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IPM Research Center

Policy Paper [PP/01/2009]

The Belarusian Insurance Market Characteristics in the Context of Economic Liberalization: Analysis and Policy Recommendations

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Minsk, March 2009



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Summary

Some general trends towards economic liberalization in Belarus in the recent years have been long-awaited. Financial sector, namely the banking sector, has also experienced deregulation since mid 2000th. Regulation of the Belarusian insurance sector, on the other hand, remains strong. Recent changes in the insurance legislation have been divergent by nature. Insurance premiums have been growing, but their share in GDP remained less than 1%. The biggest share of the insurance market belongs to the state-owned insurers. Opportunities for the development of private insurers and insurers with foreign ownership are limited.

Modern market economy needs a strong insurance sector to provide economic sustainability, complement the functions of the banking sector and facilitate investments. In this context liberalization of the insurance sector could facilitate its development. Among the policy recommendations the following could have positive effect: equal regulatory conditions for state-owned and private insurers, facilitation of market capitalization growth, demonopolisation of the national reinsurance system, and others.

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1. Introduction

The share of the insurance sector as a percentage of GDP in the developed countries is rather high. The insurance sector is an important tool of investments transmission to the economy. Belarusian insurance sector, on the other hand, is currently underdeveloped. Insurance capital and resources are moderate. The sector is highly concentrated, monopolized, and dominated by the state ownership. It leads to preferences for the state controlled insurance companies. According to international experts, insurance sector in Belarus (as well as other transition countries in the process of accession to the WTO) is less open and liberalized than the banking sector; its regulation is less developed.

In 2008 the Belarusian government has started to realize some long-awaited liberal reforms in the economy. Changes were already made in the protection of investors' rights, registration and liquidation of enterprises, taxation, etc. Reforms in the insurance sector, on the other hand, were divergent in their nature. Its liberalization remains an important issue for further development of insurance in Belarus.

Second part of this paper studies the structure of the Belarusian insurance market, analyses its main segments, provides data on the volumes of insurance premiums and claims, their dynamics, sector performance indicators, and capitalization. Third part deals with the main developments in the sector regulation, in the context of liberalization in particular, their influence of the sector performance. Forth part resumes main issues, touched upon in the paper, and provides policy recommendations.

2. Insurance market in Belarus

2.1. Insurance market structure

In 2008 twenty four insurance companies operated in the Belarusian insurance market, including 8 with the state ownership (full or partial), 16 private (among them 11 with the foreign ownership)¹. In the same year the first insurance company with 100% foreign ownership was registered in the country (Closed Joint-Stock Co. "Generali"). Still, the share of foreign capital in the sector is small. The government sets 30% quota for the foreign capital in the aggregate authorized capital of the insurance companies. Currently only 6% is taken up². The main access barrier for the foreign capital, entering Belarusian insurance market, is rather insurance sector regulation than the existing quota.

According to the Belarusian legislation, compulsory insurance can be provided only by fully state-owned insurers or insurers with more than 50% state ownership. There exist limitations for the voluntary insurance as well. In particular, in the segments of life insurance, property insurance performed by state organizations, insurance companies with more than 49% foreign ownership are not allowed³. The list of Belarusian insurance companies, indicating their form of ownership and service segments is provided in the Table 1.

Table 1: Insurance companies in Belarus, their form of ownership and service segments, 2008

Company name	Ownership type	Compulsory insurance	Voluntary insurance, including					
			Private property insurance	Private vehicle insurance	Commercial property insurance	Medical expenses insurance	Personal accident insurance while traveling abroad	Life insurance
Belgosstrakh	<i>s</i>	X	X	X	X	X	X	X
Beleximgarant	<i>s</i>	X	X	X	X	X	X	X
AlVeNa	<i>fp</i>		X	X	X	X		X
BASO	<i>fp</i>		X	X	X			X
Belneftestrakh	<i>ps</i>	X	X	X	X			X
Benir	<i>fp</i>				X			
Brolly	<i>fp</i>		X	X	X	X		X

¹ Hereinafter, statistical data will be provided from: "Financial Stability in the Republic of Belarus", National Bank, <http://www.nbrb.by/publications/finstabrep/2007.pdf>, Ministry of Finance, <http://www.minfin.gov.by>.

² According to the head of the Insurance Authority Department of the Ministry of Finance, http://www.neg.by/publication/2008_09_09_10264.html.

³ Decree № 530 dated 25.08.2006 "On Insurance".

Company name	Owner-ship type	Compul-sory in-surance	Voluntary insurance, including					
			Private property insurance	Private vehicle insurance	Commer-cial prop-erty insur-ance	Medical expenses insurance	Personal acci-dent insurance while traveling abroad	Life in-surance
Victoria	<i>fp</i>		X	X	X		X	
Garantiya	<i>fp</i>		X	X	X	X	X	
Kentaur	<i>fp</i>		X	X	X		X	
Promtransinvest	<i>ps</i>	X	X	X	X	X	X	
TASK	<i>ps</i>	X	X	X	X	X	X	
Belingosstrakh	<i>fp</i>		X	X	X	X	X	
Generali	<i>fp</i>							
BNSPF	<i>p</i>							X
Bagach	<i>p</i>		X	X	X		X	
B&B Insurance	<i>fp</i>		X	X	X		X	
Pens. Garantii	<i>y</i>							X
Stravita	<i>s</i>							X
Kupala	<i>fp</i>		X	X	X	X	X	
Belcoopstrakh	<i>ps</i>	X	X	X	X	X	X	
Belvneshstrakh	<i>p</i>		X	X	X		X	
Seventh Line	<i>p</i>							X
BNRO (Re)	<i>s</i>							

Deals exclusively with reinsurance

Note. *s* – state ownership; *ps* – with the state share more than 50 %; *p* – private ownership; *fp* – including foreign capital.

Source: Insurance Market of the Republic of Belarus, <http://infobank.by/932/Default.aspx>.

Belarusian insurance sector structure was constant during the recent years. Absolute leader in terms of written premiums is "Belgosstrakh". Out of USD 363.4 m written premiums in the sector in Jan-Oct 2008 it took USD 209.8 m (about 58% of the market). "B&B Insurance" (private insurance company with foreign ownership) follows in the list of leaders with USD 32.1 m written premiums. "TASK", "Promtransinvest", "Belneftestrakh", "Belcoopstrakh", "Beleximgarant", "Stravita" belong to the following group of leaders with written premiums exceeding USD 10 m (Table 2).

Belarusian insurance business concentration is still very high. Herfindal-Hirshman's index for the insurance sector in 2007, calculated on the written premiums, was 0.35⁴. The majority of premiums are concentrated at the small number of insurers, mainly state-owned insurers, as well as "B&B Insurance". Other insurers are rather passive in the market.

The tendency towards concentration and monopolization in the Belarusian insurance market has increased again in 2006, when the "Belarusian National Reinsurance Organization" (BNRO, Belarus Re) was created⁵. It is the first exclusive reinsurance company in the country. Authorized capital of BNRO was initially shaped from the state budget in the amount of EUR 20 m, and has been further increasing annually. The authorized capital of BNRO was increased by the state by BYR 350 bn at the end of 2008.

The creation of the reinsurance organization, on the one hand, provides Belarusian insurers with the opportunity to reinsure risks⁶ within the country, limits the outflow of insurance premiums abroad. On the other hand, it limits the opportunities for the Belarusian insurers to freely choose reinsurers. The amount of excess risks, subject to obligatory reinsurance at the BNRO by the Belarusian insurers (irrespective of their ownership type) is set by the government. Moreover, all reinsurance contracts of the remaining excess risks should be also registered at BNRO. It means that the choice of reinsurer by insurers is limited by the Belarusian legislation and can not be made based on economic factors. The government aims at gradually concentrating all reinsurance contracts at the BNRO in the future.

The share of private insurers in the gross written insurance premiums in Belarus currently accounts for 16%. The number of private insurers, on the other hand, is twice as high as those

⁴ "Financial Stability in the Republic of Belarus", National Bank, <http://www.nbrb.by/publications/finstabrep/2007.pdf>.

⁵ Resolution of the Council of Ministers № 1463 dated 04.11.2006 "On the creation of Belarusian National Reinsurance Organization".

⁶ According to the Belarusian Legislation, an insurer can bear risk of potential pay-off no more than 20% owned capital. The rest should be reinsured.

with the state ownership. It is caused primarily by the restrictions made for private insurers to deal with the compulsory insurance. In the beginning of 2008 the National Bank prepared amendments for the Decree №530 with the aim to bring back the private insurance companies the opportunity to conduct voluntary insurance. These propositions are not adopted yet.

Table 2: Indicators of insurance companies performance, Jan-Oct 2008, USD m

Company name	Gross Writ- ten Premium	Premium written less reinsurance	Claims Paid	Claims paid less reinsurance	Profit / Loss
<i>Non-life insurance</i>					
Belgosstrakh	209.8	207.4	100.8	100.6	5.2
B&B Insurance	32.1	34.0	19.9	20.1	0.6
TASK	25.1	23.5	12.0	11.6	0.5
Promtransinvest	19.5	15.5	16.6	7.0	0.5
Belneftestrakh	14.4	13.5	5.8	5.5	0.7
Belcoopstrakh	10.3	9.9	4.2	4.2	0.3
Beleximgarant	10.2	9.6	3.0	2.8	1.3
Brolly	6.7	6.4	2.9	2.8	0.3
AlVeNa	3.8	3.9	2.0	2.0	0.4
Belvneshstrakh	3.2	2.7	1.4	1.4	0.2
Kupala	2.7	2.5	1.4	1.3	0.0
Belingosstrakh	2.3	2.1	0.8	0.9	0.0
Victoria	1.9	1.8	0.0	0.0	0.2
Kentaur	1.7	2.0	1.0	1.0	0.0
BASO	1.0	1.5	0.4	0.6	0.1
Bagach	0.5	0.5	0.3	0.3	0.0
Garantiya	0.3	0.3	0.1	0.1	0.0
Benir	0.0	0.0	0.1	0.1	0.0
BNRO (Re)	0.0	3.6	0.0	0.7	1.4
Generali	0.0	0.0	0.0	0.0	0.5
<i>Total</i>	<i>345.4</i>	<i>340.9</i>	<i>172.6</i>	<i>162.8</i>	<i>12.2</i>
<i>Life insurance</i>					
Stravita	12.0	12.0	1.5	1.5	0.9
BNSPF	5.0	5.0	0.5	0.5	0.0
Seventh Line	1.0	1.0	0.1	0.1	0.1
Pens. Garantii	0.0	0.0	0.0	0.0	0.1
<i>Total</i>	<i>18.0</i>	<i>18.0</i>	<i>2.2</i>	<i>2.2</i>	<i>1.1</i>
<i>Grand total</i>	<i>363.4</i>	<i>358.9</i>	<i>174.8</i>	<i>164.9</i>	<i>13.3</i>

Source: Own calculations based on the Ministry of Finance and the National Bank.

Moreover, the existing restrictions for the activities of insurers with foreign ownership defer investments to the sector. Insurers with more than 49% foreign ownership currently can not perform life insurance (long term), compulsory insurance, insurance of state-guaranteed orders, state property insurance⁷. All the above mentioned restrictions create preferential conditions for the state owned insurers, halt competition, and deprive consumers of the competitive insurance products.

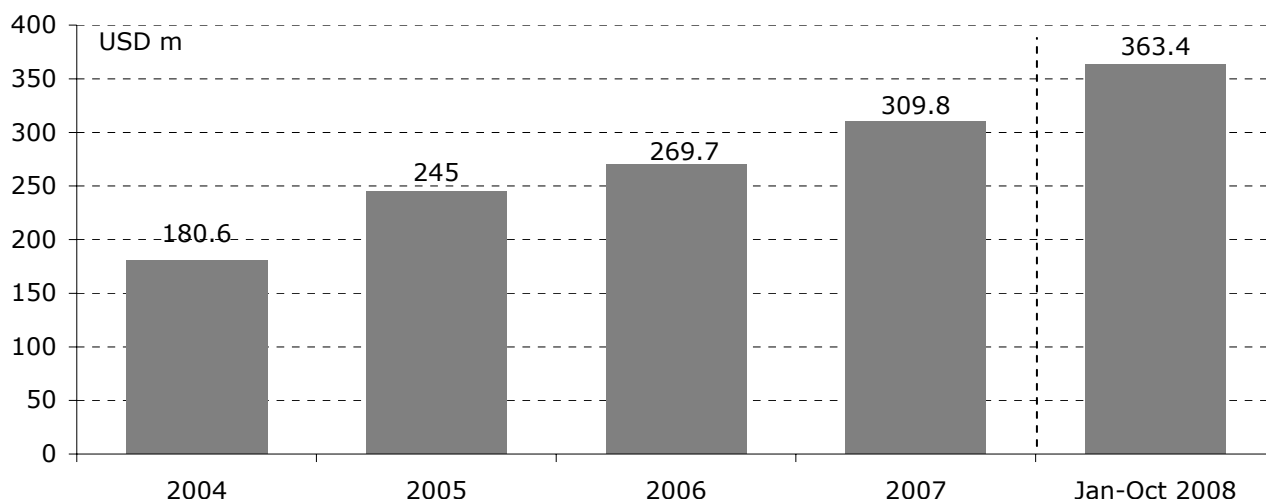
2.2. Main indicators of the insurance market performance

Notwithstanding numerous regulatory barriers, written insurance premiums in Belarus were growing in the recent years. Belarusian insurance market has not been sharply affected by the financial crisis comparing to other countries, mainly due to its limited integration into the international financial system, underdevelopment and state protectionism.

Insurance premiums increase in Jan-Oct 2008, comparing to the same period in 2007, was 41.9% and amounted to USD 363.4 m (Figure 1). According to market specialists, premiums growth in 2008 was stimulated mainly by some liberal legislative reforms, as well as the modest inflow of foreign investments (more details see further in the paper).

⁷ Decree № 530 dated 25.08.2006 "On Insurance".

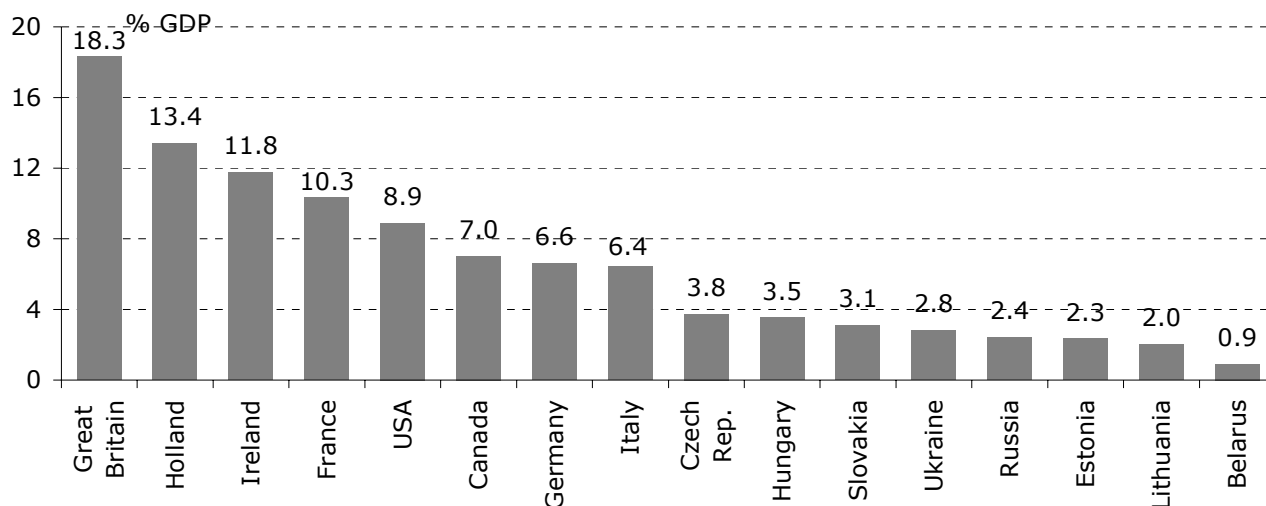
Figure 1: Written insurance premiums, USD m



Source: Calculations based on the data from the Ministry of Finance and the National Bank.

Still, the share of written premiums in GDP in Belarus is low, accounts for less than 1%. It corresponds to USD 30 per capita in 2008. In this indicator (the share of written premiums to GDP) Belarus lags behind not only developed western countries, Central and Eastern Europe, but also some CIS countries (Ukraine and Russia) (Figure 2).

Figure 2: Share of insurance premiums to GDP in several countries, 2007, %



Source: World Insurance Report, 2007.

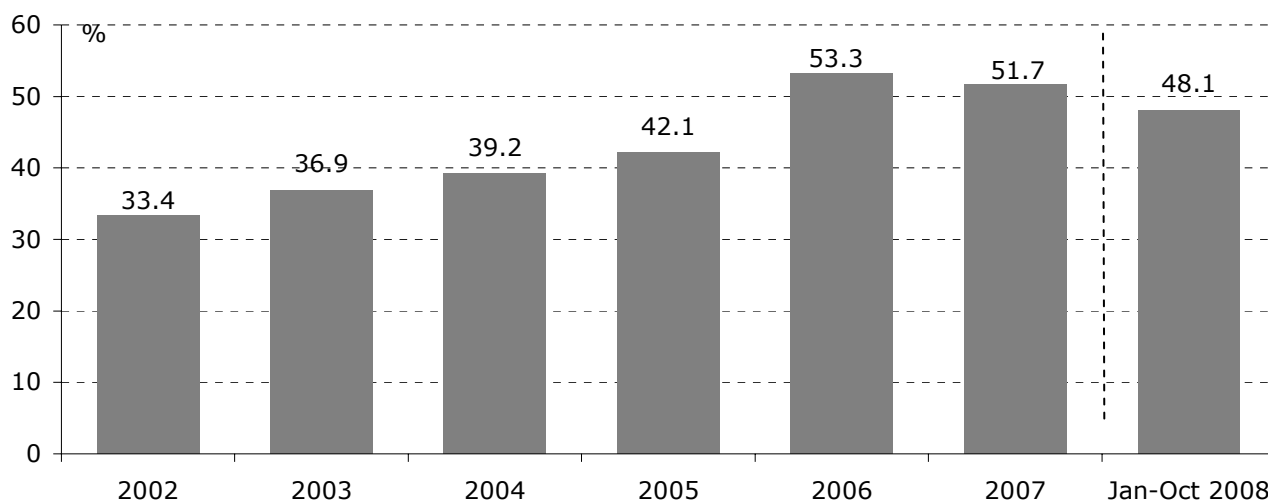
Insurance claims were growing simultaneously with the written premiums in the recent years. In Jan-Oct 2008 insurance claims amounted to USD 175 m (35% higher than in 2007). The share of insurance claims in gross insurance premiums accounted for 48.1%. The dynamics of shares of insurance claims in insurance premiums for 2002-2008 are provided in Figure 3.

In the second half of 2000th one can observe considerable growth of insurance claims, that was caused primarily by the crash of the satellite "BelKA" (it accounted for 70% of claims in the commercial property insurance, and 30% in all voluntary insurance claims), irruption of petrochemicals in the accident at the "Unecha-Polozk" pipeline, as well as the crash of IL-76 aircraft in Somali.

As already mentioned in the paper, compulsory insurance prevails in the country for the reasons of state protectionism, numerous restrictions for the private insurers' development, absence of insurance culture. The compulsory insurance's share growth in the amount of written premiums in the beginning of 2000th was explained by the gradual introduction of additional types of compulsory insurance to the market with the aim to support and develop insurers controlled by the state. In the second part of the decade, as the result of some liberal reforms

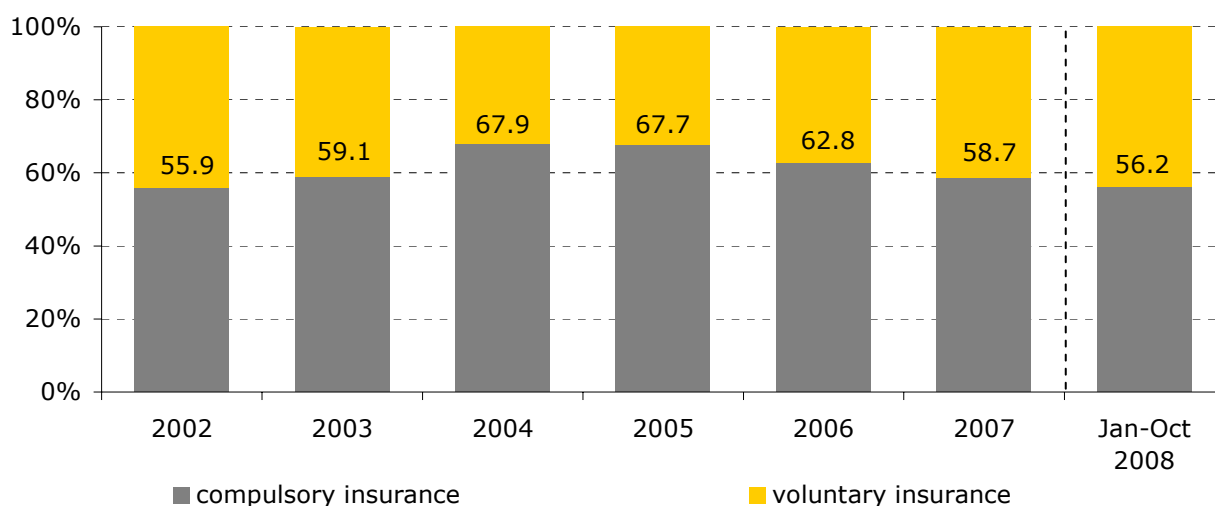
in the sector, the share of compulsory insurance in GDP has gone down to 56.2% in Jan-Oct 2008 (Figure 4).

Figure 3: Share of insurance claims in insurance premiums, %



Source: Ministry of Finance.

Figure 4: The share of compulsory/voluntary insurance in the total sum of insurance premiums, %



Source: Ministry of Finance.

Voluntary insurance currently expands mainly thank to the permission to include expenses for some types of voluntary insurance into costs of production, as well as owing to the development of associate business (growth of consumer landing facilitated extension of automobile insurance; development of leasing led to the development of commercial property insurance), introduction of 'voluntary-compulsory' insurance (e.g., tenancy, cargo insurance).

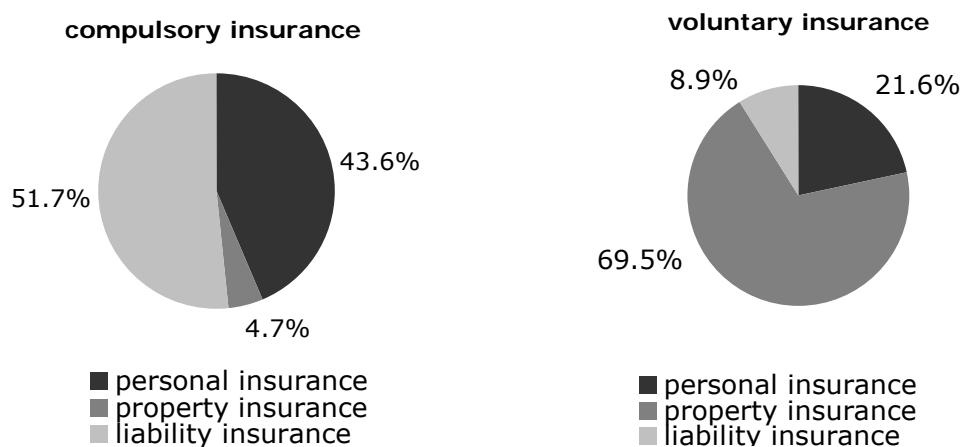
Segments of compulsory and voluntary insurance are shown below. More than half of compulsory insurance (51.7%) falls at liability insurance; the share of personal insurance is also high (43.6%). On the other hand, the biggest segment in voluntary insurance is property insurance (69.5%) (Figure 5).

Long-term insurance segment traditionally dominates in the amount of insurance premiums in the developed countries. The share of life and pensions insurance in gross written premiums in Belarus was only 5% in 2007. About 97% of life insurance contracts was made by corporations, and only 3% by individuals. Preferences in long-term insurance in Belarus currently exist only for corporate clients⁸. Conditions for state owned and private insurers are also unequal in

⁸ Since Jan 2009 Belarusian citizens can get income tax deduction at the amount of two base units (one base unit equals BYR 35 thsd) per month in case they have bought life and pension insurance for the pe-

long-term insurance. Life and pensions insurance premiums can be included in the production costs only if insurance contracts made with state-owned insurers. These premiums are also deductible from social insurance tax base.

Figure 5: Segments of compulsory and voluntary insurance in 2007



Source: National Bank.

Insurance loss ratio (ratio of insurance claims to insurance premiums) in 2007 was 0.52 and did not change considerably comparing to 2006. Voluntary insurance loss ratio decreased from 0.5 to 0.44 in 2007. It is explained by the higher growth of insurance premiums (33.8%) comparing to claims (18.4%). Compulsory insurance loss ratio has grown from 0.55 to 0.57, where insurance claims were growing higher (16.1%) than insurance premiums (12.6%).

In 2007, as well as in Jan-Sep 2008 insurance sector financial result was positive (in 2006 five insurance companies had losses). The ratio of gains to the annual average equity capital in 2007 fell by 4.6 percentage points, but remained relatively high – 23.6 % (in comparison, return on equity for the banking sector was 10.7% in 2007).

Still, profitability of the Belarusian insurers appears to be quite low. Insurance companies constantly bear policy handling expenses (travel expenses, database maintenance, and paperwork). In the world practice such expenses amount to 40% of the written premium. In Belarus these expenses are limited by 30% by the legislation. This amount is not usually enough for covering operating expenses of insurers. Insurance companies are forced to cover the difference from the balance sheet profit, thus lowering the actual profitability level.

On the other hand, it should be noted, that profitability differs considerably depending on the type of insurance. In compulsory insurance premiums are usually several times higher than claims. It can be claimed that in these types of insurance premiums have been overvalued for several years. As the result, again we come across inequality in business opportunities for state-owned and private insurers, as the latter are deprived of the opportunity to perform obligatory insurance.

Equity capital of Belarusian insurers neared USD 162 m as of 01.10.2008 (equaled to USD 142 m in 2007), increasing considerably in the recent years (e.g., was around USD 35 m in 2003). Nevertheless, insurance market's capitalization is not sufficient for insuring large risks. It can be raised by the attraction of foreign investment to the sector, as well as through the capitalization of profits. The existing insurance market regulation, as well as the general regulatory environment does not build incentives for the inflow of domestic as well as foreign capital. Opportunities for profits capitalization are limited. Private insurers have limited opportunities for its extension; profits of state-owned insurers can be withdrawn into the budget. Taking into account the negative impact of the world financial crisis for the Belarusian economy, the government decided to increase capitalization of the state-owned banks and some insurance companies at the end of 2008. In particular, USD 302 m were placed from the surplus budget balance as of 01.12.2008 into the authorized capital of "Belgosstrakh", and USD 163 m will be

riod not less than 5 years, or voluntary medical expenses insurance. (Act № 1327-12 dated 21.12.1991 "On Citizens' Income Tax", with amendments dated 01.01.2009).

placed into the authorized capital of "BNRO". It means that the authorized capital of "Belgoss-trakh" grew 48 times, "BNRO" – 7.1 times. These fundamental for the Belarusian insurance sector state-owned enterprises will thus strengthen their hand. Insurance market as a whole can also gain growth incentive thank to the multiple capitalization growth.

3. Changes in the insurance market regulation in the context of liberalization

Belarusian insurance market remains one of the most heavily regulated not only comparing to the neighboring countries, but also comparing to other sectors of the Belarusian economy (e.g., banking sector regulation is more liberal), despite several reforms conducted in the sector since 2006.

In 2006 basic insurance legislation was renewed. There was adopted the Program of Insurance Sector Development in the Republic of Belarus for 2006-2010⁹. In particular, the Program aims to increase the share of insurance premiums in GDP to 1.5%; reach parity in compulsory and voluntary insurance. In 2007 the state-owned insurance companies, though, did not achieve the growth parameters specified by the Program (accomplished three parameters out of twenty). The actual amount of written voluntary insurance premiums, for example, amounted to 86% of the planned amount; profitability and net profit parameters were also not fulfilled.

Decree № 530 "On Insurance"¹⁰, with amendments and changes in 2007 and 2008 has introduced Regulation on Insurance, which sets regulatory framework for the insurance market. In particular, it defines main actors, registration rules for insurers, framework for the market performance and voluntary and obligatory insurance regulations. According to the Program of Insurance Sector Development and Decree №530, authorized capital of insurers should be increased to EUR 2 m (EUR 400 thsd before) for life insurers, EUR 1 m (instead of EUR 200 thsd) for non-life insurers, EUR 5 m (EUR 500 thsd earlier) for reinsurers. Insurance companies which have been created before this regulation came into force will be obliged to increase their authorized capital by 01.05.2011. Failure to carry out this regulation will lead to the insurer's liquidation. The regulation is aimed to increase insurance market capacity, capitalization, decrease the volume of reinsurance transferred abroad, and facilitate investments in the economy.

Regulatory reforms in the insurance sector have been divergent by nature. Although the government announces the intention to liberalize the economy, it enacts regulations that preserve unequal conditions for the state-owned and private insurers. Decree №236¹¹, dated 28.04.2008, has obliged the state-owned enterprises and organizations to insure their property (all kinds of property insurance, except life insurance) only at the state-owned insurers (with 50% and more state ownership).

On the other hand, in the same 2008 there have been adopted some liberal reforms in the sector. For example, Decree № 280¹² has allowed including property insurance premiums (commercial property insurance, hull insurance, cargo insurance), export risks insurance premiums, some kinds of liabilities (passenger carriers' liability, etc.) insurance premiums in the production costs. These rules apply to all kinds of liabilities with all types of insurers. Thus, this Decree has provided additional opportunity to further develop private insurers' business, especially in the cargo insurance sector.

In the context of economy liberalization as a whole, as well as insurance sector liberalization in particular, the government considers the possibility to allow foreign insurers enter into the life insurance segment in Belarus. It also supposes to gradually liberalize other insurance segments, but does not take any concrete decisions in this respect meanwhile. Moreover, it also doesn't plan corporatization and sell of shares of "Belgosstrakh", the dominant company in the insurance market.

⁹ Not in circulation (closed for the public).

¹⁰ Decree № 530 dated 25.08.2006 "On Insurance".

¹¹ Decree №236 dated 28.04.2008 "On Amendments to Some Decrees of the President of the Republic of Belarus on Insurance".

¹² Decree № 280 dated 19.05.2008 "On Inclusion of Costs of Voluntary Insurance, except life insurance, in the Production Costs".

4. Policy recommendations

Insurance sector analysis, conducted over several years by the IPM Research center and German Economic Team¹³, has shown that notwithstanding several reforms in the sector in the second half of 2000th, there are no considerable steps towards its liberalization. Main impediments of the way of Belarusian insurance sector development are:

- Absence of free competition between state-owned and private insurers (including those with foreign capital) leading to the inadequate use of market-based principles that leads to the overvalued insurance tariffs, lack of motivation to introduce innovative insurance products to the market, low operational efficiency;
- Prioritized status of compulsory insurance (the biggest share in the amount of written premiums); underdeveloped insurance culture;
- Restrictions posed for the state-owned organizations to choose insurers (they are obliged to insure risks at the state-owned insurers);
- Insufficient capitalization of the insurance market, limiting the amounts of insurers' business, preserving volatility in the insurance sector;
- Restrictions on the inclusion of several voluntary insurance costs into the production costs, hampering the development of these kinds of insurance, depriving economic entities of the opportunity to follow international standards of work;
- Concentration and monopolization of reinsurance within the country, what is risky for the economy as a whole;
- Underdevelopment of long-term insurance (life insurance), that could become an important source of internal investments for the economy.

It could be stated, that the insurance sector development is not currently in priority in the state policy, insurance being developed 'on leftovers' basis. Insurance is not currently considered as an important component of the market economy, economic stability factor, the source of the needed investments for the economy.

Notwithstanding some reforms in the second half of the decade, insurance sector faces several regulatory barriers that halt its growth. The following regulatory changes could bring positive effect for the sector:

- Creation of equal market conditions for the state-owned and private insurers (including those with foreign capital) that will lead to the expansion of competition, insurers' performance efficiency growth, insurance market growth as a whole;
- Elimination of the restriction for the state organizations to buy insurance products only from the state-owned insurers; the choice of insurers should be made based of economic factors, not the type of ownership;
- Expansion of the list of voluntary insurance types that can be included in the production costs (e.g., commercial risks insurance, professional liability insurance) and their clear definition; it should facilitate the development of private insurers and creation of the insurance culture in the society;
- Creation of stimuli for the insurance sector capitalization growth;
- Removal of regulatory restrictions that defer the inflow of foreign capital to the sector (into the life and risky insurance, e.g.), that could lead to the insurers' capitalization growth, bring new technologies and expertise of work in separate segments;
- Integration of Belarusian insurance sector into the international market, because limited competition lowers performance efficiency of domestic insurers, impedes introduction of innovative insurance products and technologies to the Belarusian market;

¹³ Volchok, V., Giucci, R. (2004). The Insurance Sector in Belarus: Analysis and Recommendations, PP/07/04, <http://research.by/pdf/pp2004e07.pdf>.

- Demonopolisation of the national reinsurance system, as reinsurance business is international by nature (disseminates risks); granting Belarusian insurers right to freely choose reinsurers (including "BNRO") based on the market factors.

To sum up, in case of further insurance sector liberalization, rethinking of insurance policy, recognizing its vital potential role in the financial system, being the source of the necessary investments in the economy, insurance sector could facilitate growth and development in the Belarusian economy.