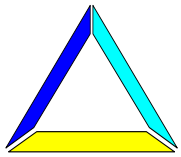
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Improving the Regulative Framework for Insurance Intermediation in Ukraine

Executive summary

Presently in Ukraine insurance companies in most cases sell private insurance policies directly to consumers, while at developed markets the most of insurance policies are sold via intermediaries. The low level of insurance intermediation impedes use of private insurance in the society. To improve the situation, we put forward several recommendations concerning regulation and supervision of the market. First, to increase safety of insurance intermediation the supervisory body for insurance activity (the "State Commission") should regulate all types of intermediaries present at the market. Second, it should adopt concrete licensing criteria concerning professional competence, repute and financial standing of insurance intermediaries and organize a centralized register for all of them. Moreover, to level the playing field between insurance brokers and agents, insurance brokers should be allowed to receive commissions from insurance companies. And lastly, to improve customer protection and raise trust in insurance intermediation we recommend introducing information disclosure requirements and obligatory professional liability insurance for all types of intermediaries.

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1. Introduction

The importance of adequate private insurance in the economy is beyond any doubt. A functioning private insurance sector can significantly contribute to the well being of population and foster economic growth. In Ukraine private insurance is vastly underdeveloped. One of the major reasons for this is the lack of insurance intermediation[1] at insurance market. Mainly insurance companies sell insurance policies directly to consumers, not through insurance intermediation, as it is a case in the most of developed countries. The rudimentary insurance intermediation in Ukraine could be explained by general distrust in intermediation activity. Consequently, one major task for policymakers aiming at private insurance popularization is a creation of a safe and effective framework for insurance intermediation in Ukraine.

At developed markets several reasons justify the dominance of insurance intermediation in distributing private insurance policies over direct sales accomplished by insurers. Firstly, frequently a choice of insurance services is not as easy for consumers as a choice of other financial services like banking. That is especially true for the countries with a low insurance culture. The choice of insurance product completely conforming with particular client's needs often requires an individual approach and thorough analysis of several insurance proposals available at the market. An external competent advice provided by insurance intermediary could be, therefore, helpful and demanded by potential insurants. Secondly, in contrast to insurers' personnel, insurance intermediaries have more incentives to represent and advocate clients' interests. They have more freedom in relations with insurance companies and more flexibility in their activities, as mediation is a separate business that allows compatibility with other jobs.

Insurance intermediation affects the financial status of insurance consumers, therefore it should be safe and trustworthy. Only reliable intermediation could grow in importance and become widespread in the economy fostering private insurance. To ensure safety of insurance intermediaries and push its development, proper regulation and supervision is necessary. The goal of this paper is to propose recommendations for improving current Ukrainian regulation and supervision of insurance intermediation. In Part 2 we compare the role of insurance intermediaries in different countries and describe their major types. In Part 3 we elaborate more on the current situation with insurance intermediation in Ukraine. In Part 4 we provide policy recommendations.

2. What are insurance intermediaries?

International experience proves that the usual way of selling insurance policies is not directly from insurance companies to its consumers but through insurance intermediation. Insurance intermediaries constitute the largest distribution channel for insurance policies in most of the EU countries (see Table 1), usually accounting for 70-90% of the total insurance premiums collected by insurers. Compared to them,

[1] Hereafter by referring to insurance intermediation activity we mean both insurance and reinsurance mediation.

Ukraine is severely lagging behind with regard to insurance intermediaries involvement in the distribution of insurance policies.

Table 1
Role of insurance intermediation in insurance distribution in selected countries (% of insurance premiums collected by insurers through insurance intermediation)

Country	Non-life insurance	Life insurance
Belgium	85	60
Germany	87	77
Ireland	69	67
Italy	94	45
Latvia	90	n/a
Luxemburg	90	n/a
Poland	43	59
UK	88	53
Ukraine[2]	5	

Source: Volker Henke, Proceedings of the Roundtable organized by Institute for Economic Research and Policy Consulting and German Advisory Group in Kyiv (February 2005)

There are two major types of insurance intermediaries operating at insurance market: insurance agents and insurance brokers[3]. An *insurance agent* performs insurance mediation for and on behalf of one or more insurance companies acting under the entire responsibility of these companies. An *insurance broker*, in contrast, is not tied to any insurance company and acts in its own name. Broker is closer to insurance customers and usually represents their interest in intermediation.

In different countries insurance agents and brokers play different role (see Table 2). In Belgium, Ireland and the United Kingdom insurance brokers prevail, whereas in Germany and Italy insurance agents, usually representing one insurance company, control the largest part of insurance distribution system. In Ukraine insurance brokers account for 5% of the total premiums received by insurance companies. There are no reliable data available on the involvement of insurance agents; however, there are anecdotal evidences that it is also very limited.

Table 2
Insurance distribution channels in selected countries[4] (% of insurance premiums collected by insurers through separate types of insurance intermediation)

Country	Insurance intermediaries				Direct sales	
	Brokers		Agents		Non-life	Life
	Non-life	Life	Non-life	Life		
Belgium	70	50	15	10	3	5
Germany	15	12	72	65	5	5
Ireland	65	50	4	17	30	33
Italy	18	3	76	42	5	19

[2] The statistics on Ukraine relates only to insurance brokers' intermediation activity. Lacking regulation over insurance agents complicates the estimation of insurance intermediaries involvement in distributing insurance policies.
[3] Definitions of insurance brokers and agents differ in different countries. In this paper we follow standard terminology adopted by the Ukrainian legislation and the EU Directive (2002/92/EC).
[4] In some countries banks occupy a significant portion in insurance distribution. However, we do not discuss this channel in this paper.

Latvia	10	n/a	80	n/a	5	n/a
Poland	15	3	28	56	55	40
UK	70	48	18	5	10	2
Ukraine	5		n/a		n/a	

Source: Volker Henke, Proceedings of the Roundtable organized by Institute for Economic Research and Policy Consulting and German Advisory Group in Kiev (February 2005)

Because of the importance of insurance intermediaries for establishing a well functioning insurance market, in 2002 the EU authorities substantially improved regulation for brokers and agents through the adopted *EU Directive on Insurance Mediation*. The regulatory framework of the Directive is aimed at reducing barriers for providing cross-border mediation of insurance products in the EU member states. It concentrates largely at improving customer protection and ensuring equality of treatment between various persons and institutions distributing insurance products. In particular, it includes registration requirements applied to all types of insurance intermediaries, professional requirements that are to be fulfilled by intermediaries before applying for registration, and information disclosure requirements with respect to insurance customers.

For Ukraine it would be advisable and reasonable to utilize a positive European experience in regulation and supervision of insurance intermediation market. Foremost because it is good aiming at securing customer interests, as well as because of existing Ukraine's EU ambitions.

3. Current situation in Ukraine

Notwithstanding a recent continuing significant growth of the Ukrainian insurance market, insurance intermediation in Ukraine does not exhibit signs of development. On the contrary, against a background of constantly expanding insurance sector, its significance is gradually declining. Currently insurance intermediation involvement is very low. Insurance brokers distributed only 5% of total insurance policies sold in 2003, the lion's share of which constituted commercial property insurances but not private lines. In 2004 the *State Commission for Regulation of Financial Services Markets* (State Commission) listed 76 insurance brokers in the State Register of insurance and re-insurance brokers, most of which are located in several largest regional centers, for example, in Kiev – 45.

With regard to insurance agents, existing statistics is very uncertain and unreliable, since insurance agents are neither regulated, nor supervised in Ukraine. Although it is hard to evaluate for certain the role of insurance agents at the Ukrainian market, their involvement in insurance policies distribution is also very limited.

On the side of regulation of insurance mediation activities some progress has been made. According to effective Ukrainian legislation, both insurance brokers and insurance agents perform insurance mediation. The Ukrainian definitions of insurance intermediaries as cited in the Law On Insurance (2001) do not differ from those generally applied in the EU. That is, insurance agents perform their activities on behalf of and as instructed by one or several insurers, whereas insurance brokers are not tied to any insurer and act in their own name. Clear distinction between the two types of

insurance intermediaries is a positive feature of current Ukrainian legislation allowing the preclusion of possibly misleading interpretations or misuse of the concept.

However, the State Commission's treatment of insurance agents and insurance brokers is different. Insurance brokers in Ukraine are subject to licensing, that is they have to obtain an allowance from the State Commission for performing insurance mediation. Brokerage licensing in turn requires appropriate knowledge in insurance field, the level of which is confirmed via certificate provided by the authorized teaching center. Also, insurance brokers are subject to registration in the centralized State Register, which is generally open for a wide public use and assures that listed brokers fulfill the requirements necessary for professional insurance mediation activity. Insurance agents, on the contrary, are neither licensed, nor registered by the regulator. The State Commission is not entitled to control their performance and professional characteristics. As a result, the level of competence and reliability varies significantly among insurance agents in Ukraine posing additional risks at insurance consumers.

Insurance brokers at developed markets are usually allowed to receive commission payments from insurance companies and their clients. In Ukraine brokers are prohibited from receiving job remuneration from insurers. Thereby the State Commission aims at guaranteeing that insurance brokers represent the interests of their clients and do not seek for higher benefits paid by insurers. However, by imposing such restriction, the regulator creates unequal performance conditions for brokers versus agents, whose commissions are paid by insurers. Generally it is difficult for brokers to collect money from customers. Insurance clients often are mistaken by perceiving brokerage activity simply as advice on a particular insurance contract and are not ready to pay for it. Though, brokers' responsibility usually includes not only advising on a particular insurance company and insurance product, but also concluding insurance contract and further assisting in its administration and performance, particularly in the event of a claim.

Overall, insurance intermediation in Ukraine is underdeveloped and the regulative framework for it is not satisfactory. To improve the situation and promote development of insurance mediation, a proper regulation and supervision should be adopted.

4. Policy recommendations

To foster Ukrainian private insurance market and guarantee an adequate protection of consumers, policymakers should focus on development of insurance intermediation in Ukraine. We provide our recommendations through answering two main questions: who and in what way should be regulated at the Ukrainian insurance intermediation market. We largely base our arguments and proposals on the best practices in insurance mediation regulation and supervision applied in the EU.

Who should be regulated?

Both insurance agents' and brokers' activity affect the interest and financial standing of insurance consumers, so it should be safe and trustworthy. To make intermediaries secure, they have to be adequately regulated and supervised. Currently in Ukraine only insurance brokers are subject to certification, licensing and registration. However,

even minor negative experience gained by insurance clients with insurance agents could be sufficient to adversely affect the reputation of all intermediaries and restrain the market from developing in a proper way. That's why, for Ukraine it is advisable to introduce equivalent provisions for carrying out a professional activity by insurance agents and brokers, as it is established in most countries. Both types of intermediaries should be regulated and supervised equally, with no preferential terms and/or any discrimination of any of them. This will give freedom and stimulus to the market to develop in its own way, with the market forces determining what type of insurance intermediaries will occupy a predominant market position.

Recommendation 1: Regulation should apply to all insurance intermediaries present at Ukrainian insurance market – both brokers and agents – and also in the event when insurance mediation is not the principal profession of the intermediary.

How should insurance intermediaries be regulated and supervised?

One of the mechanisms for insurance intermediation regulation is a state licensing. Only insurance intermediaries who have received a license should be allowed to act professionally at the market. This rule must apply to all types of intermediaries – both insurance brokers and agents. For licensing it is necessary to establish concrete criteria and conditions serving as a sufficient must for operating at the intermediation market. Licensing requirements should aim above all at safety of insurance intermediaries. At the same time, they should not be very tough or imply burdensome bureaucratic procedures; otherwise they may create a stimulus to evade its fulfillment, for example by means of corruption.

The minimum necessary requirements should relate to adequate training of insurance intermediaries and satisfactory results of examination, as well as their good repute and financial capacity. As a minimum, they shall have a clean criminal record, especially in relation to crimes against property and financial activities.

Recommendation 2: Adopt concrete criteria necessary for insurance agents and brokers to be licensed. The requirements should relate both to professional competence, good repute and financial capacity.

Insurance intermediaries who have received a license for professional activity should be registered with the competent authority. This measure also adds to safety and transparency of insurance mediation. A list of insurance agents and brokers will serve as justification for any interested party that insurance intermediaries fulfill stated requirements. An established centralized register should allow quick and easy access to its information for a wide public use and must be kept constantly updated. It is necessary to ensure that insurance intermediaries who cease to fulfill the requirements are removed from the State Register in due course. One of the professional organizations (the League for Insurance Organizations of Ukraine or the Federation for Insurance and Reinsurance Intermediaries) could be entitled to keep a list of insurance brokers and agents in Ukraine.

The State Commission should provide for appropriate sanctions in the event that a person exercising the activity of insurance mediation is not registered. These sanctions should apply both against insurance intermediary and insurance company, which uses the insurance mediation services of the person who is not registered.

Recommendation 3: Establish a centralized list of insurance agents and brokers in Ukraine and control its adequate maintenance.

To ensure adequate remuneration for insurance intermediation and to level, thereby, the playing field between separate types of intermediaries, insurance brokers in Ukraine should be allowed to receive their commissions from the same sources as insurance agents do, i.e. insurance companies. Adequate prudential supervision in turn should be aimed at customer protection and prevention of rent seeking by intermediaries.

Recommendation 4: Allow insurance brokers in Ukraine receive commissions from insurers.

In order to improve insurance customer protection, it is reasonable to specify and adopt the obligations, which insurance intermediaries should have in providing information to their clients. Hereafter we base our proposal mainly on information requirements that is a part of the regulative framework applied in the EU. According to it, prior to the conclusion of any initial insurance contract, an insurance intermediary should inform its client on whether he/she provides advice based on a fair analysis, or he/she is under contractual obligation (any) with one or more insurance companies. If an insurance intermediary declares that he is independent from any insurer (this refers to insurance brokers), he/she should carry out a fair and sufficiently wide-ranging analysis of the products available on the market, and present a well-grounded advice in a written form. This should be a kind of a protocol certifying the accomplished job by an insurance intermediary and precluding it from giving an unreliable advice. Such officially adopted form of relations between an intermediary and a client will prevent the former from promising much, generally improving customer protection. It also makes easier dispute resolutions in courts.

Overall, insurance customers should be left with a choice on whether they need a written comprehensible advice or not. For customer's request and under its official recognition, an intermediary should be allowed not providing such a protocol.

Recommendation 5: Introduce information requirements for insurance intermediaries and an obligation to present their clients a written advice (protocol).

It is a generally accepted practice among insurance intermediaries at developed markets to insure their professional liability, i.e. to buy an insurance policy that guarantees the coverage by an insurer of the financial losses, which may arise from intermediary's professional negligence. For insurance agents that are usually tied to particular insurer the latter may undertake full responsibility for the intermediary's actions. Overall, obligatory professional indemnity insurance fulfills an important task of social protection and raises trust of insurance clients in insurance intermediation.

Recommendation 6: Introduce obligatory professional liability insurance for all types of insurance intermediaries.

R.G., H.H., Lector: V.M.
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