPLs) remains important, in spite of some recent important improvements. For example, the NPLs to gross loans ratio is 32.4 in Algeria (as of end 2005), 20.9 in Tunisia and 10.9 in Morocco as of end 2006 (Tahari & al., 2007<sup>2</sup>).

## 2. Outcome of the Questionnaire

### **Institutions in Charge of Banking Supervision**

Each jurisdiction may assign one authority or co-operating institutions to carry out banking supervision. These duties may lie with the central bank or a specific financial supervisory authority in charge of banking or following the concept of integrated supervision an integrated regulator.

The vast majority, six jurisdictions indicated that banking supervision is carried out directly by the central bank. In most of the cases the central bank plays a key role as independent institution which is not accountable to a government body such as a ministry. This is also corroborated by the fact that where the central bank is the supervisor, the central bank is typically also in charge of regulation (see below). Two jurisdictions on the other hand designed a special body as a banking regulator whereas another one stipulates interdependence between the central bank and a supervisory entity. In that case the supervision responsibilities are split between the Central Bank and another authority in a joint approach.

### **Accountability of Supervisory Institutions**

To define the status of an authority it is worthwhile to see to whom this entity is responsible or accountable, e.g. in terms of reporting about its operations. Accountability to a prominent rank may serve as an indicator for an institution's standing.

In three jurisdictions the status of the authority is expressed by the fact that reference is made to the Head of State in that concern. In two other jurisdictions ac-

countability is addressed to the Governor of the central bank. In another jurisdiction reference is made to the State Council, another one foresees reporting to the Council of Ministers and Parliament.

### **Legal Liability of Supervisors**

This item addresses the question whether the supervisor in charge can be held liable for administrative action or an omission of necessary activity. The extent of liability both in terms of threshold and addressees may vary in each jurisdiction. Some may also hold liable the employee in charge whereas others may restrict the liability to the institution itself, the legal person.

All the respondents but one indicated that their supervisors are legally liable for their actions. One of the jurisdictions giving an affirmative answer clarifies that legal liability cannot occur as long as the supervisor acts within the scope of its mission. Further specifications are not provided. The answers do not aim to encapsulate the whole liability system in each jurisdiction as this would mean a very detailed description and reduplication of legal provisions which would not serve the purpose of this questionnaire.

### **Deposit Insurance System**

An effective deposit insurance or deposit protection scheme may be of high relevance both for boosting market confidence and integrity as well as investor protection. The EU has covered the statutory deposit insurance system in the Deposit Guarantee and Investor Compensation Directives from 1994 and 1997. In the aftermath of the recent financial turmoil the European institutions are committed to further enhance the deposit protection, the EU threshold per depositor appears to increase ways above the current 20.000 €. Furthermore as the European Directive only stipulates

minimum standards a number of Member States have gone beyond for investor's sake. Also on an international scale deposit protection has become a prominent issue.

However, to which extent such system is needed depends significantly on the market conditions. While the majority of respondents gave an affirmative answer, three jurisdictions clearly stated that they do not have an explicit insurance system in place. In one of these jurisdictions the market circumstances did not call for such system as there has been a surplus of liquidities so far. The other two jurisdictions indicated that governmental or central bank steps may be taken for the sake of investors. Four out of the six respondents confirming the existence of a deposit guarantee scheme have certain thresholds in place up to which a reimbursement is safeguarded. This underlines that the deposit protection mainly aims to protect retail clients.

## **Legal Framework for Banking Supervision**

This chapter focuses on the question which authority is in charge of licensing and compliance. This item is related to the first question above but puts a stronger emphasis on the particular field of supervision.

The first question aims to point out which authority gives authorisation of banking establishments, i.e. licensing. In five jurisdictions the central bank is in charge of authorizing banking establishments. In two jurisdictions the same other authority which is generally in charge of supervision is also responsible for licensing. In the other two jurisdictions authorization is embedded with a different institution, i.e. a special council or the Ministry of Finance.

The second question raises the issue which institution has powers to address compliance with (banking) laws

as well as safety and soundness concerns. Except one jurisdiction, the same institution is both in charge of licencing and compliance.

## **Basel Accords Compliance**

Since the Basel Accords are of utmost relevance, one key part of the questionnaire was to verify to which extend the jurisdictions have settled for the respective banking requirements. In the European Union the Basel II requirements are in place since 2007. It is in the discretion of the credit institution whether the follow the Standard Approach which to a great extent is similar to Basel I or the Advanced Approach. So far a significant majority of banks decided to apply the Standard Approach while only a smaller number of banks opted for the Advanced Approach which may be more challenging for institutions especially in the beginning.

All MEDA jurisdictions comply with the Basel I requirements.

All respondents expressed their commitment towards the implementation of Basel II. The transposition is currently in place or should at least be envisaged in the near future. One jurisdiction declared to review the Basel II requirements in the wake of the financial turmoil and to adapt the rules if necessary. The respondents indicated that banks usually follow the Standard Approach. In two jurisdictions the Advanced Approach is explicitly only foreseen as of 2010.

## **Number of Banks**

Globally, banking markets in the area have a relative big size, and are diversified.

The amount of banks may serve as a good indicator for the degree of competition and to which extent the

citizens are in a position to rely on banking service even though disparities in the level of servicing may vary between urban and rural areas.

The number of banks is two digits in all jurisdictions varying from 16 to 50. It varies from one country to another, with an average of 32 per country and a standard deviation by 16.22 (Table 3). The smallest market in terms of number of banks is Morocco with 16 banks whereas the biggest number of banks is 64 in Lebanon.

Access to financial services is often low, transaction costs tend to be high and the legal basis for collateral enforcement remains limited. These are the main reasons why financial intermediation relies heavily on retained earnings, thus limiting growth. This is particularly true for SMEs, which very often have no other choice than relying on internal and/or family finance.

In order to analyse the market and its exposure it is also worth knowing whether the market is dominated by domestic banks or foreign banks also play an active role. All jurisdictions do have foreign bank exposure though the extent of foreign bank business varies a lot. One jurisdiction is dominated by domestic banks in a way that the only foreign banking subsidiary and the four foreign banking branches only amass a total of less than 2% of the market share. As concerns the other jurisdictions foreign banks have a stronger standing. The figures of the market share or assets of foreign banks provided by some other respondents lead to the conclusion that the vast majority of market share is in the hand of domestic banks. A final conclusion cannot be drawn since three jurisdictions could not specify the market share.

## **Size of the Banking System**

To determine the position and power of a country's banking system it is helpful to see the relation of the

banking assets to the GDP as well as the correlation between the banking assets and the total financial system assets.

In the majority of jurisdictions the banking sector assets represent more than the annual GDP. In one country the banking assets amount to 362% of the national GDP indicating a strong standing of the banking sector in the economy, One jurisdiction ranges slightly below the annual GDP and in two jurisdictions the banking assets represent about two third of the GDP (Table 4).

Six out of the nine respondents also provided figures with regard to the correlation of banking system assets as a percentage of total financial system assets. In one jurisdiction the assets make about 40% of the total assets (including government bonds) whereas the other jurisdictions indicated higher degrees. In the country with the highest participation of banking system assets these represent more than 86% of the total assets (Table 4).

## **Accessibility of Banking**

A well-developed banking sector ensures that the population has sufficient access to banking services. The accessibility is typically expressed by the ratio of bank branches and the number of inhabitants. The figure reflects the overarching situation across each jurisdiction. Certainly the accessibility may vary in different regions of each country, e.g. one may assume that the capital and other major towns allow for higher accessibility. However, a further differentiation was not chosen as these figures just should provide a general nationwide overview.

A fine indicator of the market and in particular the potential access of the population to banking services is given by the number of branches serving every 100 000 people : this figure varies from 4 to 21,5 among MEDA

countries (Table 5). These figures are comparatively low taking indications e.g. in European countries into account: in Germany for instance it is 47.6, 63.1 in France and 57.6 in the Euro area. Nonetheless the banking industry is in an emerging process in most of the MEDA countries which may go in hand with higher accessibility in the future unless other channels such as online services substitute the need of agencies to a greater extent.

This indicator shows then a broader banking structure than the single number of banks as an indicator could have illustrated.

## **Government Ownership**

To assess the banking sector in a country it is worth verifying to which extent the State or the government respectively runs or owns a bank. The extent of government activities may have an impact on the competitiveness as well as the services of the banking industry.

This issue is to which extent the banks are commercial banks, also referred to as private banks or whether they are public banks.

This question led to a very diverse picture of MEDA countries. While three jurisdictions indicated that they are no public banks whatsoever, other jurisdictions reported about public banks (Table 6). But even in those jurisdictions with a public banking sector a wide disparity exists to which extent these banks penetrated the whole banking market. In the other six countries the figures vary from 4% to 38% meaning that in none of the countries the state-owned credit institutions stay for the majority in number.

To really determine the government ownership and its market role it is also relevant to indicate whether public banks are larger than the commercial banks in

the respective jurisdiction. The lowest percentage is about 27% of all the banking assets. In further two jurisdictions the banking assets accumulate about 30% whereas another two contribute more than 40%, and in one jurisdiction the public banking sector dominates to an extent that it encompasses a maximum of 92% of the deposits and credits (Table 6).

## **The Competitive Environment**

This chapter reflects the competitive environment by indicating the concentration of the banking industry. A high level of concentration may stay for restricted competition, on the other hand these credit institutions may be in a better position to offer a wide range of products and services.

The study comprises the percentage of assets and deposits accounted for by the largest, the three largest and the five largest banks.

Out of the seven jurisdictions which provided figures for the largest bank as regards assets two jurisdictions indicate about 15% another three jurisdictions provide figures or roughly speaking one quarter. Another one quotes 30% and in one country the biggest bank accumulates more than 37% of the assets. This country also provided a figure for the two largest banks which is 56.3%.

Seven jurisdictions, too, indicated the assets for the second threshold, assets of the three largest banks. While four indicated between 36 and 44%, the figures are 60% or above in three jurisdictions going up to three quarter. As concerns the “top five” data is available from eight jurisdictions. In three jurisdictions the figures range between 50 and 60%, one jurisdiction indicated a concentration of the “top five” with an asset percentage of 94%.

As concerns the percentage of deposits the question referred to the “top three” and “top five” only. The seven answers received give a quite diverse picture again. In one jurisdiction the three largest banks only make up 37 ½ % whereas five jurisdictions indicate a majority of assets amounting up to more than 75%. Similar disparities appear when it comes to the top five banks in this field. While all the answers indicate a majority of deposits accounting for the “top five” the figures range all the way from 52 to almost 95%. In the latter case the top five banks are the predominant credit institutions with barely any room left for market share of others. Two jurisdictions did not quote figures for the “top five” but for the eight largest and ten largest banks respectively (Table 7).

Measured by the Herfindhal-Hirschman Index (sum of squared market shares of individual banks’ assets) the banking industry shows a relatively low concentration (Table 7).

## Foreign Involvement in Banking

Both market concentration and share of state-run banks are good indicators for the banking sector. As mentioned before it may be worth knowing to which extent the banks are domiciled in the respective jurisdiction or are from abroad to complete the picture. However, the domicile alone does not express the actual ownership so the question aiming to measure foreign involvement focuses on the percentage of banks which are foreign-owned as well as the share of foreign ownership in terms of bank assets.

In all jurisdictions foreign-owned banks are the minority so that the market is predominantly domestic. However the participation varies a lot. In one jurisdiction the number of foreign banks is almost half of the total amount while the lowest number is 7.7% only (Table 8).

Apart from the absolute number, it is also worth reflecting the actual bank assets that are foreign-owned as a sheer number of foreign banks do not indicate their market share in a country. In that concern it is remarkable that six respondents indicated a lower threshold in terms of banking assets compared to the sole number of banks. In most of these countries the actual banking assets are roughly speaking only one third of the percentage of banks. That may indicate that foreign banks have a lower market share than domestic-owned ones. Only in one country the amount of banking assets (compared to the total) exceeds the percentage of foreign-owned banks giving those banks a comparatively high market share. However, since this jurisdiction is the one with the lowest level of foreign-owned banks (7.7%), the percentage of bank assets is below one fifth of the total amount.

## Permissible Powers of Banks

Depending on the supervisory context and framework credit institutions are allowed a different range of activities. A jurisdiction may opt for universal banking allowing a wide range of financial services while it may also restrict the banks to particular fields of duty. The framework would regulate whether the banks shall carry out classical banking services only or also go across this segment and also offer insurance activities or real estate services. If that was the case the regulator must take the wider field of operation into account since the bank would then for instance also act like an insurance undertaking. Nonetheless even in case of separation between banking and insurance companies the bank may also engage in an insurance undertaking e.g. by acquiring voting rights unless there is a further restriction not to engage likewise.

The answers reflect a wide range of different regulatory approaches.

As concerns the first question whether banks are allowed to carry out securities activities such as underwriting, dealing and brokerage services for securities and mutual funds the respondents gave all sorts of possible answers. Two jurisdictions stated unrestricted activities whereas two others declared that those activities are prohibited. The other five jurisdictions indicated that those activities were more or less permitted. The answers just aim to get a general overview so that it cannot be specified to which extent permitted activities differ from unrestricted ones. The notion permitted may however imply that a bank must take other factors into consideration while executing services in this field while this compliance test seems more remote in a fully unrestricted environment.

The second question deals with insurance activities such as underwriting and selling of all kinds of insurance policies and acting as a principal or agent. Three respondents gave an affirmative answer that this business is permitted. Three jurisdictions allow for these services in a restricted manner only. In one jurisdiction a bank is prohibited from carrying out this business. Another jurisdiction differentiates: while carrying out insurance activities as an agent is restricted, it is prohibited to carry these services out as a principal.

The third question on real estate services led to all sorts of answers again. One jurisdiction offers the option of unrestricted operating in real estate services, another two jurisdictions permit this business. Three jurisdictions take a restricted approach towards carrying out this business. In two states this business is prohibited for banks (Table 9).

## **Ownership Opportunities**

How do credit institutions interact with companies of non-financial background? This question touches both the extent to which banks may participate in non-finan-

cial firms and on the other hand also whether such firms may hold a share in banks.

Two jurisdictions explicitly stated that banks are not allowed to own any non-financial firms. Another jurisdiction makes a distinction between conventional and Islamic banks. While conventional banks are not allowed to do so, Islamic banks may own such firms as this is required in order to operate in line with Islamic banking principles. The other jurisdictions take per se a more open approach towards ownership opportunities. However, the applicable rules and regulations set certain limits for this kind of ownership. Four of these jurisdictions apply limits according to certain thresholds such as a percentage in relation to the bank's funds.

The other way round four jurisdictions allow non-financial firms to engage and own banks without any further restrictions. One jurisdiction requires non-financial firms to totally refrain from ownership in banks. The remaining four jurisdictions give a basically affirmative but conditional answer. In these jurisdictions the ownership is restricted, e.g. two of these jurisdictions foresee an approval by the supervisory institution.

## **Rating of Banks**

Significant banks which play a vital market role and are active in the international arena are often rated by international credit rating agencies. A rating may be of high relevance to assess an institution and its solvency. For an international exposure it therefore matters whether the major banks have got a rating.

In one jurisdiction all the ten biggest banks are rated by at least one international rating agency. Seven other respondents indicated that two to six banks have been rated in their jurisdiction.

### 3. Conclusion

All countries are well aware of the importance of modernizing their financial sectors and have been implementing reforms for some time, with encouraging results.

Essential Banking laws and regulations are now in place in most countries of the region and Central Banks are upgrading their oversight capacity. Management systems are becoming more and more sophisticated and often include enhanced risk-based supervision functions procedures, with related manuals for supervision and training of staff. Bank Corporate governance as well as regulatory compliance with capital adequacy ratios have significantly improved as a result of staff better prepared to carry out their newly introduced or strengthened obligations.

Despite progress and a number of successful reforms, several challenges remain and need to be addressed to prepare the banking industry. Some of the necessary reforms would also facilitate financial integration in the region accommodating the envisaged free trade:

- Strengthen the soundness of the banking systems in all countries. In particular it is important to reduce the high level of non performing loans, to restructure state-owned banks, and to secure compliance with prudential rules ;
- Increase competition in the banking system. Notably, extensive state ownership and restrictions on foreign bank entry stifle competition and financial deepening in the region; opening up the banking sector for commercial banks both for domestic credit institutions and those abroad is a solution ;
- Deepen the financial markets where they are bank-dominated. Financial markets (money, interbank, foreign exchange, equity, and securities markets) are

nascent or shallow in most countries, and nonbank financial institutions are generally underdeveloped ;

- Upgrade financial sector infrastructure. In particular, accounting and auditing practices, transparency and corporate governance, the legal and judicial framework, and the payment systems need to be strengthened.

## Tables

**Table 1. Gross national income (GNI) per capita, PPP (current international USD)**

	2000	2005	2006	2007	2007/2000 (%)
ALGERIA	5 130	6 820	7 140	7 640	49
EGYPT	6 886	8 638	9 262	9 852	43
ISRAEL	18 890	22 610	24 310	25 930	37
JORDAN	3 270	4 480	4 850	5 160	58
LEBANON	7 530	9 480	9 610	10 050	33
MOROCCO	2 560	3 520	3 860	3 990	56
SYRIA	3 150	3 880	4 110	4 370	39
TUNISIA	4 600	6 080	6 640	7 130	55
TURKEY	8 600	10 250	11 390	12 350	44
GERMANY	25 670	30 540	32 120	33 530	31
FRANCE	26 390	30 830	32 230	33 600	27
EURO AREA	25 007	29 442	31 029	32 508	30

Source: *World Bank*

**Table 2. Indicators of financial development**

	DOMESTIC CREDIT PROVIDED BY BANKING SECTOR (% OF GDP)		DOMESTIC CREDIT TO PRIVATE SECTOR (% OF DGP)	
	1995	2006	1995	2006
ALGERIA	45	NA	5	12
EGYPT	81	99	37	55
ISRAEL	78	76	65	89
JORDAN	89	116	75	98
LEBANON	52	196	55	78
MOROCCO	79	78	48	58
SYRIA	48	33	11	15
TUNISIA	71	71	68	64
TURKEY	20	46	14	26

Source: *WDI (World Bank)*

**Table 3. Banks**

END 2008	BANKS OWNED BY THE STATE (PARTLY OR TOTALLY): NUMBER	NATIONAL PRIVATE BANKS: NUMBER	PARTIALLY OR TOTALLY FOREIGN BANKS: NUMBER	TOTAL
ALGERIA	6	2	11	19
EGYPT	6	27	7	40
ISRAEL	1	4	5	10
JORDAN	0	15	8	23
LEBANON	0	54	10	64
MOROCCO	5	6	5	16
PALESTINIAN AUTHORITY	0	10	11	21
TUNISIA	10	4	11	25
TURKEY	8	19	23	50
FRANCE	1	129	161	291

Source: MEDA countries and CECEI report 2008 for France

**Table 4. Banking assets**

	BANKING ASSETS AS A PERCENT OF GDP 2007	BANKING SYSTEM ASSETS AS A PERCENT OF TOTAL FINANCIAL SYSTEM ASSETS* 2007
ALGERIA	69.3	NA
EGYPT	121.0**	55.0**
ISRAEL	145.0	40.7
JORDAN	239.9	NA
LEBANON	362.0	75.7
MOROCCO	106.0	55.0
PALESTINIAN AUTHORITY	180.0	NA
TUNISIA	92.0	86.4
TURKEY	67.9	75.7

\*: as measured by the sum of banking system assets, stock market capitalization, and bonds outstanding

\*\*: as of June 2008

Source: MEDA countries

**Table 5. Measure of the accessibility of banking to the population: average number of branches serving every 100,000 people (2008)**

ALGERIA	4.0
EGYPT	4.3
ISRAEL	15.0
JORDAN	9.7
LEBANON	21.5
MOROCCO	14.9
PALESTINIAN AUTHORITY	5.2
TUNISIA	10.6
TURKEY	11.5
GERMANY	47.6
FRANCE	63.1
EURO AREA	57.6

Source: MEDA countries and ECB

**Table 6. State presence in the banking market (%)**

END 2008	PART OF BANKS OWNED BY GOVERNMENT	PART OF BANKING ASSETS OWNED BY GOVERNMENT
ALGERIA	38	90*
EGYPT	15	47
ISRAEL	4	30
JORDAN	0	0
LEBANON	0	0
MOROCCO	24	27
PALESTINIAN AUTHORITY	0	0
TUNISIA	25	41
TURKEY	14	30

\*: deposits and credits

Source: MEDA countries

**Table 7. The competitive environment**

	PERCENT OF ASSETS ACCOUNTED FOR BY THE LARGEST BANK	PERCENT OF ASSETS ACCOUNTED FOR BY THE 3 LARGEST BANKS	PERCENT OF ASSETS ACCOUNTED FOR BY THE 5 LARGEST BANKS	PERCENT OF DEPOSITS ACCOUNTED FOR BY THE TOP 3 BANKS	PERCENT OF DEPOSITS ACCOUNTED FOR BY THE TOP 5 BANKS	MEASURE OF MARKET CONCENTRATION BY THE HERFINDAHL-HIRSCHMAN INDEX
ALGERIA	37.7	NA	NA	NA	NA	NA
EGYPT	22.9	43.4	52.6	43.4	52.8	NA
ISRAEL	30.0	75.7	94.0	75.7	94.8	0.22
JORDAN	23.6	46.3	58.9	50.5	62.3	NA
LEBANON	14.7	37.6	53.8	37.4	51.8	NA
MOROCCO	25.7	63.4	81.1	67.0	83.3	0.17
PALESTINIAN AUTHORITY	NA	60.0	80.0	65.0	79.0	NA
TUNISIA	14.9	43.2	61.4	44.8	63.3	0.1
TURKEY	NA	NA	59.8	NA	62.2	0.088*
GERMANY			22.0			0.0183
FRANCE			51.8			0.0679
EURO AREA			54.7			0.1006

Source: MEDA countries and ECB "EU banking structures" October 2008

**Table 8. Measure of foreign involvement in banking**

2008	PERCENT OF BANKS THAT ARE FOREIGN-OWNED	PERCENT OF BANKS ASSETS THAT ARE FOREIGN-OWNED
ALGERIA	57.8	8*
EGYPT	17.5	6.5
ISRAEL	7.7	17.8
JORDAN	34.8	11.2
LEBANON	15.6	4.3
MOROCCO	31.3	21.7
PALESTINIAN AUTHORITY	52.4	52.0
TUNISIA	35.0	27.6
TURKEY	46.0	14.0
FRANCE	55.3	10.9

\*: estimate

Source: MEDA countries and CECEI for France

**Table 9. Permissible powers of banks**

	ALGERIA	EGYPT	ISRAEL	JORDAN	LEBANON	MOROCCO	PALESTINIAN AUTHORITY	TUNISIA	TURKEY
<b>SECURITIES ACTIVITIES (UNDERWRITING, DEALING, AND BROKERAGE SERVICES FOR SECURITIES AND MUTUAL FUNDS)</b>									
UNRESTRICTED	X				X				
PERMITTED		X	X	X		X			X
RESTRICTED			X*					X	
PROHIBITED							X	X	
<b>INSURANCE ACTIVITIES (UNDERWRITING AND SELLING ALL KINDS OF INSURANCE, AND ACTING AS A PRINCIPAL OR AGENT)</b>									
UNRESTRICTED				X	X				X
PERMITTED	X**		X***						X
RESTRICTED		X				X		X	
PROHIBITED							X		
<b>REAL ESTATE SERVICES (INVESTMENT, DEVELOPMENT, AND MANAGEMENT)</b>									
UNRESTRICTED	X			X					
PERMITTED		X							
RESTRICTED			X		X			X	
PROHIBITED						X	X		X

\*: mutual funds

\*\*: maisons mères des filiales (agrément)

\*\*\*: agent: restricted, principal: prohibited

Source: MEDA countries

## Notes

1 Levine, Ross, 2005, "Finance and Growth: Theory and Evidence," in Philippe Aghion and Steven Durlauf, eds., *Handbook of Economic Growth*, Vol. 1 (Amsterdam, Netherlands: Elsevier Science).

2 Tahari & al., *"Financial Sector Reforms and Prospects for Financial Integration in Maghreb Countries"*, IMF Working Paper WP/07/125

# B. Insurance

by

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## Introduction

In year 2007, the insurance sub-group of the « Financial services » working group of the EuroMed Market Programme met twice. The final aim of the EuroMed Market Programme is “to contribute to the creation of a free trade area in year 2010”, this being set as a target date.

It was noted during these two meetings:

- that insurance legislations of MEDA countries were rather close to one another from the one end, to EU insurance legislation from the other hand;
- that insurance services trade, among MEDA countries from the one end, between MEDA countries and EU from the other end, were still limited in extension. It must be noted, however, that insurance services trade among EU countries also remain limited in extension, at least when it comes to services which are not provided through an establishment (see below).

The Euromed program was extended for year 2008, with the aim, with regards to insurances services,

- to develop a comparative analysis of insurance legislations of MEDA countries, and of MEDA countries vs EU;
- to examine whether conditions of an insurance services free-trade area, either between EU and MEDA countries, or, in a more limited way, within smaller areas (for instance, among some MEDA countries, or between some MEDA and some EU countries) were already met.

The questionnaire on insurance services was sent to MEDA country representatives on 4th July 2008. On 28 and 29 November 2008, a meeting in Luxembourg permitted a first study of received answers and a discussion on the conditions of an insurance services free-trade area, and on the aims and form of the report.

## Conditions for a free-trade area

Generally admitted conditions for such an area are the following:

- Prudential rules (security rules) should be equivalent;
- Organisms or bodies supervising that these rules are complied with should also be « equivalent », and trust one another.

Often, economic and political conditions are added —for instance, the absence of substantial imbalance between the countries.

To this respect, the EU experience and history is an interesting laboratory, and could contribute to relativize the first condition. At present, the insurance services free trade area within the EU is nearly completely completed, whereas prudential rules are by no means equivalent.

Before undertaking the analysis of MEDA countries insurance legislation, a few words should be said about the EU insurance legislation, as well as about another „international insurance legislation“ that is also of interest for the MEDA countries, that of the IAIS/AICA.

## Relevant international rules for the region

### A) IAIS / AICA rules.

The International Association of Insurance Supervisors, or IAIS<sup>1</sup>, groups (as of 08.12.2008) 144 Member jurisdictions<sup>2</sup>. With regards to the Euro-Mediterranean region, are members:

- Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia, Turkey;

- The 27 Member States of the EU.

For many jurisdictions, IAIS standards, rather than being fully enforceable standards, are rather seen as „strong“ recommendations. As a matter of fact, most jurisdiction endeavour to implement these standards.

AICA standard cover all areas of insurance supervision, including:

- quantitative, or financial aspects: for instance, calculation of liabilities (technical provisions), asset valuation, solvency requirements;
- qualitative aspects: for instance, corporate governance, fitness and propriety rules, cooperation between supervisors.

It is generally admitted that IAIS rules are more developed on qualitative aspects. When it comes to quantitative (or financial) standards, there is no doubt that EU rules are more elaborated —even though they do not, at present, correspond to a full harmonization.

The difference between EU rules and IAIS standards with regards to insurance groups —a specially relevant theme for this study— has for long been a perfect reflection of this. While the EU legislation<sup>3</sup> has since 1998 provided detailed rules on the elimination of double gearing, on the calculation of group solvency, only recently has the IAIS produced a (less) detailed standard.

## B) EU rules

When it comes to insurance services, the UE has practically reached a complete free trade area since the 1st January 1994, when the „3rd directives“<sup>4</sup> were implemented into national legislation. The move to „closed“ market to the free trade area hasn't been performed

overnight; on the contrary, it took several decades. This should be kept in mind when thinking about an insurance services free trade area, whether it should cover the whole Euro-Mediterranean area or smaller sub-areas.

Another relevant point when reflecting upon insurance free trade area is that, contrary to what is often spontaneously thought or said, sometimes even by EU officials, the EU insurance services free trade area was set at a time when legislative harmonization was far from being fully completed.

## First conclusions

The received answers, hereunder analysed, confirm what already came out from the 2007 meetings: most MEDA countries insurance legislations are, in most areas, rather similar to one another, and rather similar to EU legislation. This does not mean that these legislations are (fully) harmonized, but it's just been seen that EU legislation neither is.

When it comes to the possibility, in the existing insurance legislation and supervision, of setting up a free trade area, a number of respondents underline the substantial differences between insurance legislation and supervision, the lack of sufficient confidence among supervisors, and the substantial gaps between markets, in terms of size, economic wealth, and consuming habits. While the first two elements could probably be relativized —they also exist within the EU and did not prevent the Single market to be set up— the third one should not be neglected. Finally, one should keep in mind that if EU insurance supervisors had been asked about the feasibility of a single market when the « first directives »<sup>5</sup> were taken and set up legislative harmonization, very few of them would have provided an affirmative reply.

## Analysis of received answers

This analysis is divided into 12 chapters, which correspond to the 12 chapters of the questionnaire<sup>6</sup>. A number of chapters start with a reminder of the corresponding legislation within the EU—and within the IAIS, when appropriate; it then analyses the MEDA countries answers. These latter, depending on the questions, are in turn also separated into two parts in some chapters: *i*) existing legislation; *ii*) future possible options.

### 1. Competent authority

a) IAIS and EU regulations; the situation within the EU.

EU legislation does not impose any specific form for the insurance supervisor. IAIS standards—in particular, ICP n°3<sup>7</sup>—do not either explicitly prescribe any special form, even though they *implicitly* tend to recommend an independent organization (see EC *d, e, f, g, h, o, p*)<sup>8</sup>.

Within the EU, there is a noticeable diversity of forms of insurance supervisor. The German supervisor (BAFIN), for instance, is an « integrated », that is, it is both distinct from the government, and common to insurance, bank and securities supervision. The French supervisor (ACAM) is also a non-governmental authority; but, different from Bafin, it only supervises the insurance sector, and banking and securities supervisions lie with two other authorities. The Spanish authority (DGS) also only supervises the insurance sector and is a department of the Finance Ministry of Spain.

Within the EU, a definite incentive towards the setting up of non-governmental authorities has been the financial independence, which, in practice, provided higher resources, and, sometimes too, a greater flexibility in hiring staff.

At present, there is not within the EU a clear demonstration that a certain form of supervisor would be more, or less efficient than the others.

b) Results of the questionnaire.

Responses to the questionnaire show a variety of forms of supervisors within MEDA jurisdiction that is similar to the variety existing in EU. In Algeria, Morocco and Turkey, the supervisor is a part of the Finance Ministry. In Lebanon and Tunisia, authorities only supervise the insurance sector and are separated from the Ministry. The Palestinian Authority supervisor is an integrated authority.

## 2. Market Data

The number of supervised insurers varies from 11 (Palestinian Authority) to 54 (Lebanon). These data should also be considered with respect of each market size.

The part of insurance premium in GDP varies from 0.70% (Algeria) to 2.90% (Lebanon).

Main marked data are summed up in the table below:

NUMBER OF SUPERVISED INSURERS	DZ	JO	LB	MA	PA	TN	TR
ANNUAL TURNOVER IN 2007 (M€)	16	29	54	18	11	18	52
PART OF INSURANCE PREMIUMS IN GDP (%)	656	282	518	1752	51	675	391
NUMBER OF LIFE INSURERS	0.0	2.60	2.90	2.87	2%	2%	1.30
NUMBER OF NON-LIFE INSURERS	1	1	5	1		2	21
NUMBER OF «COMPOSITES» INSURERS	3	11	18	8		3	30
NUMBER OF REINSURERS	11	17	31	8	11	12	
NUMBER OF MUTUALS; MARKET SHARE OF MUTUALS	1	0	1	1		1	1
	2 ; 6%	0		3 ; 6%		4 ; 19%	0

## 3. Duties of the supervisor

a) *IAIS and EU regulations; the situation within the EU.*

IAIS / AICA regulation sets the minimum that must be supervised: for instance, licensing (ICP 6), portfolio transfers (ICP 8), exits from the market (ICP 16), tech-

nical provisions (ICP 20). IAIS / AICA regulation does not impose that all these tasks must fall upon one single authority, although it is expected that the “core” tasks, like the supervision of technical provision, fall upon the insurance supervisor, whereas more “peripheral” tasks, like licensing, could be allotted to other authorities.

EU regulation neither imposes that these various tasks fall upon a single authority, but it is more precise than IAIS regulation on a number of points.

In various areas, EU regulation sets what must *not* be regulated. For instance, article 8.3 of 73/239 Directive prohibits prior approval of tariffs in non-life business, except as part of general price control systems. This means that maximum tariffs would be allowed as part of a price control system, but minimum tariffs as part of a supervisory system are prohibited. This provision was introduced by Directive 1992/49. It does not apply to *life insurance*, where tariffs control is allowed (art. 21 of Dir. 2002/83).

Practice in UE varies with regard to “peripheral” supervisory tasks. In France for instance, licensing, amicable portfolio transfers do not lie with the ACAM (even though its advice should be requested – but not necessarily followed).

Licensing withdrawal lies with the ACAM but the Court will appoint a liquidator, on whom the ACAM has no control. Situation is similar in Germany, where petition for the opening of insolvency proceedings against the insurer may only be filed by the supervisor. The insolvency court must immediately forward the order to open insolvency proceedings to the supervisor. The supervisor can demand information on the status of proceedings from the insolvency court and the insolvency administrator at any time.

In other countries, the insurance supervisor has wider powers such as licensing, portfolio transfers, appointment of a liquidator.

With regards to the scope of insurance supervision, situation has evolved over time, and varies among country within the authorized limits of EU regulation.

For instance, with regards to the non-life premium tariffs, in Germany as well as in France, a supervisory control —that is, the right for the supervisor to set minimums— existed until the implementation of the directive 1992/49.

With regards to life premiums, some countries, like France, set maximum guaranteed interest rates and “minimum” mortality tables; other countries, like United Kingdom, do not have national legislation on this point. In Germany as well, the prior control of premiums in life and non-life was abolished in 1994 with the implementation of the third generation directives. However, the insurer must notify the supervisor about new principles for the calculation of the premiums and mathematical provisions in life and health insurance.

With regards to the policy conditions, prior control was likewise abolished with the implementation of the third generation directives, but most supervisors though exercise a form of supervision. In Germany for instance, in compulsory insurances the intended use of new or changed general insurance policy conditions must also be lodged with the supervisor. In France (art.L.310-18), insurers can be required to send insurance contracts to the Minister for him to examine them.

Finally, IAIS regulation states that supervisors should deal with consumer protection (ICP 25). As a matter of fact, most EU supervisors have a department that is dedicated to the dealing of consumers’ complaints.

*b) The results of the questionnaire*

Answers show a variety of situation that is similar to that existing —or that existed— within the EU.

Concerning the “peripheral” activities, all MEDA countries require that an insurer must be authorised for insurance business, but in two countries (Algeria and Tunisia) licensing lies with a Ministry. In one country as well an insurer’s liquidation does not fall upon the supervisor, and in one case the publication of statistical information on the insurance market lies with a Ministry.

Life premiums are not controlled in Jordan and Lebanon; they are controlled in other countries (from 2009 on in Tunisia). In Algeria there is also a provision that sets a minimum guaranteed interest rate.

For non-life premiums, the situation is quite different from one country to the other, and similar to that that existed in EU before the implementation of 92/49 Directive. Lebanon does not control non-life premiums. 3<sup>rd</sup> party motor insurance premiums must be over a minimum in Turkey (supervisory control). In Jordan, the Palestinian Authority and Tunisia, these are fixed: this is both a price control (still allowed in EU) and a supervisory control (prohibited in EU since 1994). In Algeria and Morocco, non-life premiums in general are controlled.

All countries report the control of insurance policies.

All MEDA countries except Lebanon and Algeria control the shareholders of the companies.

All supervisors deal with consumers’ complaints.

The prevention of money-laundering is also common in all MEDA jurisdictions.

With regards to the “core” activity of insurance supervision (e.g. supervision of the insurer’s investments, of technical provisions, of capital requirements and

of public financial returns, on-site inspections...), all these tasks lie with the insurance supervisor, as could be expected.

#### **4. Freedom of establishment / of taking a participation in an insurer; licensing regime**

##### *Results of the questionnaire*

###### *i) Existing legislation*

All jurisdictions reported detailed prudential regulations both for domestic and foreign investors. Fit and Proper testing, competence and financial soundness of shareholders is also applied in all MEDA countries.

As a principle, the granting of authorisation does not depend on the access that MEDA countries have in other countries (no reciprocity condition)<sup>9</sup>. Several jurisdictions explicitly state that it does not depend on the shareholder's nationality (Lebanon, Tunisia and Turkey).

The following table is a—partial—indicator of how each market is opened to foreign investors:

	DZ	JO	LB	MA	PA	TN <sup>10</sup>	TR
NUMBER OF INSURERS THAT ARE CONTROLLED BY FOREIGN INVESTORS	4	3		4	0	0	29
MARKET SHARE OF THESE INSURERS	8%	11%		23%			52%
NUMBER OF INSURERS WHOSE MORE OF 20% OF CAPITAL SHARE IS OWNED BY FOREIGN INVESTORS	4	6		6		6	29

In four cases, an authorisation from the supervisor is required for the taking of a participation in an insurer when the participation goes over determined thresholds. Lebanon and the Palestinian Authority do not provide such authorization. One jurisdiction hasn't answered.

Several jurisdictions (Lebanon, Morocco, Palestinian Authority, Tunisia) specify that application for authorization may be considered in the light of the economic requirements of the market<sup>11</sup>. Turkey, on the contrary, explicitly states that authorization does not depend on economic requirements of the market.

Composite insurers—that is, insurers that are allowed to simultaneously operate in life and non-life—are prohibited in Morocco<sup>12</sup>, Turkey; they are prohibited in Algeria from 2011 on (that is, former composite insurers will have to split up into two separate entities). In Jordan and in Lebanon, new composite insurers are not allowed, but those already licensed can continue to operate. In the Palestinian Authority and Tunisia, composite insurers can be licensed but must comply with strict separation requirements.

###### *ii) Future possible options.*

4 jurisdictions out of 7 consider that conditions for freedom of establishment in their country are currently met<sup>13</sup>.

When it comes to the freedom of establishment of domestic operators—and in particular of domestic insurers—in other countries, answers vary. Lebanon notes that such freedom of establishment would be appropriate towards MEDA countries, but perhaps not towards EU where markets are more developed. In a similar way, Tunisia notes that it would be more appropriate to establish in similar markets (e.g. from North Africa) where consumers behaviours etc. are similar. Morocco and Turkey do not notice particular restrictions.

As regards regulation, in most cases a domestic insurer can freely create an insurance subsidiary or take a participation in an existing insurer; in one case, when it must require authorization this is for other reasons (e.g. exchange transactions control) than insurance supervision. However, authorization is required by the Palestinian Authority, and by Morocco unless the acquired shares are listed in OECD, EU or UMA.

## 5. and 6. Regulation and supervision of insurance groups and of financial conglomerates

### Results of the questionnaire

None of the MEDA countries reported to have regulations about insurance groups and conglomerates.

However, in some jurisdictions (Jordan, Morocco, Palestinian Authority and Turkey) double gearing is eliminated inasmuch as, in the calculation of available own funds, investments in insurance subsidiaries are deducted.

In a number of cases (e.g. Morocco, Tunisia, Turkey), provisions regarding group / conglomerate regulation, as well as cooperation between insurance / banking supervision, are under discussion and should be adopted in the (relatively) short run.

## 7. Provision of services: licensing and authorisations with regard to non-domestic providers

Classically, there are two ways for a foreign provider to provide services in a host jurisdiction, when not establishing a subsidiary:

a) Provision of services through a branch that is supervised by the host jurisdiction

b) "Free provision of services" (FPS), that is, direct provision of services by the foreign insurer<sup>14</sup>.

### Results of the questionnaire

#### i) Existing legislation

Regarding the provision of services from a foreign insurers, the results are as follows: (L, Licensing ; D, simple registration or Declaration; N, Not allowed).

	DZ	JO	LB	MA	PA	TN	TR
PROVISION OF SERVICES THROUGH A SUPERVISED BRANCH	L	L	L	N	D	L <sup>15</sup>	L
FPS (OR PROVISION THROUGH AN UNSUPERVISED BRANCH)	N	N	N	N <sup>16</sup>	N	N	N

As can be seen, the free provision of services or the establishment of a non-supervised branch is not allowed in the MEDA area. Morocco (following former disappointments) does not authorize branches, and Tunisia restrictively authorizes it. In other countries, a branch of a foreign insurer needs to undergo a formal licensing procedure, except in the Palestinian Authority who only require registration. In no case can authorizations be dependent on the petitioner's nationality<sup>17</sup>.

When it comes to cross-border provisions emanating from domestic insurers, 1 country does not authorize them, 1 submits them to specific authorization, 2 require the information of the supervisor and 3 have no particular requirements<sup>18</sup>.

#### ii) Future possible options

Most respondents do not believe that in the short run, the FPS is an appropriate means to promote a free-trade area for insurance services, or at least are reluc-

tant to accept FPS as host jurisdiction, even in the case where the insurance services come from neighbouring MEDA countries. On the other hand, convergence of regulatory regimes<sup>19</sup> being what it is, respondents believe that the provision of services through licensed branches supervised by the host authorities, is a more appropriate way to develop cross-border provision of services.

The Palestinian Authority, however, notes that FPS could be envisaged coming from MEDA countries, with safeguards such as limitation to some insurance classes, institution (by the home jurisdictions) of a guarantee fund protecting policyholders against the failure of the insurer, and as long as the host supervisor remains responsible to supervise contracts and their fulfilment and is allowed to take sanction against the insurer.

On the other hand, 2 MEDA countries would find it appropriate that a freedom be granted to insurers from their jurisdiction to provide services to all host MEDA and EU jurisdictions; one other would find FPS appropriate only towards MEDA countries; one answer notes that such LPS would depend on host supervisors and the ability of domestic insurers to comply with the host country provisions; 3 countries do not provide an answer.

## **8. Exchange of information between authorities — standardization of supervisory returns and of public accounts**

Results of the questionnaire

### i) Existing legislation

In most cases there is no general provision on the exchange of information between authorities<sup>20</sup>. Most often, exchange of information takes place on a case-

by-case basis<sup>21</sup>, and / or through MoUs or particular agreements<sup>22</sup>, and / or in regular meetings, working groups etc that are set up by regional institutions<sup>23</sup>. In two cases, such exchange is not yet allowed, or has been recently allowed and hasn't yet taken place.

The content of these exchanges also vary on a case-by-case basis.

There is a fair cooperation between supervisors with regards to the settlement of international disputes, in particular relating to motor insurance: parties cooperate through the Orange Card system<sup>24</sup>, and / or the Green Card system<sup>25</sup>, though the Palestinian Authority states that such cooperation is hindered as long as there is no freedom of circulation. Jordan also mentions that there are also ADR<sup>26</sup> mechanisms that are available to foreign policyholders.

### ii) Future possible options

The question of what information exchanged between supervisors could favour complete or partial / restricted FPS (such as exchange of information on the financial position of insurers, on insurance legislation, etc), and whether the UE "Sienna" Protocol<sup>27</sup> could constitute (among other) an appropriate basis for such information exchange, could not be discussed at length in the Working Group. Jordan noted that the scope of exchanged information should be quite extensive, including general information sharing, requests for assistance, insurance legislation and training. The Palestinian Authority noted that the Sienna Protocol could be an appropriate basis for the exchange of information.

With regards to current exchanges of information (are they appropriate? How should they be standardized), two jurisdictions state that they still haven't taken place; one jurisdiction finds them appropriate, but another one noted that they still lacked practicability and were of little use. One jurisdiction noted that supervisory re-

turns should be standardized, and other statistical and qualitative data should be available, for the information exchanged between supervisors to be fully relevant.

## 9. Guarantee fund

### a) *Reminder of EU regulation and practices (TBC):*

At present, there is no directive from the EU covering insurance guarantee schemes. However, the Commission set up a working group on Insurance Guarantee Schemes in 2001.

Within the IAIS, nothing either exists; it has been proposed, as an advanced criteria to ICP 25 (Consumers protection), to recommend such fund covering compulsory insurances, to the benefit of retail policyholders.

Germany has a guarantee fund for life and health insurance. The legal basis was implemented in 2004. The objective of both schemes is the continuation of insurance contracts. Paying compensation is not considered to be a function of the schemes. The funding takes place on the basis of contributions from the insurers participating.

Since 1994, there is also a guarantee fund in the area of Third-Party-Liability Insurance (TPL). This fund pays i.a. compensation for damage to persons or property in case the TPL insurer becomes insolvent.

There are no differences in eligibility criteria depending on nationality, place of residency of the policyholder, location of the risk or the way the contract was underwritten (directly with the insurer, through a branch or through FPS). All contracts of the participating insurers are protected.

### b) *results of the questionnaire*

#### i) *existing legislation.*

In 4 jurisdictions a guarantee fund currently does not exist at all<sup>28</sup>, but in two of them (Algeria and Jordan) a project is under review.

Morocco has a fund covering 3<sup>rd</sup> party motor insurance, other compulsory insurances and health insurance.

Tunisia has a fund that covers all insurance policies, without other limits than those stipulated in the contracts.

Turkey has a guarantee fund covering losses in respect third party motor liability insurance and other compulsory insurance. The amount that can be paid by the fund cannot be higher than coverage limit set by the Minister.

In all cases where a fund exists, there is no discrimination with regard to the nationality of the policyholders, or to the way the insurance contract was underwritten (*ie*, the fund would cover any contract underwritten by the insurer, whether the contract was underwritten in the jurisdiction, through a branch or —if applicable— through FPS).

#### ii) *Future possible options*

To the question whether the setting up (by the foreign home jurisdiction) of a guarantee fund would favour the FPS (in the domestic host jurisdiction) in those classes covered by the fund, 1 jurisdiction says it wouldn't, 1 doesn't answer and 5 say it would but, in two cases, with the caveat that this should be studied on a case by case basis and that such LPS assumes the equivalence of supervisory regimes<sup>29</sup>.

Conversely, to the question whether the domestic home jurisdiction could envisage the setting up of a guarantee fund, in order to favour the FPS by its own insurers in

foreign host jurisdictions, 2 jurisdictions say they do not envisage such device, 1 doesn't answer, 3 say it could be envisaged and 1 say it already exists.

## 10. Calculation of technical provisions

### a) reminder of IAIS and EU regulations (TBC)

The establishment of run-off triangles is often an important supervisory tool to assess the robustness of non-life outstanding claims provisions. A description of such possible triangles is provided by the IAIS supervisory standard on non-life disclosure (§28)<sup>30</sup>, but there are other examples. IAIS' standard provides that such triangles should be segmented among main insurance classes, and should be disclosed.

### b) Results of the questionnaire

With regards to non-life provisions, there is no tangible difference as to the provisions an insurer should set up, such as provisions for unearned premiums, for unexpired risks, and for claims outstanding. Understandably, equalisation/catastrophe provisions are not compulsory in every jurisdiction.

Differences are more tangible in the field of life insurance where, according to the local features of insurance contracts, insurers may have, or may not have to set up provisions for bonuses and provisions for unit-link policies. This is summarized in the table below:

	DZ	JO	LB	MA	PA	TN	TR
MATHEMATICAL PROVISION	Y	Y	Y	Y	Y	Y	Y
PROVISION FOR BONUSES	N	N	Y	Y	Y	Y	Y
PROVISION FOR UNIT-LINKED INSURANCE POLICIES	N	N	N	Y	Y	Y	N

With regards to calculation methods of the provision for outstanding claims, in all countries a case by case method is compulsory, and in most countries this must be, in some insurance classes (typically motor insurance), completed by statistical methods such as chain-ladder methods or the use of other statistical means. Please refer to the table of answers for further details.

Two countries do not provide for run-off triangles in supervisory returns. 4 make them compulsory in supervisory returns, and one makes them compulsory in both supervisory returns and public accounts..

Two countries report that (non-life) claims outstanding provisions should be discounted.

With regards to the *maximum discount rate* used in the calculation of *life* insurance provision, 1 country has a provision that is similar to that of Article 20.1.B.a.i) of the 2002/83 Directive ("prudent" discount rate, as "not more than x % of the rate on bond issues by the State"), 1 is about to implement similar provision, 3 provide that the discount rate should be set by an actuary (and, in one case, disclosed in application of IFRS4), and 2 have no specific provisions.

With regards to *mortality tables*, 3 countries provide tables to be used by the insurer; in 2 countries the tables should be notified to the supervisor, who can require the use of other tables; 2 countries have no specific requirements.

Finally, most countries have specific requirements with regards to assets covering technical provisions (see below and table of detailed answers).

## 11. Investment regulation

### a) Reminder of IAIS regulations, EU regulations and practices

Present EU legislation sets limits on assets that are admitted to cover technical provision (list of admitted assets). These rules are then implemented in various ways and details by Member states.

In Germany for instance, each insurer must report on a regular basis about its assets. These have to be placed in accordance with the legal provisions whose objective it is to have investments which are profitable and secure. A proper mix and diversification of the investments are to safeguard the insurer and thus the insured against the risk of major losses of assets

### b) Results of the questionnaire

All countries report detailed regulations on admissible assets, along with specific rules on diversification and spreading, similar to those existing in current EU regulation. Besides, the Palestinian Authority seems to have a mixed system of the prudent person approach and detailed regulations on admissible assets, and Turkey also has a capital charge on assets (see below §13).

4 countries reported the existence of mandatory investments<sup>31</sup>.

In 3 countries assets are accounted for at purchase price, and in 2 they are accounted for at market value<sup>32</sup>.

## 12. Capital requirements

### Results of the questionnaire

With regards to *life insurance*, 4 respondents describe a system quite similar to the one set up by EU 2002/83 Directive, whereas in 2 cases own funds requirements are only based on premiums<sup>33</sup>. Besides, Turkey also reported a more complete risk based approach, taking asset, reinsurance, excessive premium increase, underwriting and currency risks into account; the higher amount is retained.

With regards to *non-life insurance*, 3 respondents likewise describe a system similar to the one set up by EU 1973/239 Directive, with the finer approach of underwriting risk in the case of Morocco (capital charge depending on lines of business). Jordan also reports a capital charge on assets, and Turkey reported a more complete risk based approach similar to the one it has in life.

## 13. Elements eligible as own funds

### Results of the questionnaire

Quite similar to life technical provisions, with regards to elements eligible as own funds, most countries have “core” common elements, and differentiated elements (such as subordinated loans) depending of the characteristics of their financial markets. Please refer to table of answers for further details.

Most countries provide that own shares (and sometimes own bonds) should be deducted from admissible own funds. Algeria, however, does not provide any deduction. Lebanon the Palestinian Authority and Tunisia provide the deduction of intangible assets.

Quite interestingly, Jordan, Morocco and Turkey provide the deduction of investments in financial or insurance subsidiaries. As said earlier, such provision supplements the absence of double gearing prohibition in conglomerate / insurance group regulation.

## Conclusion

The study showed that the prudential insurance legislations of the MEDA countries were, with few exceptions, quite similar to the current legislation in the European Union and consequently there was also little difference between each legislation of individual MEDA countries. However, there is probably more difference between the way in which legislation is implemented, especially when it comes to the methods used by supervisors to exercise prudential control; this was in any case the overall perception of the supervisors that responded to the questionnaire.

The differences between the MEDA countries should not however lead us to forget that similar differences also exist within the European Union, but have not prevented the creation of a single insurance market. The absence of „complete“ harmonisation between insurance legislations and control systems should not be regarded as an insurmountable obstacle to the (gradual) creation of one or more free-trade areas in insurance.

On the other hand, one factor which needs to be borne in mind if we are using the European Union as a point of reference is that the single insurance market was not created overnight but through a long, gradual process; in fact, it could even be argued that this process is not yet finished. Two decades passed between the adoption of the „first“ directives which introduced freedom of establishment in the early 1970s and the „third“ directives which put the final touches to freedom of service provision; legislative harmonisation continued in 2002 with the adoption of the „Solvency 1“ directives, and is now continuing with the „solvency 2“ reform, which is still a work in progress.

Therefore, and as some of the respondents emphasised, efforts aimed at setting up a free-trade area for insurance could have limited objectives to start with, in terms for example of the area covered (regional sub-

unit) and/or the insurance services to which it would apply (as was the case for a time in the EU). Whatever their scope, the creation of these areas should be accompanied by greater cooperation between supervisors. Finally, several responses made the point that the setting up of guarantee funds by countries, which would step in to cover the liabilities of any defaulting insurer, would encourage insurance free trade in areas (such as motor vehicle insurance) covered by these funds.

## Notes

1 In French: AICA, *Association internationale des contrôleurs d'assurance*.

2 The term „jurisdiction“ is used rather than „State“, because Members do not always coincide with countries or states. With regards to France and Germany, for instance, both the insurance supervisor (ACAM and BAFIN) and the Finance Ministry are members. With regards to UK, are members, besides the UK supervisor as such (the FSA), Gibraltar, Guernsey, the Isle of Man, British Virgin Islands, Jersey, etc. The European Commission is also member of the IAIS.

3 1998/78 Directive on insurance groups

4 1992/49 (non-life insurance) and 1992/96 (life insurance) directives.

5 73/239 (non-life insurance) and 79/267 (life assurance) directives.

6 Chapter 5 and 6 were merged.

7 The *Insurance Core Principles* (ICPs), adopted by the IAIS in October 2003, set the « core » of insurance supervision. Direct links : [http://www.aisweb.org/\\_temp/Principe\\_de\\_base\\_en\\_matiere\\_d\\_assurance\\_french.pdf](http://www.aisweb.org/_temp/Principe_de_base_en_matiere_d_assurance_french.pdf) (French version) ; [http://www.aisweb.org/\\_temp/Insurance\\_core\\_principles\\_and\\_methodology.pdf](http://www.aisweb.org/_temp/Insurance_core_principles_and_methodology.pdf) (English version).

8 ICP comprise of *essential criteria* (EC) and of *advanced criteria* (AC). Evaluators such as IFM or World Bank use EC to assess the observance of an ICP. IFM and World Bank assessment reports are available on the websites of these organizations.

9 This applies to insurers that are *incorporated* in the jurisdiction. On the other hand, when it comes to *branches*, reciprocity condition may apply (e.g. Algeria).

10 Tunisia specifies that authorization for investors to hold more than 50% of equity has recently been implemented (Feb. 2008).

11 In EU, as early as « first » directives (1973/239; 1979/267) it has been prohibited that authorization may be considered in the light of the economic requirements of the market (cf. art. 8.4 dir. 73/239). In practice, in various cases this consideration has continued to operate for several years after these provisions were adopted.

12 In Morocco, insurers that simultaneously operate in health insurance (accident and sickness) and life insurance are permitted.

13 Algeria, Jordan, Lebanon, Turkey.

14 In theory, one could think of a third way: the provision of services through a non-supervised branch. Such third way is difficult to distinguish from the „free provision of services“. In EU regulation, the third way is treated as free provision of services.

15 In Tunisia, branches' activities is limited to non-residents.

16 In Morocco, the FPS is allowed on a case-by-case basis, for instance when a prospective policyholder does not find local insurers to cover their risk

17 With an exception in the case of Morocco, where, pursuant to an agreement with the United States, insurers from this country are free to provide services in *ships and transportation classes*.

18 With the exception, in one case, of a restriction due to exchange control legislation, when the transferred amount exceeds a given ceiling.

19 This expression not only refers to the legislative framework, but also to supervisor's *practices* and how confident they feel toward each other.

20 With the exception of the Palestinian Authority.

21 E.g. Lebanon.

22 E.g. Jordan, Tunisia, Turkey

23 E.g. Algeria.

24 The *Orange Card System* is an inter-Arab agreement between 15 countries, which organises the settlement of “cross-border” motor insurance claims.

25 Similar to the *Orange Card Agreement*, the *Green Card System* is an agreement between Member States of the EU relating to motor insurance, to which non-Member states such as Morocco or Turkey are also parties.

26 Alternative Dispute Resolution

27 Protocol relating to the collaboration of the supervisory authorities.

28 Lebanon has a provision under the terms of which an insurer should deposit a certain amount of funds at a bank; should the insurer fall insolvent, these deposited funds would serve to indemnify policyholders. These deposited funds are called “guarantee fund”. However and despite the terminology resemblance, such device is not comparable to the “guarantee funds” that are designed to indemnify policyholders according to amounts settled in the law or in the insurance contracts, and not according to the amount of funds secured by the insurer.

29 This caveat is probably shared by other respondents.

30 Direct link : [http://www.aisweb.org/\\_temp/Standard\\_on\\_disclosure\\_concerning\\_technical\\_performance\\_and\\_risks\\_for\\_non\\_life\\_insurers\\_and\\_reinsurers.pdf](http://www.aisweb.org/_temp/Standard_on_disclosure_concerning_technical_performance_and_risks_for_non_life_insurers_and_reinsurers.pdf)

31 Such as bonds guaranteed by the State.

32 Two countries have not responded.

33 One country has not responded.