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Tunisia's Insurance Sector

Dimitri Vittas

Despite a new modern insurance code that fosters competition and solvency monitoring, Tunisia's insurance sector is underdeveloped. What it especially needs is the restructuring and re-capitalization of capital-deficient companies, radical reform of the social pension system, and stronger supervision of the industry.

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Summary findings

The main economic functions of the insurance sector are to cover financial risk and to mobilize long-term savings. The sector can also play an important role in developing the private sector and modernizing the securities market.

But to play its economic and financial roles, the insurance sector must operate within a framework of stable, liberal regulation that provides incentives for efficiency, allows companies to innovate, and creates a contestable market with relatively free entry and exit.

In most developing countries, regulation has deviated greatly from this ideal. Often dominated by state-owned companies, the insurance industry in many developing countries features:

- Strict controls on new entry.
- Prohibitions against majority ownership by foreign companies.
- Fixed premiums (especially for compulsory lines).
- Prior approval of tariff changes and new products.
- High local retention ratios (which discourage reinsurance from overseas companies).
- Insurance reserves used as a captive source of funding for public deficits.
- Weak prudential controls and inadequate monitoring of solvency.

In recent years there has been a growing trend away from direct controls on premiums, products, and investments, and toward more monitoring of the solvency of companies, through more effective supervision and clear prudential controls.

Vittas argues that Tunisia's insurance sector has been hampered by restrictive regulations, by the country's low incomes (which limit long-term savings capabilities), and by its pay-as-you-go social pension system. Tunisia's life insurance is seriously underdeveloped.

The insurance industry also suffers from structural problems. Worst of all, prudential regulations and standards are unequally applied, and some companies are still operating with insufficient capital (in a few cases, with greatly negative equity).

What is needed? Capital-deficient companies need to be restructured and recapitalized, state-owned companies need to be privatized, and the market needs to be opened up to majority foreign-owned firms. Supervision must be strengthened and corrective measures applied more equitably and forcefully. The social pension system must be radically reformed, to include one fully funded pillar that will generate long-term savings and transform the prospects for life insurance business.

This paper — a product of the Financial Sector Development Department — is part of a larger effort in the department to study pension funds and insurance companies. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Priscilla Infante, room G8-118, extension 37642 (25 pages). May 1995.

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I. INTRODUCTION

The insurance sector can play a very important part in the development of the private sector and the modernization of the securities markets. By covering economic and financial risks, it enables enterprises to better manage their financial affairs and protects households from the financial losses arising from accidents and injuries. In addition, the industry, especially the life insurance sector, mobilizes long-term savings that can facilitate the financing of both enterprises and households with resources that have a much longer maturity than traditional loans from the banking sector.

In order to play its economic and financial role, the insurance sector requires a framework of stable and liberal regulation that provides adequate incentives for efficiency and allows individual companies to innovate. Insurance regulation must aim at creating a contestable market that is open to new entry by qualified companies and facilitates the exit of insolvent firms. It must also aim at safeguarding the stability of the sector and the solvency of individual companies and at protecting the interests of policyholders.

In most developing countries, insurance regulation has traditionally involved some or all of the following[1]: domination by state owned companies; strict controls on new entry; prohibition of majority ownership by foreign companies; fixing of premiums (especially for compulsory lines); prior approval of tariff changes and new products; discouragement of reinsurance with overseas companies through high local retention ratios; use of insurance reserves as a captive source for funding public sector deficits; and weak application of solvency monitoring and prudential controls. In recent years, there has been a growing trend away from direct controls on premiums, products and investments and a greater reliance on solvency monitoring of individual companies, involving a combination of clear prudential controls and effective supervision.

This paper discusses the structure, regulation and prospects of the insurance industry in Tunisia. It complements earlier work on the options for pension reform in Tunisia (Vittas 1993c) and forms part of ongoing work on the promotion of contractual savings and institutional investors in developing countries and on their contribution to the development of the capital markets[2].

II. THE INSURANCE INDUSTRY IN TUNISIA

Reflecting the relatively low level of income and the restrictive regulation of the market, the development of the Tunisian insurance industry has been rather slow. The sector appears to have suffered from the structural adjustment of the economy that has been under way since the mid 1980s. The growth rate of insurance premiums has decelerated considerably in recent years: the level of premiums in relation to GDP has fallen from 1.75% in 1986 to 1.60% in 1990, but recovered to 1.72% of GDP by 1993.

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[1] Insurance policies in developing countries have been analyzed by Skipper (1987), Outreville (1990, 1992 and 1994) and Vittas and Skully (1991), while UNCTAD (1990) and Sigma (1994) have collected statistics on insurance in developing countries.

[2] See Vittas and Skully (1991), Vittas (1992, 1993a, 1993b and 1993c), Wright (1992), Vittas and Iglesias (1992), Grace and Barth (1993), World Bank (1994), McIsaac (1995), and McIsaac and Babbel (1995).

Insurance penetration in Tunisia lags behind several countries at a similar level of income and economic development (Table 1). The growth of insurance has been held back by several structural problems.

The Tunisian insurance industry has long been subject to restrictive regulations that have limited its ability to engage in technical risk and financial management. Several of the companies report cumulative deficits that exceed their authorized capital and thus operate with negative equity. In fact, the capital shortfalls of these companies exceed the capital of all the other companies so that the industry as a whole suffers from negative equity. The compulsory personal lines are in chronic deficit, while the returns on financial investments have been suppressed by the low yields on government securities as well as on the equities in which insurance companies have invested their technical reserves. Insurance also suffers from a large tax burden, especially on the premiums paid in some lines of business.

Table 1
International Comparison of Insurance Premiums, 1992
(percent of GDP)

Africa		Asia		Latin America	
South Africa	12.8	China	1.0	Brazil	4.3
Zimbabwe	4.8	Korea	12.3	Panama	3.3
Kenya	2.4	Japan	8.6	Chile	3.0
Morocco	2.1	Taiwan	4.8	Venezuela	2.2
Tunisia	1.7	Malaysia	3.8	Uruguay	2.0
		Singapore	3.7	Colombia	1.8
		Philippines	2.3	Argentina	1.6
		Thailand	2.0	Mexico	1.5

Source: Sigma, World Insurance in 1992, Swiss Reinsurance Company, 3/94.

The adverse effects of premium regulation in some lines have been compounded by ill-advised competition for market share in others. Companies that are better managed and are more aware of the costs of different coverages are often undermined by the low premiums offered by companies with weak capital base or less sophisticated management. The industry also suffers from widespread mistrust between insurers and the insured, which is aggravated by the lack of adequate information and by the weakness of controls against moral hazard and inflated loss claims. To contain costs, the industry has often engaged in delaying tactics and disputes with loss claimants. This has contributed to its negative public image and has fueled the mistrust between insurers and insured, especially in the compulsory automobile line.

To improve matters, there is a strong need for a reform of regulation, strengthening of supervision, recapitalization and restructuring of capital-deficient companies, privatization of state-owned companies, modernization of financial management to enhance the investment performance of insurance companies, intensive training programs for both regulators and market practitioners, and a major campaign to improve the public image of the industry.

Structure of the Tunisian Market

The Tunisian market comprises 22 companies. Of these, 11 engage in multi-branch operations, 4 are single branch companies (2 specialize in life insurance, 1 in export insurance and 1 in reinsurance) and 7 are off-shore companies authorized to conduct operations with nonresidents. In terms of legal status, 5 of the 15 resident companies are state-owned[3], 7 are set up as joint stock companies (societes anonymes) and 3 are mutual companies. Excluding two state-owned companies that specialize in reinsurance and export insurance, the business of the remaining 13 companies is structured as shown in Table 2.

Table 2
Market Structure, 1990 and 1993

	1990		1993	
	PREMIUMS (MD)	%	PREMIUMS (MD)	%
STAR	62.1	36.0	86.8	33.2
EL ITTIHAD	13.4	7.8	24.4	9.3
LLOYD TUNISIEN	8.3	4.8	11.7	4.5
PUBLIC SECTOR	83.8	48.9	122.1	47.1
GAT	20.1	11.6	30.3	11.6
COMAR	17.9	10.4	30.4	11.6
ASTREE	14.9	8.6	20.6	7.9
MAGHREBIA	11.3	6.5	20.5	7.8
CARTE	8.4	4.9	12.7	4.9
HAYETT	0.7	0.4	2.0	0.8
AMINA	0.8	0.5	1.1	0.4
PRIVATE SECTOR S.A.	74.1	42.9	117.6	45.0
CTAMA (Agricultural)	7.6	4.4	10.8	4.1
MGA (Agricultural)	4.1	2.4	5.6	2.1
MAE (Teachers)	3.1	1.8	4.3	1.6
PRIVATE SECTOR MUTUAL	14.8	8.6	20.7	7.9
TOTAL	172.8	100.0	261.2	100.0
CONCENTRATION C3	100.1	58.0	147.5	56.5
HHI	1789		1654	

Source: Ministry of Finance, Direction Generale des Assurances and F.TU.S.A.

[3] El Ittihad, which is owned by the trade unions, is officially classified as a mutual company. In practice, however, it appears to be heavily supported by capital injections or at the very least implicit guarantees from the state.

Insurance companies must be established under Tunisian law and must be majority owned by Tunisian interests. Four of the resident companies have extensive foreign participation, ranging between 44% and 48%, although this is in most cases divided between 2 or more companies. Divided minority foreign participation implies relatively small stakes and limited managerial involvement. This results in fewer benefits for the local companies concerned in terms of transfer of financial technology, product innovation, and enhanced risk and investment management.

Table 3
Insurance Premiums by Line, 1990 and 1993

	1990 PREMIUMS (MD)	%	1993 PREMIUMS (MD)	%
MOTOR	55.5	32.8	83.8	32.8
GROUP HEALTH	33.3	19.7	52.3	20.5
TRANSPORT	18.6	11.0	25.0	9.8
FIRE	17.0	10.1	24.1	9.4
WORK ACCIDENT	16.4	9.7	22.1	8.6
MISCELLANEOUS	16.2	9.6	32.4	12.7
LIFE	12.0	7.1	15.9	6.2
TOTAL DIRECT	169.0	100.0	255.6	100.0
ACCEPTED REINSURANCE	3.8		5.6	
TOTAL PREMIUMS	172.8		261.2	

Source: Ministry of Finance, Direction Generale des Assurances and F.TU.S.A.

The insurance industry is dominated by state owned companies, which account for 47% of total 1993 premiums (based on the 13 resident companies that engage in ordinary life and/or nonlife business). The share of state-owned companies has suffered a slight fall in recent years. State-owned companies used to enjoy a strong preference by state entities and other state-owned companies but in recent years there has been a gradual defection of public sector business to private companies, which appear to charge higher premiums but offer a better service.

Market concentration is quite high as the three largest companies control almost 57% of the market (Table 2). The Herfindahl index of concentration was 1654 in 1993, down from 1789 in 1990. This is close to the limit of 1800 used by US authorities in blocking mergers for anticompetitive reasons[4]. The small decline in the index reflects the gain of market share by the two private companies among the big three insurers at the expense of the largest company, which is state owned. It is notable that El

[4] As the experience of Canada, the Netherlands and other high income countries shows, high concentration per se is not incompatible with competitive efficiency if the market is contestable by potential new entrants. In most developing countries, it is the combination of high concentration, dominant state ownership and restrictive regulations that tends to have adverse effects on the degree of competition, innovation and overall efficiency.

Ittihad, a company with a large negative equity, increased significantly its market share between 1990 and 1993. This company mostly engages in automobile and group health insurance, two of the loss making lines. The increase in market share may be expalined by a policy of underpricing. But given the large negative equity and the low coverage of reserves, its customers either suffer from an illusion of insurance or they rely on the implicit backing of the state.

The compulsory personal lines of insurance, which include third party automobile and work accident, account for over 40% of total business (Table 3). Group health insurance represents about 20%, while transportation, fire and miscellaneous risks, which tend to be large industrial and commercial risks, account for about one third of total premiums. Life insurance is poorly developed and represents only 6% of the total. Most life insurance is linked to bank loans and, though not imposed by the state, is effectively compulsory for borrowers. As discussed further below, the existence of social security probably crowds out the purchase of life insurance.

Table 4
Structure of Insurance Business in Selected Countries, 1992
(percent of total premiums)

	Life	Nonlife
Africa		
South Africa	80.5	19.5
Zimbabwe	60.4	39.6
Kenya	20.8	79.2
Morocco	19.0	81.0
Tunisia	6.0	94.0
East Asia		
South Korea	79.7	20.3
Taiwan (China)	68.8	31.2
Singapore	62.2	37.8
Philippines	60.9	39.1
Thailand	55.0	45.0
Malaysia	44.7	55.3
Indonesia	30.0	70.0
China	30.0	70.0
Latin America		
Chile	60.0	40.0
Mexico	33.3	66.7
Colombia	22.2	77.8
Argentina	12.5	87.5
Brazil	11.6	88.4

Source: Sigma, Swiss Reinsurance Company, 3/94.

The relative underdevelopment of the insurance industry in Tunisia is shown by the low share of life business in total premiums (Table 4). This is much lower than the corresponding share in Morocco

and Kenya, let alone in East Asian countries. Tunisia's share is even lower than that of high inflation countries in Latin America.

Reinsurance plays a big part in the large industrial and commercial risks, where ceded premiums amount to between 60% and 70% of gross premiums. Reinsurance is less important in personal lines. Tunis Re, the state-owned local company, absorbs about 20% of ceded premiums, while the rest is placed with international reinsurance groups.

The Distribution System

Insurance companies employ well over 2,500 people, but for the distribution of their products they also use a network of about 360 insurance brokers. Most of these brokers are tied to individual companies and sell the products of these companies only. The largest networks are held by the largest companies. There are also 4 companies of independent brokers that are not tied to any individual company but sell the products of all companies and 15 agents authorized to sell life insurance, capitalization policies and annuities.

The insurance brokerage part of the market suffers from a number of problems. Agents are not always professionally qualified or trained and, as in other countries, they often use aggressive selling techniques that do not always take into account the best interests of consumers. It is for this reason that the recently introduced new insurance code has specified minimum qualification requirements for brokers and selling agents and has also stipulated the use of detailed procedures and forms to protect consumers.

Another problem with insurance brokers has resulted from lax financial controls of some companies, especially the state-owned ones. Insurance brokers have been allowed to accumulate large amounts of premiums that have been collected from customers but not transferred over to the companies concerned. This has inflated the claims of insurance companies on their agents and, in some cases, when action to recover those claims was taken, insurance agents were unable to meet their obligations causing losses for the companies concerned.

The insurance industry also employs about 50 experts for motor insurance claims and 21 loss adjusters, who specialize in particular in adjusting claims arising from international transport insurance.

Underwriting Performance

Efficiency in the insurance industry is difficult to measure because, like all other types of financial services, there is no easy definition of the output of the sector. Various measures are used for comparative purposes but these are subject to considerable subjectivity that substantially reduces their usefulness.

Nonlife Insurance. In nonlife business, underwriting performance is measured by four basic ratios: the loss ratio, the expense ratio, the combined ratio and the operating ratio.

The loss ratio measures claims paid and provisions for losses incurred but not settled as a proportion of retained premiums, i.e. gross premiums received less premiums ceded to reinsurers. It shows the percentage of premiums that are paid back to the insured; a high ratio normally indicates an efficient and competitive industry. But because payments for losses may be spread over a number of years, especially for so-called long tail business, such as automobile insurance where claims may take several years to settle, insurance companies make transfers to loss reserves to cover future payments.

Differences in reserving policies and manipulation of reserves for tax and other purposes reduce the usefulness of the loss ratio as an index of efficiency. Nevertheless, a low ratio would indicate relative inefficiency.

The expense ratio is computed as general expenses and net commissions paid (i.e. commissions paid to agents less commissions received from reinsurers) as a proportion of gross premiums[5]. It provides a measure of the acquisition costs of insurance business. A high expense ratio would suggest low operating efficiency in marketing and product innovation and in processing claims as well as an uncompetitive distribution system.

The combined ratio, which is often used as a measure of the underwriting profitability of insurance companies, is the sum of the loss and expense ratios[6]. Finally, the operating ratio also takes account of the investment income earned on loss reserves. It is obtained by deducting investment income as a ratio of retained premiums from the combined ratio.

Traditionally, nonlife insurance companies aimed to operate with a combined ratio of 95% and earn a 5% profit on their premiums without taking account of investment income. With an average ratio of premiums over equity of 3, this resulted in a satisfactory return on equity of 15%. But high inflation and high nominal rates of investment returns as well as a growing level of reserves in relation to premiums forced insurance companies to take account of investment income on reserves and to engage in what has become known as cash flow underwriting. When investment income is high as a proportion of premiums, insurance companies may lower premiums in relation to expected losses and the combined ratio may exceed 100%, giving rise to an underwriting loss. This is made up from the investment income earned on reserves.

International comparisons of nonlife insurance results are complicated by differences in accounting conventions, market structure, business mix, inflation rates, and data coverage. Differences in business or product mix are particularly important because both acquisition costs and loss claims vary significantly across different lines. In most countries, automobile insurance operates with very high combined ratios, because premiums tend to be regulated, while expenses and losses are high. In contrast, the fire contract is almost everywhere associated with low loss ratios. In some cases, this reflects the biases of the official tariffs that for political purposes involve a considerable amount of cross subsidization across different lines and tend to keep motor premiums low and fire premiums high. But even in countries with no tariff controls, fire premiums are generally high. Such pricing structures may reflect a cartelization of the industry with leadership pricing and gentlemen's agreements but they could also reflect a lack of price sensitivity among consumers, especially for household policies[7].

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[5] Gross premiums is used as the basis for calculating the expense ratio because acquisition costs are incurred for the generation of gross premiums, and not just retained premiums.

[6] It is customary to add the two ratios even though one is based on retained premiums and the other on gross premiums.

[7] The explanation for the generally high fire premiums could be more complicated, although hard evidence on this is not readily available. Insurance companies that lower their fire premiums may be attracting customers who are price sensitive and engage in comparative shopping. However, these customers may be high risk customers, not necessarily in the sense of suffering more fire accidents, but

In Tunisia, the reported underwriting results of the insurance industry as a whole have been very poor for a long period. The cumulative technical deficits of the industry, i.e. before taking account of investment income, have amounted to 50 MD over the four year period 1989-92. These corresponded to about 25% of annual premiums. Two compulsory lines, motor insurance (mostly for third-party claims) and work accident insurance, accumulated technical deficits well in excess of 80 MD over the same period.

In 1992, the technical deficit for all lines amounted to 15.9 MD or 9.2% of retained premiums. As acquisition costs amounted to about 20% of premiums, this implied an overall loss ratio of 89%. After allowing for investment income on technical reserves of 24 MD (14% of premiums) and various provisions for precautionary and depreciation reserves, the industry suffered a net loss of 5.8 MD, equivalent to 3.4% of premiums. 4 of the companies reported net losses of a total of 10.2 MD, while the remaining 9 companies produced a net profit of 4.4 MD.

These results were obtained after the transfer of substantial amounts to technical reserves for the coverage of outstanding claims (losses already claimed but to be settled in the future) and for current risks (i.e. losses that have occurred but have not been claimed). In Tunisia, technical reserves for nonlife business were about 170% of retained premiums in 1992. This is a reasonable level by international standards. It reflects the need to maintain adequate reserves because of the long delays in effecting settlement. However, reserving, like provisioning against nonperforming loans in banking, is highly subjective. Without rather detailed audits, it is not possible to tell whether Tunisian companies undertake the right amount of reserving, engage in excess reserving in order to understate profits and minimize corporate taxes, or suffer from deficient reserving in an attempt to bolster profits. In addition, Tunisian insurance companies appear to have created rather substantial precautionary reserves, which also allow considerable room for subjective judgment and manipulation of reported results.

Motor Insurance. In motor insurance, the main problem is the low level of premiums, which are set by the authorities for different classes of cars and the inexorable rise of costs. Authorized increases in premiums have been inadequate and have not kept pace with the rising costs of repairs and the size of court awards in cases of personal injuries or deaths. A no-claims bonus system was introduced recently, but the discounts and penalties are set out in detail by the authorities. This prevents companies from providing greater incentives to attract the better and more responsible drivers. Insurers would like to introduce a "baremization" system that puts upper limits on court awards for personal injuries and loss of life, similar to those that exist in Spain and Canada.

In general, the motor insurance line suffers from long delays in settling claims, lack of clarity and disputes between insurance companies and claimants, regarding the extent and severity of damages and the cost of repairs. The combined ratio amounted to 133% in 1992, resulting in an underwriting loss (technical deficit) of 22.6 MD. Data from one company indicate that losses arise in third party insurance where premiums are too low for the risks involved. This company reports a combined ratio of 143% for third party risks, while the technical result for other motor risks is positive.

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rather in the sense of knowing the "rulebook" and having a higher tendency to submitting claims and pursuing them more aggressively than the average customer. Thus, lowering fire premiums may be counterproductive if it is associated with higher claims. This argument is similar to the explanation put forward for the persistently high rates of interest on credit cards in an otherwise highly competitive industry.

Work accident insurance. The problems in work accident insurance took a different form. Companies were free to set their premiums, but there was a tendency to engage in ill advised competition and to use this line (as well as group health insurance) as a loss leader for establishing relations with customers, especially with the larger employers. In the case of work accidents, insurance companies suffered from the use of master policies that did not specify by name all the workers covered by them. Employers tended to under-declare the number of their employees and to claim indemnities for those workers who suffered accidents. The loss ratio was thus higher than the companies took into account in setting their premiums. This line reported an underwriting loss of 4.2 MD in 1992, equivalent to 22% of premiums.

Lack of data on loss experience and ineffective monitoring as well as long disputes regarding the severity of injuries aggravated the situation. Insurance companies have been pressing for the introduction of nominal policies, which would record by name all the workers covered by particular policies, but the government decided to transfer work accident insurance to the social security funds as of the beginning of 1995. The Caisse Nationale de Securite Sociale (CNSS) has adopted a more aggressive stance against enterprises that are late in paying social security contributions and has the relevant database to ensure that nominal policies are effectively used for work accident coverage.

But transferring work accident insurance to the public sector goes against the recent trend of greater reliance on the private sector. Moreover, there are concerns among private sector employers that the change may be motivated by the need to increase the revenues of the social security funds with a simultaneous reduction in effective coverage and benefits.

The problems faced by the work accident insurance line are typical of an insurance sector that is inadequately capitalized and ineffectively regulated. The answer to these problems is not the transfer of business to a state monopoly supplier but the introduction of more effective prudential regulations and solvency monitoring that will both prevent companies from charging very low premiums and force them to monitor better the use of insurance coverage by their customers. The appeal by private companies to the government for the legal imposition of nominal policies is indicative both of the weakness of the financial and technical management function in the private sector and of the ineffectiveness of corrective measures. As discussed further below, the regulatory authorities have put in place a reasonably effective system of monitoring, reporting and inspection. What seems to be lacking is a forceful and equal application of solvency standards and corrective measures.

Group health insurance. Like work accident insurance, group health insurance has also generated negative results, mainly because it has been used as a loss leader. The underwriting loss in 1992 amounted to 3.5 MD or 8% of retained premiums. This line appears to suffer less from disputes with the insured. Several companies indicate that claims are settled with very short delays (generally less than two weeks). The competition with the health insurance services provided by the social security funds may be a factor explaining the better service offered by private companies in this line.

Some of the better run private companies report gains in this line of business, despite charging higher premiums than state-owned companies. In some cases, state entities or state controlled enterprises have transferred their group health insurance to private sector companies.

Other risks. Fire, transport and miscellaneous risks produce positive underwriting results, which are very high in the case of fire insurance. But insurance companies tend to cede a big part of large industrial risks to Tunis Re and foreign reinsurance companies and thus they benefit less from the superior

performance of these lines. The combined ratio for these lines was only 55% in 1992, giving an underwriting profit of 45% of retained premiums. This was unusually high. In 1990, the underwriting profit amounted to 15% of premiums.

Life insurance. The life business is not well developed for several reasons. First, the low level of income and wealth of the vast majority of the population has reduced the affordability of long-term saving. Second, the existence of a social security system offering generous pensions to both employees of the public sector (civil servants and public utilities) and private sector employees (especially employees of banks, other financial institutions and large industrial firms) has weakened the demand for life insurance. Third, the returns on life insurance policies have been quite low as a result of the restrictive investment regulations (see below) And, fourth, life insurance has not benefitted from fiscal incentives as in other developing countries that have experienced high growth in life insurance. The prospects for life insurance are very likely to improve substantially in the future if the pension system is reformed and a capitalization pillar is established to complement the existing partially funded, defined benefit first pillar.

In life insurance, the concept of the loss ratio has less meaning, as it would include only claims paid due to death or maturity of contract. For a growing industry, the loss ratio would be quite low because a substantial part of premiums is placed in reserves to cover the long-term liabilities inherent in life policies. If benefits and dividends paid to policyholders and additions to technical reserves are treated as representing the premiums paid back to policyholders in the long run, then this pay-back ratio could be a better measure of efficiency for life insurance business than the loss ratio. In Tunisia, the pay-back ratio amounted to 58% of premiums in 1992. Expenses absorbed 17% and commissions another 7%, leaving an underwriting profit of 18%.

Reinsurance

Unlike many other developing countries, especially in Latin America (prior to the recent wave of reform) and Africa, the reinsurance market in Tunisia is not dominated by a large state-owned monopoly to which all companies are required to cede a large proportion of their business. In countries like Brazil and Argentina, such state-owned reinsurance monopolies had a disastrous experience and were forced eventually to be liquidated.

In Tunisia, insurance companies are required to cede locally 20% of their premiums but are otherwise free to enter into treaties with approved foreign companies. Some lines of business are reinsured up to 60% or 70% of premiums. Most of that business is ceded to foreign companies that often have some direct or indirect ownership link with the ceding companies.

In many developing countries, access to international reinsurance markets has provided an excellent means of technical and professional training for staff since foreign reinsurance companies prefer to have to deal with knowledgeable individuals and thus lower their transaction costs. Concerns about excessive reliance on reinsurance can be addressed by using solvency margins based on average retained claims as well as on retained premiums, but subject to the use of a minimum retention ratio of 50% for the calculation of solvency margins.

Investment Performance

Insurance companies build up substantial technical reserves, which are available for investment in long-term and marketable financial instruments. Even nonlife companies that cover relatively short-

term risks accumulate substantial reserves which, despite the short-term nature of the risks covered, represent long-term resources for companies that experience a reasonably steady growth in their business. In fact, because the loss claims facing nonlife insurance companies suffer from various processing delays until they are settled and are thus exposed to the vagaries of inflation, nonlife insurance companies in OECD countries, especially in Anglo-American countries, tend to place a high proportion of their technical reserves in corporate equities that generally provide a better hedge against inflation than bonds. The reserves of life insurance and annuities business are of a long term nature and are generally invested in long term assets.

Since the life insurance sector is not well developed, most of the reserves of insurance companies represent reserves for nonlife general insurance business. Total reserves amounted in 1993 to 455 MD, up from 324.5 MD in 1990. They correspond to 3.1% of GDP. Admitted assets, i.e. assets that are recognized for reserving purposes, cover 78% of technical reserves[8]. There are two main reasons for the deficiency of admitted assets: the excessive level of claims on brokers and agents, which are not admitted if they are outstanding for more than three months and exceed 10% of premiums; and the accumulated losses of four out of the 13 companies. As discussed below, there is significant variation in the financial condition of different companies and, although no detailed data are published, it is likely that the coverage of reserves also varies significantly from company to company. The capital deficient companies in the public and mutual sectors are likely to have low to very low coverage of their reserves.

About 50% of admitted assets are invested in government bonds (Table 5). Another 17% is represented by equities, 11% by property securities, and 14% by liquid money market assets. In the past equipment bonds were earning a below market rate of interest, but in recent years government bonds are issued on close to market terms and conditions. Some of the equity holdings are, however, very low yielding shares in other state-owned enterprises. The big increase in property investments reflects the tendency of many of the private sector companies to build or acquire offices for own use as well for rental purposes.

Table 5
Composition of Admitted Assets, 1990 and 1993

	1990		1993	
	MD	%	MD	%
Government bonds	132.2	57.0	177.2	49.7
Shares	37.0	16.0	62.5	17.5
Property	24.6	10.6	40.3	11.3
Liquid assets	24.1	10.4	48.3	13.5
Other admitted assets	13.8	6.0	28.7	8.0
Total	231.7	100.0	357.0	100.0

Source: Ministry of Finance, Direction Generale des Assurances

[8] To ensure the solvency of insurance companies, insurance regulators do not admit for prescribed regulatory ratios assets that do not meet certain criteria. For instance, excess claims on agents for premiums receivable, above a specified threshold, are not counted among admitted assets.

The return on admitted assets is generally quite poor, although there has been considerable improvement in recent years. The reported average return is below 7% and has risen slightly over the past few years. However, insurance companies have made significant unrealized capital gains in their holdings of listed equities and in their property investments.

Financial Condition

The financial condition of the Tunisian insurance industry as a whole is very poor. However, the private companies appear to be in reasonably strong financial position (at least on the basis of their reported but unaudited results), while two public sector companies -- El Ittihad and Lloyd Tunisien -- suffer from a serious capital deficiency and a persistent accumulation of losses. DGA data for 1992 show that cumulative losses suffered by four companies (the above plus two mutual companies) amounted to 57.9 MD. These exceeded the total paid up capital and reserves of the industry, which amounted to 52.5 MD. Thus, the industry as a whole operated in 1992 with a negative equity of 5.4 MD (Table 6). This represented a small improvement over 1990 when accumulated losses amounted to 44.9 MD, the reported total equity of the industry was 38.1 MD and the overall shortfall was 6.8 MD. The private companies, the state-owned STAR and the three mutual companies reported positive equity. But in the case of STAR and the mutual companies, the level of equity was well below the required solvency standards imposed by the new insurance code.

Table 6

Aggregate Balance Sheet of Insurance Industry, 1992

Assets	MD	%
Government Bonds	147.1	24.8
Equities	49.5	8.3
Properties	33.0	5.6
Liquid Assets	59.6	10.0
Personal Loans	2.9	0.5
Claims on Reinsurers	67.2	11.3
Premiums Receivable	86.1	14.5
Other Assets	90.9	15.3
Cumulative Losses (4 cos)	57.9*	9.7
Total	594.2	100.0
Liabilities		
Equity	48.3*	8.1
Insurance Reserves	412.9	69.5
Due to Reinsurers	45.9	7.7
Due to Government	37.5	6.3
Other Liabilities	49.6	8.4
Total	594.2	100.0

* The industry as a whole has a negative net equity because of the large cumulative losses of four companies.

Source: Ministry of Finance, Direction Generale des Assurances

It should also be noted that the reported equity of some companies may be overstated, because among other things the level of claims on agents is excessively high. On the basis of admitted assets only, the financial condition of state-owned companies and perhaps also of the mutual companies is likely to be much worse. On the other hand, several companies have built up substantial precautionary reserves and have also accumulated unrealized capital gains. Thus, the true financial condition of different companies is difficult to ascertain.

Table 7 shows that three of the private insurance companies (CARTE, ASTREE and COMAR) had very strong financial ratios in 1992, with solvency margins over gross premiums well in excess of the prescribed 20%, even stronger solvency margins over retained premiums, and very healthy equity to reserves ratios (the prescribed level for the last ratio is 10%). Maghrebia and GAT were closer to the prescribed norms, while the STAR was well below the required levels, though considerable progress was achieved in 1992 and is likely to have been continued in 1993 and 1994. Nevertheless, STAR continues to face serious restructuring and recapitalization problems. Needless to stress, the situation is very critical for the two capital deficient companies, which reported a negative equity of well over 50 MD.

Table 7

Solvency Margins and Capital Strength, 1992

	ASSETS	SMGP	SMRP	EQRES	RESPREM
GAT	62.0	16.6	20.6	9.9	168.3
COMAR	74.1	37.3	47.5	17.3	215.9
ASTREE	59.8	39.9	53.2	18.4	217.0
MAGHREBIA	30.4	21.0	32.4	15.2	137.7
CARTE	31.9	66.4	98.6	23.9	163.4
TOTAL FIVE	258.2	32.6	43.8	17.7	184.0
STAR	174.4	6.1	8.7	4.2	159.4

SMGP: Solvency margin over gross premium - prescribed norm 20%
SMRP: Solvency margin over retained premiums - EU solvency margin 18% to 16%
EQRES: Equity over technical reserves - prescribed norm 10%
RESPREM: Reserves over premiums

Source: Ministry of Finance, Direction Generale des Assurances and Company Annual Reports

III. REGULATORY AND MARKET REFORM

To enhance its efficiency, expand its role in the development of the securities markets, and increase its contribution to the promotion of the private sector, the Tunisian insurance sector needs to undergo fundamental regulatory and market reform. This would require a partial, yet significant, reform of the recently introduced insurance code. But by far the most important change would need to be a more effective enforcement of corrective measures, especially with regard to the capital deficient companies and to companies that fail to meet the prescribed prudential norms.

The following measures would need to be considered:

Insurance supervision

* strengthening of insurance supervision, including a more forceful and equal application of corrective measures;

Market structure

* restructuring and recapitalization of capital-deficient companies;
* privatization of state-owned companies;
* opening of the Tunisian market to foreign competition;

Regulatory reform

* rationalization of solvency margins;
* liberalization of motor insurance premiums and possible introduction of "baremization";
* rationalization of the tax treatment of insurance premiums;

Training

* enhancement of financial and technical risk management; and
* extensive training programs for regulators and market practitioners, including actuaries, accountants, auditors, investment managers, marketing specialists and agents.

Strengthening Insurance Supervision and Enforcement of Prudential Rules

The liberalization of the insurance market and encouragement of greater competition presuppose for their success a stronger and more effective system of supervision. The insurance authorities already have the required knowledge and expertise to monitor the performance of insurance companies. What is needed is perhaps greater automation of the surveillance system and more extensive and frequent on-site inspections. Currently, insurance supervision suffers from inadequate levels of staffing, which seem to be related to the low compensation packages compared to market practice. A major effort would be necessary to recruit and train professional examiners, while the possibility of creating an insurance regulatory agency that is outside the standard civil service payscale could also be considered.

But the most important problem seems to be the inability of insurance supervisors to enforce the prudential norms. A more forceful and equal application of corrective measures is essential. This should ensure that the prudential regulations are observed by all insurance companies and no company is allowed to operate with deficient capital, both in relation to the premiums charged and in relation to losses suffered.

Restructuring and Recapitalization of Capital-Deficient Companies

As noted above several companies have long operated with negative equity. These companies belong to the public and mutual sectors, a situation that is probably explained by the weak position of supervisory authorities vis-a-vis state-owned companies and mutual companies that are akin to public sector entities. In fact, restoring the capital strength of capital deficient companies is among the corrective measures proposed by the DGA, but the budget constraints faced by the state have prevented an injection of new capital. In addition, although the supervisory authorities have raised in steps the minimum capital of insurance companies from 1 million to 2 million and more recently to 3 million dinars, state owned companies were still operating with a paid up capital of less than 2 million dinars.

A contestable market implies not only relatively free entry that would force existing firms to behave competitively but also effective mechanisms for exit if companies become technically insolvent. The continuing operation of capital-deficient companies undermines the competitive ability of well capitalized companies and may also lead to lower standards in the sense that such companies may offer deceptively low priced policies with little intention to settle claims when accidents occur or with little concern for the effect of losses on their financial condition. The latter would appear to be true for state-owned companies, while the former could be the case for small private companies. Small companies do not exist in Tunisia where the total number of companies is rather small and the minimum capital requirement rather high, but state-owned companies with deficient capital do exist and tend to undermine the competitive ability of better capitalized firms.

Companies that are unable to raise their equity to the required level to meet appropriate solvency margins should be forced to exit the market either by closing down or by merger with stronger companies. For state-owned companies, a recapitalization and restructuring could be linked to their total or partial privatization.

Privatization of State-Owned Companies

State-owned companies operate with negative, or at most, deficient equity and appear to suffer from low morale. Their ability to compete on service and product innovation is constrained by the shortage of capital and by the limitations on offering attractive remuneration packages and good promotion prospects to their more dynamic agents and staff.

To prevent the continuing adverse effect on the structure of the market from the existence of lethargic institutions or institutions that spoil the market through the charging of uneconomic premiums, the authorities should give high priority to the restructuring and privatization of the state-owned companies. As in other sectors, the role of the state should be limited to that of regulating and supervising the operations of private companies, leaving the latter to compete and innovate to better serve the needs of their customers.

If there is a need for serving social sectors that the private markets might neglect, then a certain presence by a state-owned company might be justified. However, such a company would at most account for 10% or 15% of the total market, instead of the present dominant share of over 34% held by STAR and of over 45% by the three companies classified as state-owned in this paper. It should also be noted that the role of the public sector in insurance is much greater if account is also taken of the insurance operations of social security institutions.

International experience shows that public enterprises in any sector are more likely than private companies to be interfered by politicians. They are also more likely to delay restructuring and avoid exit (since they are less likely to be subject to bankruptcy, liquidation, hostile takeover, and closure). Public enterprises are less scrutinized by the capital markets and they are less well supervised by their bureaucratic managers than private firms which are subject to supervision by their owners or by professional managers whose careers depend on the performance of the companies they manage. In Tunisia, as in many other developing countries with large state-owned sectors, bureaucratic managers are often moved around from one company to the next, often in unrelated industries and with little reference to their past performance. In many developing countries, state-owned companies have evolved over time into institutions that exist to serve the interests of their employees rather than those of the state or of their

customers. This has often resulted in poor financial performance and poor quality of service, with little innovation and high costs.

Privatization of state-owned insurance companies would require detailed audits and actuarial reviews to ascertain their financial condition and the level of their liabilities to policyholders. It would also require the formulation of a detailed plan of action that would aim to restructure the companies, remove from their balance sheets any nonperforming assets or insupportable liabilities, and prepare them for offer to the market.

Opening of the Tunisian Market to Foreign Competition

When Tunisia emerged from the colonial times at the time of its independence, a high priority of government policy was the Tunisification of various important sectors of industry, commerce and finance that were traditionally dominated by foreign interests. This was a historically appropriate response that had as its main aim the promotion of indigenous forces that would be better tuned to the needs of the country. This process was also evident in the insurance sector where foreign companies were either forced to leave the country or were offered minority participations in companies set up under Tunisian law and with majority ownership in Tunisian hands.

However, opening the local market to majority participation by foreign companies could have significant benefits for the Tunisian economy. Foreign companies would be more likely to innovate and transfer their financial and insurance technology to the Tunisian market if they had majority ownership and managerial control of local companies. Restricting foreign companies to minority participations often results in small stakes and limited managerial involvement in the affairs of local companies, other than attending periodic board meetings, which often assume a vacational character for the directors involved.

Most developing countries are reluctant to allow foreign banks and insurance companies to enter their local markets for several reasons. First, they are afraid that foreign institutions may acquire a dominant position in the markets. Second, they are afraid that foreign institutions may engage in "cream skimming", serving only the most profitable segments of the market. And, third, they are concerned that foreign institutions may have a rather weak commitment to the local economy and may depart from a local market both when prospects in that market are poor and when conditions in their own home market are unfavorable. The retrenchment over the late 1980s of many American banks from European and other markets, which was partly motivated by the banking crisis and economic recession in the United States, lends support to this concern.

One way to prevent foreign institutions from dominating a local market would be to require ownership of all major participants in a market to be widely dispersed. This would ensure that no national bank or insurance company could be acquired by a foreign financial institution. A second measure would be to require all foreign institutions to operate through locally established subsidiaries and to offer to the public a growing part of their equity, depending on their relative size in the market. A third alternative would be to encourage joint ventures with foreign institutions in the majority position and with the responsibility of managerial control.

Protecting the local market from foreign domination through these measures would allay the fears of the authorities of most developing countries, while encouraging the entry of foreign institutions with superior technology and management skills. One of the biggest advantages of allowing foreign institutions

in a country is the training provided to local managerial staff, who often leave to manage domestic institutions.

The Tunisian authorities should give serious consideration to opening the insurance market to more active foreign entry along the lines suggested above as the financial and technical benefits from doing so are likely to exceed the political risks of foreign domination, especially if appropriate measures are taken to prevent such domination from occurring.

Revision of the Insurance Code

Although recently introduced, the new insurance code, which was issued in March 1992, contains many provisions that appear to require amendment to make it more consistent with emerging trends in insurance regulation in OECD countries. However, it is not the objective of this paper to provide a detailed commentary and analysis of the insurance code, which must be undertaken by a team of local experts representing both the public and private sectors, who would be better informed about the specific needs of the Tunisian market.

The new code involved a significant and commendable modernization of some aspects of the conduct of the insurance business. In particular, the code sought to clarify the responsibility of the insured to pay the premiums (under the preceding code, insurance companies or their agents were responsible for the collection of premiums). It has also introduced the concept of partial and proportional coverage if insurance contracts are not based on the full market value of the items insured. This provides a strong incentive for policyholders to keep the value of their insurance contracts in line with inflation and thus protects insurance companies from the long-term impact of inflation.

The code also aims to provide greater protection to the buyers of insurance services by requiring a stronger professionalism on the part of agents and insisting on the use of formal procedures for the evaluation of the insurance needs of consumers. However, the code appears to have imposed ambitiously high standards and minimum credentials for agents, while the protection of consumer interests has been sought through the use of forms that appear to be bureaucratic and are rather ineffective in protecting consumers. The concern of the authorities to raise the professionalism of brokers and salesmen seems to be fully justified. However, the pace of implementation needs to be aligned with the circumstances prevailing in the Tunisian market. Moreover, the ability of regulators to enforce the new standards must also be taken into account.

Minimum Capital Requirements and Solvency Margins

The purpose of a minimum capital requirement is to act as a screening device to ensure that only companies with some financial standing are allowed to enter the market. A minimum capital that is set at too high a level in relation to the projected volume of business will act as a barrier to entry, while a minimum capital that is too low may cause a fragmentation of the industry with potentially adverse effects on standards of service and prudence.

The new code increased the minimum capital for multi-line companies to 3 million dinars and for single line companies to 1 million dinars. Also, the required capital for mutual companies is set at 500,000 dinars. The level of these requirements seems reasonable and in line with standards introduced in OECD countries.

The question of whether there should be a legal requirement to engage in life and nonlife operations through separately capitalized subsidiaries should be one of the issues to be examined by the team of local experts. In EU countries, it is no longer permitted to authorize composite companies (i.e. companies that engage in both life and nonlife business). There are advantages in requiring separately capitalized subsidiaries, not least in record keeping and reserving policies, while there are few marketing disadvantages since the selling of life and nonlife business requires different qualifications and market knowledge.

The new code also requires a solvency margin that is set at 20% of gross premiums. This appears to be rather high by international standards. It also deviates from the standard definition used in OECD countries whereby the solvency margin is related to the level of retained premiums (i.e. gross premiums less premiums ceded to reinsurers). The solvency margin is set in the EU at 18% of retained premiums for the first 10 million ECU and at 16% for amounts above that level.

But EU regulations also provide for a solvency margin related to average losses paid over a 3 or 7 year period. This measure is aimed at preventing aggressive companies from charging deceptively low premiums that bear little relation to the average level of losses that are incurred in a particular line of business. EU provisions set this margin at 26% of annual average claims up to 10 million ECU and 23% for amounts above that level. A claims related solvency margin provides a reasonable inhibition to excessive and ill advised competition for purely prudential purposes and is a superior measure to the traditional fixing of premiums.

The use of gross rather than retained premiums aims to emphasize the need for solidity in the Tunisian market. However, a better way to achieve this objective would be to require a higher solvency margin, though still based on retained premiums. As it is, a gross premium margin penalizes companies that resort more extensively to the reinsurance market. To protect against excessive reliance on reinsurance and against the practice known as "fronting", whereby a local insurance company acts effectively as a broker for a foreign company, a minimum retention ratio of 50% could be used for the calculation of solvency margins. This is the approach adopted in the EU and now spreading in most countries in Latin America and Asia.

Liberalization of Premiums

Insurance regulation has traditionally followed two distinct approaches. One approach has emphasized the fixing of premiums at levels that are adequate to pay future claims and avoid insolvencies, while the alternative approach has relied on solvency monitoring. The first approach often involves high premiums that are then partially rebated to customers, except for mandatory coverage in motor insurance where most regulatory authorities tend to impose inadequate premiums that result in underwriting losses. The second approach allows insurance companies to set their own premiums but relies on solvency monitoring along the lines discussed above to discourage deceptively cheap policies.

The Tunisian regulatory authorities have the right to set minimum and maximum premiums and to approve all new products and contracts. However, except for the premiums for compulsory third party motor insurance, it appears that insurance companies are free to set their own premiums. In fact, as already noted, ill advised competition in some lines tends to result in premiums that are too low to ensure satisfactory profitability.

There is a clear need for a liberalization of motor insurance premiums and their fixing by insurance companies at levels that would ensure adequate long-term profitability. The industry needs to expand its use of incentives to reward good driving records and to develop a better monitoring of claims, a more effective control of car repairs, and a more equitable system for the award of damages. Eliminating, or at least substantially reducing, the cross-subsidization that is currently taking place between different lines would increase the profitability of insurance companies and allow more of them to list their shares on the stock market.

Use of solvency monitoring, and especially introduction of solvency margins based on claims, would discourage the offer of excessively low premiums in motor insurance as well as in other lines. In addition, the authorities could study a system of "baremization" that would put economically meaningful limits on court awards for personal injuries and loss of life. Such systems are used in Canada and Spain. It should, however, be noted that "baremization" systems are highly complex and complicated instruments that are difficult to get right. They also require frequent revision and updating. But despite their limitations, they may be a better alternative than systems where courts have no guidance whatsoever on the appropriate level of awards. A "baremization" system may also encourage the use of arbitration procedures that would avoid the heavy costs of going through the courts.

Work Accident Insurance

As noted above, responsibility for work accident insurance has been transferred as of the beginning of 1995 to the social security system. This represents a step in the opposite direction from the growing reliance on the private sector. It is regrettable that this transfer could not be avoided through greater cooperation between the social security system and the insurance industry to promote the use of nominal policies. The development of solvency margins based on past losses could also have acted as a disincentive against offering policies with very low premiums or inadequate controls on the coverage of employees. Although some private companies are not unhappy to be relieved of the burden of providing work accident insurance, the role of the social security institutions in this area would need to be kept under review and the whole question re-examined when the insurance industry becomes more robust and more effectively regulated.

Life Insurance and Social Security Reform

The promotion of life insurance would be stimulated by the implementation of a fundamental reform of the pension and social security system. Although such a reform needs to be taken on grounds concerned with the adequacy and inequities of the existing system and would clearly not be motivated by the prospects of life insurance business, there can be little doubt that establishing a fully funded pension pillar to complement the existing partially funded scheme would have immense implications for the generation of long-term savings and for the role of insurance companies in managing such funds. Several measures can be taken to encourage the growth of individual capitalization accounts for the provision of supplementary pensions. Recent moves toward reduced levels of social security pensions, especially for high income employees, suggest that group life insurance may receive considerable stimulus in the near future.

Tax Treatment

Insurance business is subject to a bewildering tax treatment that involves tax rates that range from a complete exemption for export insurance to 5% on aviation and maritime insurance contracts and as high

as 24% for agricultural insurance. Even compulsory motor insurance incurs tax at 12% while other motor risks are taxed at 10%. There does not appear to be any rationale in the structure of insurance taxes that are levied on premiums paid. A rationalization of the tax treatment would seem necessary. This should aim to bring the tax treatment of insurance in line with prevailing practice in the EU.

Enhancement of Financial and Technical Risk Management

At present, Tunisian insurance companies engage to a very limited in financial and technical risk management. Development of a sophisticated financial management function has been inhibited by the requirement to invest a substantial proportion of available funds in nonmarketable and low-yielding government securities that used to be imposed on insurance companies.

To encourage insurance companies to develop their fund management expertise, investment rules must set maximum limits for different types of securities for risk diversification purposes. In addition, insurance companies should be required to invest in marketable securities and other assets that have a well developed secondary market and can therefore be liquidated without causing substantial price declines. Limits on single and group exposures would be essential. The valuation of investment assets should as far as possible be based on market values and the frequency of reporting should be increased.

Investment regulations have been relaxed in recent years and now insurance companies are required to invest only 35% of their technical reserves in government securities or in securities guaranteed by the state. There is also a 50% upper limit on corporate bonds, equities, real estate and bank deposits, and a 5% limit on the equities and bonds of a single issuer. Individual real estate properties are subject to 10% limit, unless the property is used as a head office. Claims on brokers and other receivables are subject to a 30-day maturity limit and a 10% value limit in relation to premiums.

Some insurance companies belong to broader financial conglomerates. Such groups should be required to publish audited consolidated accounts and limits should be placed on investments in group-related companies. Any dealings with related parties should be allowed only if they are effected at market terms and conditions and should follow clear rules of reporting.

The need for better financial management is also seen in the area of receivables from agents, which represent a rather high level of premiums. As in the case of banks, insurance companies need to establish more effective monitoring systems and to take early steps to ensure the recovery of premiums both from the insured and from the agents.

The development of the technical risk management function has been inhibited by two factors. First, the compulsory motor insurance line, which represents one-third of total business, has been subject to premium controls, leaving little scope to insurance companies to develop different products to fit different classes of risks. Second, the business of large industrial risks, which represents another one-third of total business, has been based on premiums set by reinsurers to whom insurance companies cede 60-70% of the risks (and the premiums) in order to avoid large losses. Thus, for two-thirds of their business, Tunisian insurance companies have had little scope for premium setting and product innovation.

Liberalization of motor insurance and development of the capacity to retain a higher proportion of large industrial risks would increase the scope for technical risk management. Following the change in the insurance code that introduced proportional coverage in cases of underinsurance, several insurance

companies have started to offer professional advice to companies about the adequacy of their insurance cover.

But the industry needs to develop further its actuarial capabi ties and to compile more complete and reliable data on loss experience. There is also a need to develop mortality tables that cover the population of insured Tunisians. Closer and more extensive technical cooperation of insurance companies, perhaps under the aegis of the insurance association, would be helpful in this respect, although the law should ban any collusion on the setting of premiums or the introduction of new products.

Consumer Protection

The insurance code contains several provisions that aim to enhance the protection of consumers. But some of these provisions threaten to have an inhibiting effect on the growth of the industry, either by making more difficult the recruitment of agents and salesmen or by increasing the bureaucratic costs of doing business.

With regard to the minimum professional qualifications, the authorities should consider relaxing the recently introduced criteria and allow staff with one year's training and an aptitude to sell insurance to be hired as salesmen. Not every salesman of insurance needs to have a university degree in mathematics and to be an actuary. Provided the products are well designed and provided the salesforce receives adequate back-office support, persons with less extensive education but with a satisfactory minimum amount of training could be allowed to qualify.

The use of detailed forms that may be difficult to comprehend offers little protection to consumers. The authorities could consider instead the creation of an insurance ombudsman office that would be responsible for investigating consumer complaints and order insurance companies to settle disputes if the complaints are justified. Consumers should retain the right of redress through the courts. The ombudsman office could be operated under the aegis of the association of insurance companies.

Industry Dialogue

At present, it is not clear that there is a sufficient dialogue between representatives of the insurance companies and the authorities. A more effective dialogue could be promoted by the association of insurance companies, which in any case needs to develop a more independent profile and to represent the views of the industry. The association may also undertake publicity campaigns to educate the public in insurance matters and to improve the public image of the industry.

Training Programs

The modernization and development of the insurance industry would require a major effort in training that should encompass not only actuaries, financial analysts, investment managers and selling agents, but also insurance supervisors and examiners. There is already a well functioning insurance course run by IFID, but this needs to be complemented with more intensive courses, especially for actuaries and supervisors. Allowing foreign companies to enter the Tunisian market will provide a major channel for training local staff. The training of supervisors and examiners should be based on closer cooperation with supervisory authorities in OECD countries, especially the neighboring European countries.

IV. CONCLUSIONS AND RECOMMENDATIONS

The insurance industry can play a very important part in the development of the private sector and the modernization of the securities markets. At present, the industry is underdeveloped because of restrictive regulations, deficient capital, and a bad public image. The industry has also suffered from the structural adjustment of the economy.

To encourage the development of the industry and allow it to play its full part in stimulating economic growth, a more conducive environment would be needed. This would involve the creation of a contestable but well regulated market, allowing greater freedom of innovation and competition to individual companies, but imposing an effective system of prudential regulation and supervision. In this respect, the following measures would seem appropriate and would involve a partial but extensive revision of the insurance code. These would generally engender a harmonization with insurance regulation in EU countries.

* Strengthening of insurance supervision, involving a more forceful and equal application of corrective measures.
* Restructuring and recapitalization of capital-deficient companies.
* Privatization of state-owned companies.
* Opening of the Tunisian market to majority-owned foreign firms or foreign majority controlled joint ventures.
* Stipulation of solvency margin in relation to retained premiums (instead of gross premiums) and introduction of solvency margins related to average annual losses.
* Liberalization of premiums for the compulsory third-party coverage of motor insurance.
* Study and possible introduction of "baremization" system that would put economically meaningful limits on court awards for personal injuries and loss of life.
* Re-examination of the decision to transfer responsibility for work accident insurance to the social security system and introduction of nominal policies for this line of business.
* Consideration of reform of pension system, encompassing the creation of a complementary capitalized pillar that would lead to the generation of long-term savings and would transform the prospects for life insurance business.
* Rationalization of the tax treatment of insurance premiums.
* Enhancement of financial and technical risk management through further relaxation of investment rules and development of loss experience and mortality data.
* Relaxation of professional qualifications for selling agents and creation of an insurance ombudsman office to provide better consumer protection.

* Improvement of industry dialogue by promoting a more independent association to represent the views of the industry.

* Establishment of major training programs, not only for actuaries, financial analysts, investment managers and selling agents, but also for insurance supervisors and examiners.

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