



BOSNIA AND HERZEGOVINA

FINANCIAL SECTOR ASSESSMENT PROGRAM

INSURANCE SECTOR—TECHNICAL NOTE

July 2015

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INSURANCE SECTOR

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Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Bosnia and Herzegovina. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

AML/CTF	Anti-money laundering/combating terrorism financing
BiH	Bosnia and Herzegovina
BiH-IA	Insurance Agency of Bosnia and Herzegovina
CBBiH	Central Bank of Bosnia and Herzegovina
CCFSS	Coordination of Financial Sector Supervision
CEO	Chief Executive Officer
DAC	Deferred Acquisition Costs
DIA	Deposit Insurance Agency
ERM	Enterprise Risk Management
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
FBiH	Federation of Bosnia and Herzegovina
FBiH-ISA	Insurance Supervision Agency of the Federation of Bosnia and Herzegovina
GDP	Gross Domestic Product
IAS	International Accounting Standards
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principle
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
ISA	Insurance Supervision Agency
IT	Information technology
KM	Convertible mark-local currency
LIC	The Law on Insurance Companies
LICPI	The Law on Insurance Companies in Private Insurance
LoI	The Law on Intermediaries
LoIPI	The Law on Intermediaries in Private Insurance
MoF	Minister of Finance
MoU	Memorandum of Understanding
MTPL	Motor Third Party Liability
ROE	Return on Equity
RS	Republika Srpska
RS-ISA	Insurance Supervision Agency of the Republika Srpska
SCFS	The Standing Committee on Financial Stability

EXECUTIVE SUMMARY

The insurance sector in Bosnia and Herzegovina (BiH) has been growing in recent years but remains small. The total assets of the insurance companies stood at KM 1.2 billion, or about 5 percent of the financial sector assets as of end-2013. Insurance penetration is low at about 2.1 percent of GDP, resulting in vast uninsured risks. The sector collected KM 527 million in premiums in 2013, a 4.3 percent increase from a year earlier. The nonlife insurance sector collects over 80 percent of the insurance premium, including about two-thirds from the mandatory Motor Third Party liability insurance (MTPL). About half of insurance sector assets are held in bank deposits.

Ten insurance companies, accounting for 40 percent of the nonlife market, have low solvency margins and may require supervisory action in the near future. The sector's resilience could be understated since the Solvency I capital requirements do not incorporate all the relevant risks. While liquidity is not a major risk given the high share of bank deposits in assets, a few insurers are heavily exposed to real estate and hold large amounts of receivables. Life insurance is relatively new and has low interest rate risk.

MTPL insurance remains under pressure as market participants are not always compliant with the statutory tariff. In some cases, competition has led to insufficient premiums for the risks assumed. Market participants are bypassing regulations for tariffs and commissions. Technical provisions depend heavily on the views of appointed actuaries working for the companies while the regulations do not call for external actuarial audits. Actuarial reviews are carried out but of independent reviews of technical provisions are necessary.

Insurance regulation has improved in both entities but the level of harmonization between entities and with the EU directives is still insufficient. It is expected that the Insurance Agency of Bosnia and Herzegovina (BiH-IA) will enhance the harmonization of entity-level regulations within BiH as well as with the EU insurance directives. While the main laws regulating insurance activities: the Insurance Law, Contract Law, the Law on Intermediaries and the MTPL law do not have significant disparities across the entities there have been occasional differences in the legal framework as the amendments have been carried out at different times. The existing disparities and their implications on the effectiveness and decisiveness of the supervision are reflected in this assessment.

Since the 2006 FSAP, each supervisory agency has shown some progress. The previous FSAP found the Insurance Supervision Agency in the Republika Srpska (RS-ISA) not operational. However, commendable progress has been achieved since then: the staff has been doubled and has a mix of professionals with legal and actuarial backgrounds; operational processes and internal controls, as well as supervisory and inspections manuals are in place. As a result, the RS-ISA is well positioned to supervise the market. The FBiH-ISA took over the function of the old Insurance Supervision agency (ISA). While the FBiH-ISA inherited a number of experienced staff, the legacy problems hindered a fresh turn-around for the new agency. Hence, the progress at the FBiH-ISA has been fairly limited.

While the operational processes and internal controls are in place, supervision and inspection manuals are missing and the supervision is heavily reliant on a few experienced staff know-how.

Notwithstanding the progress made by the ISAs, important challenges remain:

- **The prudential framework will need to be updated once the MTPL tariffs are liberalized, the market grows, or becomes more complex.** The current framework that follows Solvency I is not risk sensitive and, as such, inappropriate for modern supervision. Liberalization of tariffs will likely benefit consumers. However, to avoid destabilizing the sector, the tariffs should only be liberalized after the supervisory framework includes early warning systems, stress testing and a risk-based solvency together with a ladder for interventions that could trigger prompt corrective actions.
- **Consumer protection and financial literacy has to be urgently strengthened.** Both supervisory agencies handle complaints but with inadequate resources. An Ombudsperson for the insurance sector is appointed in the RS, but there is none in the FBiH. Regulation should be issued and implemented based on the IAIS standards on consumer protection.
- **A national strategy to raise overall financial literacy in insurance matters should be developed.** This effort will require the participation of all stakeholders and consideration should be made on whether the BiH-IA should take the lead on this initiative.
- **The independence of the FBiH-ISA needs to be safeguarded and the staff legal protection has to be strengthened in both ISAs.** The FBiH-ISA is understaffed to discharge its obligations. The appointment of managers is not based on the prescribed legal requirements. The revision of the Insurance Law has been delayed and a proposed MTPL law was presented to the BiH-IA without the FBiH-ISA or the MoF involvement. The legal protection is provided only to the director leaving out the staff and the legal defense costs in both ISAs are not clearly to be met by the corresponding ISA.
- **Group supervision and macroprudential supervision need to be developed.**
- **A few key supervisory powers are missing in both ISAs.** The power to remove members of the supervisory board in both ISAs is missing. The RS-ISA lacks the power to enforce the voiding of voting rights of qualified shares acquired without its approval. The FBiH-ISA's legal powers to appoint a temporary administrator without withdrawing the license of the insurer need to be clarified. Finally, the power to remove board members is absent in both ISAs.

Table 1. Bosnia and Herzegovina: FSAP Main Recommendations

Recommendations and Authority Responsible for Implementation	Time ¹
It is recommended updating the Law allowing the ISAs only to be sued as institutions and not the staff. If that appears not to be possible at least the Law should be clear on the ISA as responsible for providing for the costs of defending law suits that are initiated against its staff. In addition, the legal protection should cover all FBiH-ISA staff. (Parliament)	I
The appointment of the FBiH-ISA director should follow the Law. (FBiH Government)	I
The new Insurance Law in the FBiH should be enacted making sure that if it deviates from the amended RS insurance law this is only because it is closer to converging to EU insurance directives. (FBiH Parliament)	I
The creation of a Coordinating Committee among the financial sector supervisors should be established in the FBiH. The Committee should establish a formal regular channel of information sharing with the banking sector supervisor to gain timely information on the financial soundness of all banks holding insurance sector assets above a threshold. (FBiH-government)	I
It is recommended establishing a formal regular channel of information sharing with the banking sector supervisor to gain timely information on the financial soundness of all banks holding insurance sector assets above a threshold. (RS-Coordinating Committee)	I
The RS-ISA should be granted the supervisory power to enforce the removal the voting rights of a non-approved qualified shareholder. The FBiH-ISA power to appoint a temporary administrator for recovery or restructuring actions should be specified in the regulation to eliminate legal uncertainty. Both ISAs should be granted the power to remove any board member. (Parliaments)	I
It is recommended updating the solvency regime by a gradual incorporation of risk elements into the solvency framework as well as developing an early warning system. In addition, the introduction of stress testing at the company level and market wide is recommended. Once a risk sensitive solvency regime and the early warning system are in place, the development of a ladder of intervention based on capital levels should be introduced together with prompt corrective actions. Capacity building in this area will be required (ISAs)	I
It is recommended introducing consumer protection regulation aligned with the IAIS Core principles and implementing it. (ISAs)	NT
A comprehensive strategy to increase the insurance literacy of the public needs to be developed. Collaborating with the industry in this area will be beneficial and the leadership of the BiH-IA should be evaluated. (Government)	NT
It is recommended updating governance requirements to align them with the IAIS core principles. (ISAs)	NT
Regular market wide independent actuarial reviews should be carried out. (ISAs)	I
The development of a comprehensive group supervision framework together with the required training for its supervision is recommended. (ISAs)	NT
As the market develops further, a macroprudential supervision framework should be introduced. Consideration to assign the development of macroprudential tools to the BiH-IA should be evaluated and the implementation power should be granted to the ISAs. (State government)	NT
¹ "I-Immediate" is within one year; "NT-near-term" is 1–3 years; "MT-medium-term" is 3–5 years.	

INTRODUCTION

- 1. Bosnia and Herzegovina is divided into two semi-autonomous political entities—the Federation of Bosnia and Herzegovina and the Republika Srpska.** Both FBiH and RS have their own Parliament, government, judicial system and stock exchange. Similarly, regulatory and supervisory responsibilities for banking, insurance and capital markets lie at the Entity level, while their respective laws and regulations are harmonized to a degree. In addition, there is a central, or “State” level administration but with few enumerated powers. In this context, the Central Bank of Bosnia and Herzegovina (CBBH) and the Deposit Insurance Authority (DIA) reside at the national level.
- 2. This technical note¹ covers the insurance sector supervised by the Insurance Supervision Agencies of the Federation of Bosnia and Herzegovina and the Republika Srpska.** The analysis was carried out as part of the 2014 Financial Sector Assessment Program (FSAP) of Bosnia and Herzegovina, and was based on the regulatory framework in place, the supervisory practices employed, and other conditions, as they existed in November 2014. The work was carried out by Dr. Rodolfo Wehrhahn, IMF consultant.
- 3. Regulation and supervision practices, supervisory data, and financial ratios were used to assess the resilience of the insurance sector.** The ICPs were grouped into different areas and, within each area, the standards having relevance to the financial stability of the insurance sector were assessed. Where weaknesses were identified, they were indicated and the corresponding recommendations to address those weaknesses were provided. Insurance data was examined to gain an understanding of the current financial condition of the sector. Risks and the mitigating tools applied by the supervisors and the industry were analyzed and the remaining vulnerabilities reported.
- 4. The supervisors of the two entities were evaluated independently.** The institutional framework, preconditions and the market description of BiH were discussed together for both entities; where necessary differences were indicated. The executive summary and the main recommendations’ table with the responsible implementing agency are also jointly provided. However, the assessment that led to the complete table of recommendations was carried out for each entity separately.
- 5. The assessor is very thankful to the staff of the supervisory agencies in both entities as well as to the insurance agency of Bosnia and Herzegovina, market participants and experts.** The analysis benefited from extensive and open discussions provided by the authorities and the management of interviewed insurers, associations and experts.

¹ Prepared by Dr. Rodolfo Wehrhahn, IMF consultant.

INSTITUTIONAL, REGULATORY, AND MARKET STRUCTURE

A. Institutional Framework and Arrangements

6. Two supervisory systems and a coordinating agency were assessed during the FSAP.

Bosnia and Herzegovina (BiH) encompasses two autonomous entities: the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska, (RS) with a third region, the Brčko District, governed under local government. The country is run in a highly decentralized manner. It has a bicameral legislature and a three-member Presidency composed of a member of each major ethnic group. There is a third administratively independent area with a population of about 90,000, the Brčko District that is not covered by the FSAP.

7. The BiH financial sector has independent supervisory agencies in each autonomous entity. In the spirit of the decentralized structure governing the country, the financial sector regulation has created supervisors in each autonomous entity. The RS Insurance Supervision Agency for the insurance sector (RS-ISA), the RS Banking Agency for the banking sector, and the RS Securities Commission are responsible for supervising the financial sector in the RS. In the FBiH, similar supervisory agencies have been established. The FBiH Insurance Agency (FBiH-ISA), and the corresponding supervisors for the banking sector and the securities market, supervise the financial sector in the FBiH.

8. A state-level regulatory insurance agency is in charge of coordination and external affairs. The BiH Insurance Agency (BiH-IA) was established at the state-level in 2004. The BiH-IA has the mandate to act as a coordinating agency, but is also responsible for monitoring the harmonization with respective EU-level legislation. It also consolidates insurance sector statistics for both entities, resolves possible conflicts of jurisdiction arising between the two ISAs when supervising branches of the insurers domiciled in the other entity, and is the representative body for international matters. The BiH-IA, together with entity level agencies, is in the process of preparing MoUs to enhance information exchange with foreign supervisors. While none has been signed so far, information is exchanged with relevant supervisors in certain situations (e.g., on supervisory colleges, or when assessing fit and proper of foreign insurance companies).

9. The BiH entities each have their own legal system. The legislative framework for the insurance activity in both entities comprises of the following laws and their corresponding secondary by-laws:

- the Law on Insurance Companies (LIC),
- the Law on Insurance Companies Private Insurance (LICPI),
- the Company Law,
- the Federation Company Law,

- the Standards of Corporate Governance adopted by the Securities Commission (which apply to all joint-stock companies listed on the Stock Exchange that includes all insurers listed on the Banja Luka Stock Exchange),
- the Law on Obligations (Contract Law),
- the Law on Intermediaries (LoI),
- The Law on Intermediaries in Private Insurance (LoIPI),
- the Law on Bankruptcy Proceedings,
- the Law on Liquidation Proceedings,
- the Law on Consumer Protection, and
- the law on Motor Third Party Liability.

10. The regulatory framework for insurance is similar in both entities. The insurance legislation has common origins and with the creation of the BiH-IA all newly enacted regulation will need to be checked by the BiH-IA to ensure harmonization with the intention of converging with the EU insurance directives. The four main laws that regulate the insurance activity, the Insurance Law, the Contract Law, the Law on Intermediaries and the MTPL law present only minor differences as legislative amendments are carried out at a different pace in the entities. The existing differences and possible implications on supervision are reflected in the assessment that contains separate chapters for each entity and supervisor.

11. Market discipline is weak. Effective market discipline requires two conditions: high level of disclosure of the key parameters of the insurers, and sufficient understanding by market participants about the information disclosed. The disclosures follow IFRS. These public disclosure requirements have helped to reach a reasonable level of transparency in the RS but not in the FBiH. Also, financial literacy in the population is low. Notwithstanding the efforts undertaken by the ISAs, no institutionally organized approach to financial education of the population is in place.

12. The financial market in BiH is underdeveloped and illiquid, limiting the investment choices for insurers. There are two stock exchanges one in each entity. The securities market is undeveloped and small. The number of listed companies is large but the daily volume of trades range from KM 5,000 to KM 13,000 in the two entities. In addition, while foreign investment is allowed subject to approval by the ISAs, there are limits on foreign assets for covering technical reserves. As a result, the investments of insurance companies are dominated by bank deposits and real estate.

13. The accounting and auditing frameworks are established by the law. In both entities, the Law on Accounting and Auditing requires the use of the International Accounting Standards (IAS), and the International Financial Reporting Standards (IFRS). This law regulates accounting and auditing activities, the acquisition of titles, qualification and licensing in the accounting and auditing professions, the organization and functioning of the bookkeeping and accounting system, preparation and presentation of financial statements, audits of financial statements, establishment of the Chamber of Auditors in each entity. The Ministry of Finance grants working permits to auditing firms. Auditors of insurance companies need to be approved annually by the RS-ISA but

not by the FBiH-ISA. The FBiH-ISA operates through the Chamber of Auditors to replace poorly performing auditors. Professional associations of accountants and auditors in both entities have been established and the associations are members of the International Federation of Accountants (IFAC). Notwithstanding several requirements to evaluate the quality work of given auditors by the ISAs, the Chamber of Auditors has yet to create the corresponding quality control committees. It is recommended establishing quality control committees for auditing work.

14. The actuarial profession is developing fast. Regulation requires that every insurance company appoints an actuary responsible for signing off on technical matters. Composite insurers need to appoint two actuaries, one for life business and one for nonlife. The same actuary can be the appointed actuary of several companies as well as covering both life and nonlife businesses. The work of appointed actuaries is regulated by insurance laws in both entities. In addition, the ISAs have passed and published the Rules on the Conditions for the Performance of Actuarial Tasks. These Rules regulate the acquisition and revocation of the title of appointed actuary. The Actuarial Association in FBiH is a full member of the International Actuarial Association (IAA) as of 2012 and the Actuarial Association of RS is an associate member of the IAA and will be admitted to full membership after the implementation of continued education is completed. Currently, 30 actuaries are registered in the RS-ISA and 24 in the FBiH-ISA.

15. MTPL insurance policies are protected by Protection Fund. It has been established in each entity by the corresponding law on MTPL to cover the damages suffered by victims of traffic accidents who cannot be otherwise compensated by the system of compulsory automobile liability insurance if:

- the person responsible for the accident is unknown, (compensation only in respect of damage to persons);
- the accident is caused by an uninsured vehicle; and
- a legitimate claim cannot be paid on account of the bankruptcy or liquidation of the relevant insurer.

The Protection Fund is responsible up to the amount specified by the Law on MTPL; the secured amount per insured event shall not be less than the amount of: (i) damage to persons KM 1,000,000 regardless of the number of victims involved in the same accident, (ii) damage to property KM 350,000 per one event regardless of the number of claims arising from the same accident. All insurance companies licensed to conduct auto liability insurance in BiH, regardless of whether they have registered offices in RS or FBiH, are members of the corresponding Protection Fund.

16. The Protection Fund is governed by the Members' Assembly, a Board of Directors and the Director. The Protection Fund is financed by contributions from all its members. The contributions are calculated as a percentage of the MTPL annual premium. The rate of the contribution is determined by a decision of the Management Board of the RS-ISA in the RS and in the FBiH by the Director of the FBiH-ISA. All revenues of the Protection Fund are used for payment of injured third parties in accordance with the Law on MTPL and for financing the costs of administering the Protection Fund. The evolution of the contribution rate over the last three years is shown in Table 2.

Table 2. Bosnia and Herzegovina: Rate of Contributions to the Protection Fund

(As a percentage of MTPL premiums, 2011 -2013)

Rate of contributions	2011	2012	2013
RS	1.61	1.57	1.82
FBiH	2.6	1.9	1.8

Source: Authorities.

17. Insurance data is available to support insurance business and effective regulation. Both ISA web-pages contain relevant information on the insurance sector. The BiH-IA publishes detailed annual data on the insurance market. In addition, in both entities, the corresponding Institute of Statistics keeps the basic economic, financial and company statistics. A large amount of data is available to individual insurers in MTPL and in the RS this information is used to apply *bonus-malus* pricing.

18. The industry is represented by two insurance associations. The Association of Insurance Companies in the FBiH and the Association of Insurance Companies of RS (which is part of the RS Chamber of Economy) are established as non-statutory associations, a state level insurance association mentioned in the law has not been created. Membership of each association is open to all insurance companies active in BiH. The main purpose of both associations is to represent their members, advocate for their interests and comment on forthcoming regulation. The insurance association in the RS, founded in 2009, has collected fees only since 2013 and needs substantial development before it can be instrumental to support the supervisory work. The insurance association in the FBiH was founded in 2006 and is well organized, has issued a code of business ethics for its members, enforced by a court of honor and has strong lobbying power. Currently, the association in FBiH has proposed a new draft of the MTPL law that has reached the BiH-IA for its approval.

19. For the banking sector, a state-level Standing Committee on Financial Stability (SCFS) has been established. Its members are the Fiscal Council, CBBH Governor, the directors of both banking agencies, and the director of DIA. The creation of the SCFS formalized the cooperative arrangements for financial stability, crisis preparedness and management through the signing of a Memorandum of Understanding (MoU). The insurance supervisory agencies, however, are not members of the SCFS. It is recommended to include the ISAs in the SCFS to gain a better understanding on financial sector stability matters.

20. The Judiciary in the Federation of Bosnia and Herzegovina is governed by the Law on Courts in the Federation of Bosnia and Herzegovina (FBiH Official Gazette, no. 38/05, 22/06, 63/10, 72/10, 7/13 52/14). This Law governs the following areas: organization, competences, financing, judiciary administration and other issues of significance for the organization and

operation of municipal courts, cantonal courts and the Supreme Court of the FBiH. Municipal courts are established for the area of one or more municipalities within a canton. There are 10 cantonal courts, one for each canton. The Federation Supreme Court is the highest appeal court in the FBiH. A municipal court has jurisdiction relevant to insurance matters to adjudicate in the first instance on criminal offences punishable by a fine as the main sanction or up to 10 years imprisonment, unless otherwise another court is prescribed by under a different law. For commercial cases, municipal courts comprising commercial law departments, arbitrate in the first instance in cases relating to the rights and obligations attached to legal transactions. The decisions of the municipal courts can be appealed to the cantonal courts and the decisions of the cantonal courts appealed to the Federation Supreme Court. The Federation Supreme Court and cantonal courts may institute proceedings before the Constitutional Court of the Federation of Bosnia and Herzegovina, or the Constitutional Court of Bosnia and Herzegovina, in accordance with the Constitution and applicable regulations that govern the proceedings before the Constitutional Court.

21. For the RS courts, the organization, jurisdiction and functioning is prescribed by the Law on Courts of the RS (Official Gazette of RS, No. 37/12). The judicial authority in the RS is exercised by the courts of universal and special jurisdiction. The courts of universal jurisdiction are Basic Courts, District Courts and the Supreme Court. The Basic Courts are formed for the territory of one or more municipalities, and the District Courts are formed for the territory of two or more Basic Courts. In the RS, there are a total of 28 Basic Courts and 8 Departments of Basic Courts, formed outside of the seat of the Basic Courts, and 5 District Courts. The Supreme Court of the RS is the highest court in the RS. The courts of special jurisdiction are District Commercial Courts and the Higher Commercial Court. District Commercial Courts, as first-instance courts and these are formed for the territory covered by the District Courts, while the Higher Commercial Court, as the second-instance court, is formed for the territory of the RS. In the RS, there are five District Commercial Courts.

22. The RS-ISA appears before the Basic Courts mainly for misdemeanors. The LIC, the Insurance Mediation Act and the Motor Vehicle Liability Insurance and other Mandatory Liability Insurance Act specify misdemeanor offences and set fines for misdemeanor offences committed by insurance companies and responsible individuals in insurance companies as well as by insurance mediators. The Basic Courts are first instance courts, and the appeals filed against decisions of the Basic Courts are decided by District Courts, which are second-instance courts.

23. District Courts have jurisdiction over failure to fulfill obligations that intermediaries have acquired under the Insurance Mediation Act. District Courts have jurisdiction over first instance civil law cases, among other cases, relating to the sale of goods, services, securities, ownership and other rights over properties etc. in which both parties to the proceedings are a legal entity or an individual who, in the capacity of entrepreneur or a different capacity, carries out an economic or any other registered activity, as a core business activity or a secondary activity. This jurisdiction is important from the aspect of work of the RS-ISA given the fact that insurance agents, under the Insurance Mediation Act, may get organized as independent insurance entrepreneurs, in which case they acquire certain rights and obligations towards the RS-ISA. The consequence of the

failure to fulfill these obligations is the filing of a complaint on the part of the RS-ISA and the initiation of a procedure before the district court. The RS district commercial courts have jurisdiction for conducting first instance bankruptcy and liquidation proceedings, as well as for all disputes that arise in the course of and due to the conducting of bankruptcy and liquidation proceedings of a business entity.

B. Market Structure

24. The insurance sector in BiH remains small (Table 3). In 2013, the assets of the insurance sector amounted to KM 1,234 million or 4.9 percent of the financial sector assets. Total premium in 2013 amounted to KM 527 million, an increase of 4.3 percent from 2012 (2 percent nonlife and 15 percent life). The nonlife segment collects over 80 percent of the insurance premium and two-thirds relates to MTPL. Investments account for 72 percent of the assets of which over 67 percent are held in bank deposits. Real estate investments and receivables make up for 32 percent of assets (18.5 percent receivables 13.5 percent real estate).

Table 3. Bosnia and Herzegovina: Insurance Sector, Key Indicators 2009–2013
(In KM million)

	2009	2010	2011	2012	2013
Total assets	1006.87	1011.32	1076.77	1173.79	1234.16
Gross Premium	458.85	470.45	488.11	505.09	527.03
Investments	647.10	666.95	725.35	801.73	892.70
<i>of which:</i>					
Government securities	10.73	18.97	27.25	36.72	56.13
Corporate securities	3.41	6.44	0.00	0.13	0.05
Equities	43.03	37.89	33.01	30.67	31.97
Real estate and real-estate related	162.70	137.42	144.22	154.79	165.58
Cash and bank balances	347.07	380.14	433.76	495.67	571.51
Receivables	144.47	122.13	122.69	132.68	105.25
Intra-group/related company receivables	19.77	13.58	16.10	16.80	13.37
Reinsurance recoverables	82.43	94.64	94.85	108.57	109.83
Other assets	105.71	106.31	109.01	104.45	102.37

Source: Authorities.

25. Insurance usage remains low in global terms and BiH has the lowest expenditure per GDP on insurance when compared with peers in the region. Insurance premium is about 2.1 percent of GDP which is about half of the OECD countries' average insurance penetration. Insurance density is the lowest in the region, with USD 80 of annual expenditure per capita, 55 percent of which is attributable to mandatory insurance. Comparisons of the levels of insurance penetration and density between BiH and other countries in the region are shown in Table 4. The low usage of insurance results in vast uninsured risks. For instance, in the latest flood with an

estimated loss of KM 4 billion, only five percent of the losses were insured, of which over 80 percent were reinsured. Growing the sector will need a comprehensive strategy addressing financial literacy, trust and incentives in the use of insurance.

**Table 4. Bosnia and Herzegovina:
Regional Comparison of Insurance Usage 2013**

	Penetration	Density
BiH	2.1	80.2
Bulgaria	2.1	156.0
Czech Republic	3.8	760.0
Croatia	2.7	372.0
Romania	1.4	124.0
Slovakia	2.7	506.0
Slovenia	5.6	1309.0
Serbia	1.8	104.0

Source: Swiss Re Sigma and Authorities.

26. The further development of the insurance sector will depend on economic growth, and the set of right actions. Due to the relatively large MTPL business and the high compliance with this insurance coverage, the nonlife premium growth is strongly correlated to the number of cars and hence with the economic growth. On the other hand, the development of the life sector, in particular the long-term insurance will require strong incentives to motivate people to postpone present consumption in favor of taking long-term insurance coverage. Building trust in the industry will also be relevant for the development of the sector, as well as the reduction of frictional costs due to lack of harmonized regulation.

27. There are differences in the markets in each entity and as such, the analysis has been carried out individually in the corresponding section.

KEY FINDINGS

28. Ten insurance companies, accounting for 40 percent of the nonlife market, have solvency margins that are close to require supervisory minima. Currently two insurers accounting for 10 percent of the market are insolvent and eight insurers accounting for just over 30 percent of the market have a solvency ratio between 100 percent and 110 percent. The resilience of the sector could be even worse given that Solvency I requirements do not fully allocate capital according to the risks assumed. In addition, a few insurers have solvency ratios that are not covered by liquid assets within the limits of the regulation and some nonlife combined ratios (claims plus expenses over premiums) are above 100 percent suggesting that profits are linked to investment performance, but the yields on investments are falling. While liquidity is not a systemic risk for the sector that has on average over 50 percent of their assets in bank deposits, a few insurers are heavily

exposed to real estate and/or hold large amount of receivables. Life business is a recent development and as such, interest risk in the sector is currently not relevant.

29. MTPL insurance remains under pressure, with market participants not always in compliance with the statutory tariffs and commission limits. The fragmented nonlife insurance market with premium well distributed among the participants has increased competition. This has led in some cases to insufficient premium for the risks assumed. Market participants bypass the regulation that fixes not only the tariff but also the commissions by paying additional non-regulated expenses for instance in the areas of administration and servicing. The balance sheets of some insurers show an increment in DAC and other accounting positions that have flexibility to offset insufficient premium. The use of *bonus malus* is applicable in only one entity. The level of the technical provisions heavily relies on the appointed actuaries and regulation does not require an external actuarial audit. Actuarial reviews have been carried out but a market wide independent review of the technical provision is due.

30. Having close to fifty percent of the insurance sector assets in bank deposits creates a relevant exposure to the banking sector that needs to be monitored. The FBiH-ISA requires insurers to hold 50 percent of the minimum guarantee fund in bank deposits. The RS-ISA requires liquid assets to cover the minimum guarantee fund that ultimately result in large bank deposits. The total exposure of the insurance sector assets is KM 587 million. It becomes relevant for the insurance supervisors to have access to the relevant information on the financial condition of the banks. It is recommended to establish a formal regular channel of information with the banking supervisor to gain timely information on the financial soundness of all banks holding above a threshold of the insurance sector assets.

31. In both entities, regulation of the insurance sector has improved. However, the level of harmonization in the regulation between entities and the EU respective directives is still insufficient. The insurance legislation has common drafting origins and with the creation of the BiH-IA all newly enacted regulation is monitored with the intention to converge with the EU insurance directives. The initial four main laws that regulate the insurance activity, the insurance law, the contract law, the law on intermediaries and the MTPL law do not have significant differences, and the ability for an insurance company to operate with a branch cross entities is now well regulated and fully harmonized. The amendments to the laws, however, have been carried out at a different pace in each region, resulting in differences in current legislation. The existing dissimilarities and their implications on the effectiveness and decisiveness of the supervision are reflected in the assessment.

32. Since the 2006 FSAP, each insurance supervision agency have shown progress, albeit at different speed and from different starting points (Appendix I):

- **The last FSAP found the insurance supervision in the RS basically non-existent with the recently created Insurance Supervisory Agency in the RS (RS-ISA) un-operational.** Since then, commendable progress has been achieved: its initial staff has been doubled through hiring a mix of professionals with legal and actuarial backgrounds, operational processes and internal

controls as well as supervisory and inspection manuals are in place, the RS-ISA is positioned to supervise the market. Over 30 by-laws have been enacted; the onsite comprehensive inspections that were non-existent at the last FSAP are now taking place and market wide focused inspections have been carried out. A varied range of supervisory corrective actions has been taken and fines have been successfully imposed, on insurers and also on physical persons. Technical aspects concerning prudential matters have been established adopting the Solvency I framework.

- The Federation of Bosnia and Herzegovina Insurance Supervision agency (FBIH-ISA) took over the function of the old Insurance Supervision agency (ISA), which had been operating in Sarajevo since 1997.** This situation had the advantage of providing the FBIH-ISA with some experienced staff but also with a legacy that hindered its adopting a fresh strategy according to the new mandates. Since the 2006 FSAP, progress has been limited: five additional staff members were added to the twelve persons but only nine persons are dedicated to supervision, with the assistant director as the only actuary. Operational processes and internal controls are in place, however supervision and inspections manuals have not been developed and supervision heavily relies on the experience of senior staff. Over 80 reporting forms and several instructions and bylaws have been issued that provide the FBIH-ISA with sufficient information for offsite supervision. However, a centralized IT system that would support proper onsite supervision is not available. Onsite comprehensive inspections are taking place as well as market wide focused inspections have been carried out. Varied ranges of supervisory corrective actions have been taken and the licenses of three insurers have been revoked. These companies are in the process of liquidation. Technical aspects concerning prudential matters have been established adopting the Solvency I framework.

33. Notwithstanding the progress made by the ISAs, important challenges remain. The establishment of new ISAs, and making them operational, has required significant efforts. However, the international supervisory practices and prudential regulations have meanwhile evolved. In particular, Solvency I has been complemented with risk sensitive capital surcharges and Solvency II will be implemented in the EU soon. Harmonizing the BiH regulation with the EU framework will continuously require significant efforts by the ISAs to catch up with new international standards. Risk based supervision, group wide supervision, as well as macroprudential surveillance will need to be introduced to meet the new regulatory and supervisory standards. Consumer protection policies and gaps in financial literacy need to be decisively addressed.

34. Several weaknesses have been identified that, when removed, will enable effective supervision:

- The prudential framework will need to be updated once the MTPL tariffs are liberalized or the market grows or becomes more complex.** The current framework that follows Solvency I is not risk sensitive and as such is not appropriate for modern supervision necessary to supervise more complex markets or markets without fixed tariffs. Currently, the authorities together with the World Bank are working on the liberalization of MTPL tariffs. The liberalization of the tariffs will probably benefit consumers, however to avoid creating instability in the sector, such step

should only take place once the supervisors have implemented early warning systems, stress testing and a risk sensitivity solvency with the corresponding ladder of interventions that could trigger prompt corrective actions.

- **Consumer protection policies and gaps financial literacy have to be addressed urgently.** Both supervisory agencies handle complaints but with inadequate resources. An ombudsperson for the insurance sector is appointed in the RS but not in the FBiH. The regulation has some elements to protect consumers: It requires pre-contractual information in a clear and accurate form, the term to pay claims is regulated to be no more than 14 days or 30 days depending on the business line. However, there is scope to move consumer protection to a higher level.
 - Regulation should be issued and implemented that:
 - requires insurance companies to take into account the interests of different profiles of clients in the development and marketing of insurance products;
 - requires insurance companies and intermediaries to promote products and services in a way that is clear, fair and not misleading; and
 - requires insurers and intermediaries to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture.
- **Alternative dispute resolution mechanism for policyholders should be implemented.** The resources and powers of the ombudsperson in one entity need to be significantly increased. In the other entity, the ombudsperson with the sufficient resources and powers to proactively resolve insurance consumers' small claims and complaints should be appointed.
- **A national strategy to raise the financial literacy of the population in insurance matters should be developed.** This effort will require the participation of all stakeholders and consideration should be made whether the Insurance Agency should take the lead on this initiative.
- **The independence of the FBiH-ISA needs to be safeguarded and, in both ISAs, staff members need to enjoy clear legal protection.** The FBiH-ISA is understaffed to discharge its obligations. With no seed-funding the agency had to spend a great amount of the budget to acquire the offices and the reserves that have been accumulated will be used to acquire an IT system. The number of staff has increased from 12 in 2007 to 17 nine of whom, including an actuary that is also the assistant director are involved in supervision. The offsite inspections happen with significant delays and only the companies under supervisory measures are on a more frequent observation. Actuarial reviews have only started in the last 12 months. The appointment of the new director is not following the requirement as stipulated in the law to be proposed by the MoF, including insurance experience. The overdue revision of the insurance law is delayed and a proposed MTPL law was presented to the insurance agency without the FBiH-ISA or the MoF involvement. In the case of the FBiH-ISA, legal protection is provided only to the director but not to all supervisory staff and the legal defense costs in both ISAs are not clearly assigned to the corresponding ISA.

- **Group supervision needs to be developed.** To cover related party transactions, a rulebook on supplementary group supervision was issued in 2007 in the FBiH. According to the rulebook, insurers belonging to an insurance group are required to report on the group structure, provide the financial statements of the group, as well as details of material transactions among the group entities and other related parties. The insurer subject to supplementary group supervision is required to adjust the solvency calculation discounting related party transactions as well as the minimum capital requirements of the entities of the group. The RS has set stringent limits on related party transactions or does not allow them to be included as liquid assets. However, regulation and supervision of insurance groups needs to be improved by widening the scope of supervision and providing broader powers to the supervisor. These powers should, as a minimum, allow to inspect and supervise holding companies, limit intra-group transactions and require fit and proper control positions of the holding company. As a further step, a comprehensive group supervision framework including group capital requirements should be implemented.
- **Minimal requirements on governance structure are present in the insurance laws.** Basic mandatory governance bodies are required for insurers. Accordingly, insurers should establish the shareholders assembly, have a director, the board of directors and have an auditing body. The corporate governance requirement for insurers thus lacks qualitative elements. There is room for improvement in the areas of:

 - the board structure with the corresponding committees, governance standards, board composition and knowledge, and assessment of the effectiveness of the board;
 - remuneration policy of board members and senior management;
 - duties of individual board members including acting in the best interests of the insurer and policyholders;
 - timely and effective communication with the RS-ISA and relevant stakeholders (including policyholders) on the governance structure of the insurer.
- **A few key supervisory powers are missing in both ISAs.** In both ISAs, the power to remove members of the insurance company's supervisory board is missing. The RS-ISA lacks the power to enforce the suspension of the voting rights of qualified shares acquired without the ISA approval. The FBiH-ISA's ability to appoint a temporary administrator without withdrawing the license of an insurer needs to be elaborated to provide for legal certainty. The addition of these powers is recommended.
- **The macroprudential supervision is limited to analysing market trends affecting the insurance sector.** Both ISAs have performed market-wide analysis on the MTPL business and also carried out market wide inspections based on findings in a few insurers. Macroprudential tools have not been developed and market wide stress tests are required. There is no framework to define systemic risk in the sector. As the insurance sector develops, consideration should be made to introduce a macroprudential supervision framework. The insurance agency should be considered as the institution developing macroprudential tools. The ISAs at the regional level should be responsible for implementation.

THE FEDERATION OF BOSNIA AND HERZEGOVINA

INSTITUTIONAL, REGULATORY, AND MARKET STRUCTURE

A. The Supervisor

35. This section covers the supervisory objectives powers and responsibilities. The pertinent ICPs are ICP 1 and ICP 2 which cover the set up and mandates of the supervisor as well as its operational independence. Aspects of ICP 3 and ICP 25 are related to the exchange of information, and ICP 26 is related to cooperation in crises are also discussed.

36. The objectives of the supervisor are clearly set in the legislation. Article 6 of the LICPI sets out that the principal objective of the supervisor is to protect policyholders and insurers for the benefit of the insurance industry, the maintenance of a safe and stable sector where there is trust in the insurance function.

37. The provisions of articles 5 to 8 of the LICPI stipulate the establishment of the insurance supervision agency of the FBiH (FBiH-ISA). The FBiH-ISA was created as an independent and non-profit institution of the FBiH accountable for its operations to the government of the FBiH. The FBiH-ISA has regulatory and supervisory functions and it issues and revokes licenses for insurers and intermediaries. It is managed by a director appointed for a term of 4 years responding to the Experts Council. The Experts Council consists of the chairperson and four members who are appointed for a period of 5 years and can be dismissed by the FBiH government at the proposal of the Federal Minister of Finance. The procedures for appointment and dismissal including the grounds on which a person can be dismissed are stated in the LICPI. The Experts Council, pursuant to article 10 of the LICPI, passes the Statutes of the Agency with the approval of the BiH Federation government and adopts all bylaws as stipulated by the LICPI.

38. The FBiH-ISA is managed by the Director. The Director represents and acts on behalf of the FBiH-ISA and is responsible for its lawful work and operations and pursues other activities falling within his/her competence under the law, the statutes or some other act. All supervisory decisions are taken by the director. The requirements for the position of the Director are stated in article 30 of the LICPI :

- a university degree - VII degree in humanities,
- at least 8 years of work experience in the profession on the same or similar tasks, of which at least 5 years in managerial positions,
- possession of managerial and organizational skills,
- high personal integrity and reputation gained as an expert in the field of insurance.

The deputy director position would enhance the operational continuity of the FBiH-ISA and its introduction is recommended.

39. The Director's term coincides with the government elections. The appointment and dismissal of the director is normally carried out by the Federation government at the proposal of the Federal Minister of Finance. To add independence to the ISA, it is recommended to avoid the government election cycle to coincide with the director's term. In addition, the requirements for the director for insurance expertise, as well as the requirement that the director is proposed by the MoF and approved by the government should be respected.

40. The FBiH-ISA publishes externally audited financial statements annually and reports to the Government on a regular basis. The audited financial statements are adopted by the Experts Council and then approved by the Government. There is no internal audit function. The decisions of the FBiH-ISA can be appealed to the administrative court and this has happened. It is recommended creating an internal audit function.

41. The FBiH-ISA is organized in two sectors and has a staff of 17 of which nine are supervisors. The FBiH-ISA operates with two sectors: (i) the financial supervision and accounting sector (7 people), and (ii) the licensing and administration sector (9 people). The licensing and administrative sector consists of two core departments (the legal and the investments) and the technical supervision department. The internal organizational structure with the corresponding hierarchy is defined by the internal regulation of the ISA. Each position has a description of the qualification requirements, its task and responsibilities. A code of ethics exists and has to be signed by every employee. On an annual basis, a working plan, which covers all its activities, is adopted by the Experts Council and approved by the government. The ISA web page publishes market information as well as all regulation that is final. It is recommended to publish also draft regulation, thus allowing for an additional channel to get comments from the public.

42. The FBiH-ISA is understaffed to discharge its obligations. The funding of the FBiH-ISA is through industry levies that are linked to the premium and licensing fees. The budget has increased since 2006 from KM 1.239 million to around KM 1.996 million in 2014. The initial funding for the setup of the agency was not available and hence a great amount of the budget has been used to purchase the offices of the ISA and reserves that have been accumulated will be used to acquire an IT system. The number of staff has increased from 12 in 2007 to the current level of 17 of which nine persons including an actuary, who is also the assistant director, are involved in supervision. External experts are hired to support staff on their supervisory activities. While the FBiH-ISA is authorized to engage professionals if needed, the lack of permanent staff hinders effective, consistent supervision and the intensity is dictated by the staffing limitation rather than by the supervisory needs. It is recommended to develop a strategy to increase the number of dedicated resources to supervision and consider outsourcing of administrative work if limitations on the number of headcount exist. There is urgent need to hire actuaries. The FBiH-ISA should explore other funding for IT and use the fees for supervisory work rather than for infrastructure.

43. The legal protection of FBiH-ISA staff needs to be strengthening. Under the provisions of article 9 of the LICPI and the Statutes of the FBiH-ISA, the director will not be legally liable to third parties for any action taken or omission made in good faith while performing the functions of the Supervision Agency. Notwithstanding the above, the director will be liable to the FBiH-ISA for the

loss caused by any act or omission under the provisions of the Law on Contracts and Torts. There is no provision established for employees. It is recommended updating the law allowing the FBiH-ISA only to be sued as an institution and not the staff. If that appears not to be possible, at a minimum the legal protection enjoyed by the Director should be extended to all FBiH-ISA staff. The law should also specify that it is the FBiH-ISA that bears the expenses to defend staff sued on performing its duties.

44. The confidentiality of the information gathered by the FBiH-ISA is well protected, but the IT integrity and protection is done in-house with one person. The provisions of article 18 of the Law deal with the protection of confidentiality of information held by FBiH-ISA, including all confidential information held by the FBiH-ISA, and propose penalties for disclosure of confidential information. For instance, article 18 of the LIC states: *“All persons who are currently employed or who have been employed in the Agency of FBiH, as well as the auditors and experts hired by the Agency of FBiH, shall have the obligation of professional secrecy. None of the confidential information received during the performance of their duties may be disclosed to any other person or authority, except in total and cumulative form such that the identity of the individual insurance companies cannot be identified, without prejudging cases covered by criminal law.”*

The IT system integrity and protection is assigned to one person in the FBiH-ISA. It is recommended to boost the IT function, in particular if done in house. As an alternative, the IT could be outsourced to a reputable firm and constantly monitored by the in-house expert.

45. The FBiH-ISA is authorized to exchange information with other supervisory authorities. Pursuant to the provisions of article 18 of the LICPI, the FBiH-ISA is authorized in accordance with the provisions of the LICPI to exchange with the RS-ISA all the documents and information useful for the implementation of supervision of companies which operate both in the FBiH and the RS. Pursuant to the law, exchange of information is also permitted between the FBiH-ISA and within the FBiH and:

- the authorities in charge of supervision of credit institutions and other financial institutions and the authorities in charge of supervision of the financial market;
- bodies involved in the liquidation and bankruptcy of companies and in other similar procedures; and
- persons responsible for conducting statutory audits of the accounts of companies and other financial institutions, in the discharge of their supervisory functions, or the disclosure to bodies which administer compulsory winding-up proceedings, or to guarantee funds, of information necessary for the performance of their duties.

The information received by those authorities, bodies and persons is subject to the requirements of professional secrecy. The competent bodies of the parliament of the BiH, on the terms laid down by the LICPI, authorize the disclosure of certain information needed to conduct an investigation to the federal authorities responsible for credit, financial, investment and insurance companies, as well as to inspection bodies of the FBiH.

46. The establishment of a Coordinating Committee for the financial sector supervisors is recommended. Members of the Committee should be at the highest level of each supervisory agency: the Minister of Finance, the Director of the Securities Commission, the Director of the Banking Supervision Agency, and the Director of the Insurance Supervision Agency. The main powers and activities should be creating a formal platform for coordination and regular formal supervisory information exchange among its members. With time and if seen necessary this Coordinating Committee could evolve into an integrated supervisor for the whole financial sector.

B. Supervision

47. This section covers the quality and effectiveness of supervision. The pertinent principles are ICP 9 that looks into general aspects of offsite and onsite supervision; ICP 10 about the preventive measures available and used by the supervisor and ICP 11 that evaluates the enforcement ability of the supervisor. There is no group supervision framework in place as required by ICP 23. Macroprudential supervision is also discussed (ICP 24).

Offsite Supervision

48. The FBIIH-ISA obtains a wide range of information to perform offsite supervision.

- data recorded in the register of insurance companies;
- financial statements and the annual business report, with the opinion of a certified actuary and of the organs in the insurance company who perform oversight, with explanation;
- audit report with management letter;
- work program and reports of internal audit;
- report on implementation of coinsurance and reinsurance policy, with the opinion of certified actuary;
- business plan, articles of association and other bylaws and their amendments;
- adopted business policy actions, as well as all amendments to these acts, regarding which a certified actuary previously provided his opinion;
- notice of the appointment or change of certified actuary and internal auditor, as well as notice of employment or change of actuary and internal auditor;
- notice of convening the shareholders' meeting and the records from the shareholders' meeting; and
- other information, reports and data defined by the regulations governing the field of insurance.

49. Extensive information and data with a frequency determined by the FBIIH-ISA is available to the supervisor. Data in the format as determined by the FBIIH-ISA is required from insurers and intermediaries on a monthly, quarterly, and annual basis. For this purpose, the FBIIH-ISA

has issued a series of reporting guidelines and developed over 70 reporting forms to standardize the collection of data:²

- Decision on reporting by insurance companies;
- Decision on reporting by insurance intermediaries;
- Decision on reporting by the protection fund;
- Decision on the Form and Content of and format of financial reports by insurance companies,
- Rulebook on the Amount and Method of Investment for Covering of the Technical Reserves and Guarantee Fund of Insurance Companies;
- Rulebook on Elements and Control of Solvency Margin of Insurance Companies;
- Rulebook on Liquidity; and
- Instruction on valuation of the Balance and Off-balance Items.

Current insurance legislation does not contain requirements with regard to outsourcing. The inclusion in the regulation on the reporting of outsourced activities is recommended.

50. The FBiH-ISA receives the data in electronic form but lacks a centralized IT system for processing. Electronic submissions are required, however the FBiH-ISA does not have an IT system to capture the data and produce automatic reports. The FBiH-ISA has been using the budget to accumulate the money for the acquisition of an IT system. The procurement of such a system is currently taking place. It is recommended the acquisition of a modern IT system that will allow for efficient offsite supervision.

51. Liquidity shortages have to be reported immediately. Liquidity ratios are reported on a monthly basis but companies are required to monitor liquidity on a daily basis. If the ratio falls below the minimum level, the ratio is to be reported immediately (next working day) together with the explanations and effective remedial plan that clearly identifies the sources of new funds. The liquidity ratio that is currently used, however, does not properly reflect the liquidity situation of the companies. The ratio allows the use of the assets that are backing the technical provision as liquid assets, disregarding their subordinated condition to be used for covering the technical provision (see Appendix II). A revision of the liquidity ratio that excludes assets dedicated to cover the technical provision is recommended.

52. The offsite supervision process uses the reports received from the insurers for:

- verification of compliance by insurers with the requirements of the regulation;
- identification of risks and negative trends in the business of insurers;
- performing a qualitative and quantitative analysis of the activities of insurers;
- starting an intervention in the operations of insurers whose financial condition does not meet the established requirements or shows signs of deteriorating; and

² See Appendix for an example on a reporting form for the coverage of the technical provisions and minimum guarantee fund.

- to decide on extraordinary onsite inspections.

53. The offsite supervision needs to improve its processes and increase its frequency. The FBIH-ISA processes a set of basic indicators manually to analyze the soundness of insurers. The lack of IT systems and limited staff (the offsite reporting is analyzed only by two experts), results in inefficient, infrequent and informal offsite supervision. While receiving monthly data only every 6 months, comprehensive written reports of the insurers are produced. On a quarterly basis, the offsite supervision focuses on the insurers that are under supervisory measures to follow up on their implementation. The quarterly discussions on the analysis of the insurers are carried out orally and no written records of the discussion are produced. The FBIH-ISA is recommended allocating sufficient resources and using appropriate IT systems to produce timely offsite reports on all insurers. Any decision-making meeting where the conditions of the insurers are discussed should be documented. In a further step, the development of an early warning system by introducing a robust set of indicators, both quantitative as well as qualitative that are calibrated to the market conditions is recommended. In addition, the introduction of stress testing at the company level and market wide is recommended. Capacity building in this area will be required.

Onsite Inspections

54. The FBIH-ISA adopts an annual plan for regular onsite supervision. The plan includes insurance companies, subsidiaries of insurance companies from the FBiH, insurance intermediaries and the protection fund. The plan defines the entity, subject matter and period of supervision, as well as the persons in charge of performing the supervision. Where necessary, the plan is revised in the course of the year. The number of comprehensive onsite inspections fluctuates depending on the targeted inspections that are envisioned. During 2011, 12 onsite inspections were carried out, while only four were conducted in 2012. In 2013, nine onsite inspections took place and the same amount of onsite inspections are planned for 2014. External experts for onsite inspections have been used to carry out the first five actuarial reviews since the agency commenced operation in 2013/2014. A few onsite inspections of intermediaries and brokers have been carried out.

55. Rules for initiating and conducting onsite supervision of an insurance company are regulated by the Rulebook on Supervision Procedures. The FBiH-ISA issues a decision to initiate the supervision in which it determines the subject, the date and the persons who conduct the supervision. Regular onsite supervision is performed based on the previously issued annual plan of regular supervision activities. Extraordinary inspections are triggered by offsite supervision, complaints by policyholders or information of large deposits withdrawals as informed by the bank. In addition, onsite inspection findings could trigger a market wide inspection based on those findings. Three to four inspectors that on average spend one week in the insurers' premises carry out the onsite inspections. The whole inspection process takes a few months until completion. The inspection report is discussed with the insurer before it is officially submitted to the director and its board. The final decisions on the measures can be challenged in court. There is no internal practice of filing the initial inspectors' report that would allow changes made during the discussion within the FBiH-ISA to be tracked. It is recommended to introduce a process that allows tracking the initial

finding of the inspectors as well as the possible changes the report undergoes before it was submitted to the insurers.

56. The quality and comprehensiveness of the onsite inspections heavily relies on the experience of the inspectors. The FBiH-ISA does not have an inspection' manual. The development of internal guidelines on the conduct of regular and exceptional onsite supervision is recommended. This will allow maintaining the same level of quality and scope of inspections. It will also guide external experts on the FBiH-ISA's expectation for the scope and quality of an onsite inspection. The actuarial reviews should be carried out for all companies and the number of onsite inspections of intermediaries should be increased. The development of an inspection manual is recommended. Market wide actuarial reviews should be carried out, and the frequency of intermediaries' onsite inspections increased.

57. Onsite inspections are used to impose necessary preventive and corrective measures, if deemed necessary. Upon conclusion of the process of an onsite supervision, the FBiH-ISA interviews management and/or significant owners of the inspected insurance company regarding all relevant findings and results of the inspection, as well as on the need to introduce preventive or corrective measures. Once imposed, the implementation of the supervisory measures is followed up on a regular basis.

Supervisory Powers and Available Tools

58. The FBiH-ISA has a set of preventive and corrective measures to prevent the deterioration of the financial condition of an insurer and to correct possible existing legal irregularities. The provisions of article 55 of the LICPI stipulate the authority of the FBiH-ISA can take prompt corrective measures in the event that the insurance company does not operate in a manner that corresponds to the solid business practices or regulatory conditions. A set of procedures or corrective measures is established, which include prohibition on disposal of assets, temporary ban on acquiring new business, withdrawing the insurer's assets from a bank that is in poor financial condition. The FBiH-ISA if deemed necessary can issue orders to an insurer or intermediary to eliminate illegalities and irregularities; it can prohibit dividend payments, other measures that include the license revocation intervention and start liquidation are available to the agency.

59. Regulatory irregularities trigger the issuance of an order to remove them. The following irregularities will trigger an order to remove them:

- work on the important activity is performed by a person for whose appointment the insurance company did not provide consent, or a person for whom FBiH Agency ordered a measure of dismissal;
- an insurance company does not meet the requirements for all or certain insurance operations;
- an insurance company violates the rules on risk management, as well as rules on liquidity and solvency;

- an insurance company violates the rules on keeping business records, preparing financial statements, audit, internal audit;
- an insurance company violates the rules on reporting and informing FBiH Agency;
- an insurance company violates the rules on appointment of the authorized auditor and certified actuary;
- an insurance company does not respect the adopted business policy acts; and
- an insurance company does not respect other provisions set forth in the regulations governing the field of insurance.

60. Violations on the prudential indicators will trigger remedial actions. Violations of the liquidity or solvency ratios, capital adequacy requirements, rules on forming funds to cover technical and mathematical reserves, investment rules for covering the technical and mathematical reserves, reinsurance rules, or breaching any imposed restrictions will trigger additional measures to be imposed on the insurance company:

- an order requiring the insurance company to adopt: an action plan to meet the requirements of capital adequacy, improve liquidity and solvency, provide investment funds to cover technical and mathematical reserves;
- temporary or permanent prohibition to conclude new insurance contracts in some or all types of insurance;
- prohibition or restriction of the free disposal of the funds to cover technical reserves or funds to cover mathematical reserves and other assets of an insurance company;
- an order requiring the insurance company to remove and replace, executive directors, executive board members; and
- Whenever an insurance company does not meet capital adequacy requirements, such insurance company is required to submit a plan for short-term financial recovery, which will address deficiencies, to FBiH Agency for approval.

61. The supervisor has effective means to address management and governance problems. The provisions of article 55, article 59, article 61 and article 63 of the LICPI grant the FBiH-ISA the power to require insurance companies to replace or limit the powers of the board members, top management, key persons holding supervisory positions, major owners and external auditors if they severely or repeatedly hinder supervision.

62. Measures that are aimed at protecting the financial condition of the insurance company are available and used by the FBiH-ISA. In the case of an insurer in financial difficulties, the law provides the FBiH-ISA with the power to order that assets be held in whole or in part by a trustee, as prescribed in the paragraph 2 of article 12 of the LICPI. The assets so held may be released into the custody of the company only by consent of the supervisory agency. The trustee needs the approval of the FBiH-ISA. The FBiH-ISA may limit the volume of insurance activity within a specified period of time. This limitation may apply to the entirety of the activities of the company or to any specified part. The FBiH-ISA may also order the increase or decrease of the premium rate of a specified insurance class, if such premiums are deemed not to be adequate.

63. Administrative fines are listed and the FBiH-ISA can impose them but the amounts are insufficient to deter unwanted behavior. The provisions of articles 73 through 78 of the LICPI prescribe the pecuniary sanctions against the insurance company, the responsible person in the insurance company - directors, as well as other persons (auditor and actuary) in case of violation of legal regulations proportionate to the established violation. The fines indicated in the LICPI are proportionate to the established violation, or according to the violation, from KM 10,000 to KM 50,000 for the insurance company, or from KM 1,000 to KM 10,000 for the responsible persons in the insurance company. There is a list of actions that trigger fines with the corresponding range of the allowed fine amounts, for instance:

- providing false information;
- auditor or actuary making a false statement , false claims assessment;
- failing to comply with the orders of the FBiH-ISA;
- investing the assets contrary to the legal provisions; and
- hindering the authority to perform an inspection.

However, the amount of these fines cannot be higher than the general law on misdemeanors that sets the limits of KM 100 for natural persons and KM 500 for legal persons. This law is in the process of been changed. It is recommended to revise the amount of fines to have an effective tool to deter unwanted behavior.

64. Supervisory protective actions that effectively prevent inappropriate asset disposal are provided in the LICPI. The provisions of article 68 state that for the purposes of establishing a plan for financial restoration and a plan of short-term financing due to the failure to establish the solvency margin and the guarantee capital and in order to preserve or restore the financial situation of the company, the FBiH-ISA may intervene affecting pre-existing rights of parties other than those of the company, such as the appointment of a temporary administrator, suspension of payments, suspension of enforcement measures and reduction of claim amounts.

65. The legal provisions for the appointment of temporary administration are clear only in case of liquidation. The power granted to the FBiH-ISA to declare an insurer under temporary administration are clear in the case of the special liquidation that requires the license revocation before the appointment of the temporary administration. This condition provides the effective protection of unwanted disposal of assets only in the case of insurers that are in the process of liquidation. The legal procedures to appoint a temporary administrator for the purpose of recovery or restructuring actions are not clear. Article 68 of the LICPI requires that for the purpose of better supervision by the FBiH-ISA over the reorganization measures taken as defined in this article, the MoF may introduce procedural and material regulations on supervision over the reorganization measures. Those regulations have not been issued.

66. The FBiH-ISA may withdraw the license of an insurer or broker under certain circumstances, when policyholders' interests are severely affected. This power has been

successfully used on a few occasions. The LICPI sets out the power of the FBiH-ISA to withdraw the license from the company in any of the following cases:

- in the case of a serious violation of the provisions of the Law on Technical Provisions and Investment Funds;
- if a legally valid verdict has been pronounced that constitutes an obstacle to the conduct of business;
- if the company has ceased to fulfill the requirements for the performance of insurance activities, or requirements under which the license was granted no longer exist or have been altered to such an extent that the Supervision Agency would not have issued a license in light of the new circumstances;
- if the company has been unable, within the prescribed time limit, to take the measures specified in the restoration plan or financing scheme;
- if the company has seriously violated the provisions regarding the calculation and management of the technical provisions and of the solvency margin, resulting in the interest of policyholders being threatened;
- if the company has not started operations within 12 months from the issuance of the license, or has discontinued its operations in whole or in part for six months in a current year, wholly or partially, for a period longer than six months;
- if the company failed to satisfy an obligation to the BiH Green Card Bureau or the Protection Fund; and
- if the company does not apply tariffs and conditions for all classes of insurance.

Group Supervision

67. To cover related party transactions, a rulebook on supplementary group supervision was issued in 2007. Supplementary supervision applies to those insurers belonging to an insurance group, i.e., affiliated or related parties that consists of more than one insurer or an insurer that is part of a mainly insurance holding company. The supplementary group supervision requires reporting of the group structure, the financial statements of the group, as well as details of material transactions among the group entities and other related parties. These material transactions include loans and credits; guarantees and other businesses creating off-balance sheet liabilities; legal transactions aimed at investing in securities and other financial instruments and real estate; other legal transactions with a significant impact on the calculation of adjusted solvency margin; reinsurance services, and cost sharing agreements. The insurer subject to supplementary supervision is required to adjust its solvency calculation discounting related party transactions as well as the minimum capital requirements of the entities of the group.

68. Regulation and supervision of insurance groups needs to be improved. The FBiH-ISA rulebook on the supplementary supervision of groups needs to be enhanced to widen the scope of supervision and to provide powers to the supervisor, as a minimum, for inspection and supervision of holding companies, limiting intra-group transactions and requiring fit and proper control

positions of the holding company. As a further step, a comprehensive group supervision framework, including group capital requirements, should be implemented.

Macprudential Supervision

69. The macroprudential supervision is limited to an annual elementary overview of the market. The FBiH-ISA has not been engaged in market wide analysis on the sector except when annually producing a market overview report. On a few occasions, the regulators have initiated onsite inspection based on findings market trends findings. Macroprudential tools have not been developed nor market wide stress tests are required and there is no framework to define systemic risk in the sector. As the market develops further, a macroprudential supervision framework should be introduced. The FBiH-ISA should be included into the SCFS. In addition, consideration to assign the development of macroprudential tools and their usage to the Insurance Agency should be evaluated and the implementation power should be granted the ISAs.

C. Market Entry and Exit

70. This section covers entering and exiting the market. Licensing, including the fit and proper requirements for owners and holders of control functions as the portfolio transfers regulation and control of insurers (ICP 4–6) as well as market exiting regulatory provisions and supervisory practices (ICP 12) are analyzed here.

Licensing and Entry Controls

71. The licensing procedures are comprehensive. Insurance activity is a regulated activity and insurers and insurance intermediaries need a license to operate (LICPI article 3). Licensing requirements are transparent and are published on the FBiH-ISA webpage. The licensing requirements include a three year business plan that is analyzed with respect to its viability, funding sufficiency, and systems availability to support the operations of the plan. The internal controls and operational procedures of the insurer are also required. The source of capital and identity of the owners are tracked and checked for propriety. The mechanism to setup tariffs and the reinsurance agreements are also analyzed before the license can be granted. If complete documentation is presented, the FBiH-ISA has 60 days to issue the license. However, licenses are currently renewed within 15 days.

72. Reinsurance activity is also licensed by the FBiH-ISA. Insurance companies that operate in the FBiH are not allowed to enter into reinsurance contracts with reinsurance companies which do not have an operating license issued in the FBiH without prior approval of the FBiH-ISA. The FBiH-ISA grants approval of operating licenses to reinsurance companies which meet internationally acceptable standards for sound conduct.

73. For licensing, independent insurance intermediaries need to pass an exam and be registered. In addition to the exam, required capital has to be registered, the propriety of the person proved and the existence of a valid error and omission insurance policy have to be

submitted. Registered intermediaries are listed on the FBiH-ISA web page. The license for intermediaries needs to be renewed biannually. This is when propriety and some additional requirements, such as capital and the error and omissions policies, are checked. The FBiH-ISA has established a process to revoke licenses of intermediaries that no longer fulfill the requirements. Agents selling on behalf an insurer do not need to pass the certification exam. It is recommended requiring examination for all intermediaries of insurance including those that work as staff for an insurance company.

74. Fit and proper requirements for control functions are in place. The provisions of article 60 of the LICPI and the rulebook on persons holding key positions in an insurance company state the fit and proper requirements. Persons on key positions in insurance companies must be persons of high respect and moral, with satisfactory qualifications and management experience. To be appointed as a member of the management board of a company, the person needs to meet the following requirements:

- a university degree—a graduate economist or a graduate lawyer,
- at least three years of experience in managerial positions in a company, i.e., six years of experience on the jobs in financial institutions,
- not be a member of the management, board of directors/supervisory board of a company against which bankruptcy proceedings have been instituted, i.e., whose operating license has been revoked due to a violation of the law,
- not be a member of the management and/or a procurator in another company,
- not be a member of the supervisory board of a related company,
- not be convicted of corporate fraud and embezzlement, abuse of trust, forgery, use of forged documents, theft of public or private property, making false statements, giving or taking bribes, or any other criminal offence related to the performance of a professional activity,
- not be a person who was a member of the management board of a bankrupt insurance company or the insurance company whose license was revoked. Such a person can be nominated for key positions mentioned hereof on expiry of 5 years.

75. The scope of control functions needs to be expanded. A control position in company is considered to be the position of the CEO and other executive directors, interim managers and dissolution trustees as well as the appointed actuary. Members of the governance board appointed by the shareholders assembly are not subject to approval by the FBiH-ISA. It is recommended to require fit and proper for all governance board members and the internal auditor. This will allow the FBiH-ISA to supervise the board better and remove any board member if necessary. Unlicensed insurance activity is penalized.³

³ The provisions of article 76 of the LICPI stipulate penalties for persons who operate insurance activities without a license: “The person who, without being licensed or authorized, manages an insurance company in the FBiH or engages in an insurance activity without being licensed for or operates in any way against the provision of this Law, or as the representative of authorized person signs or mediates in signing insurance contracts in the FBiH by the

(continued)

76. The assessment of fit and proper is carried out based on documentation. Interviewing the candidates for control functions is recommended to gain a stronger opinion of the fit and proper of the candidates to conduct control functions. During the interviews, the knowledge of the insurance regulation pertinent to the position should be assessed.

77. The right to acquire insurers' shares to become a qualified shareholder (at least 10 percent of the shares or voting rights) requires the approval of the FBiH-ISA. The propriety conditions and additional conditions that apply to control functions are required to be fulfilled by candidates who want to purchase insurers' shares above 10 percent of the voting rights (article 61, paragraph 1 of the LICPI). The FBiH-ISA approval is also required for exceeding thresholds of 20 percent, 33 percent and 50 percent (article 62). While the opportunity to request propriety evidence and checks on the additional requirement that the shareholder needs to meet every time one of the thresholds is crossed are an important supervisory tool. In addition, for the 50 percent threshold the requirements equivalent to a obtaining a new license should be mandated.

78. Supervisory actions are specified in the event of a violation of the approval requirement to acquire a qualified majority in an insurer. If a qualifying holding is acquired or an existing qualifying holding is increased over the thresholds laid down in article 62 of the LICPI, without notifying in advance or without obtaining approval from the FBiH-ISA, the exercise of voting rights resulting from such holding shall be null and void. Moreover, the Supervision Agency may impose on the holders of qualifying holdings the following penalties, individually or cumulatively:

- a fine in favor of the Federation budget amounting to up to 10 percent of the value of shares transfer
- debarring individuals from serving on the company's management board, as well as from any managerial post within the company for a definite or indefinite time.

79. Portfolio transfers are well regulated. Any insurers intending to transfer a portfolio need the approval of the FBiH-ISA. Such intentions are to be made public in the press for 2 weeks; policyholders disaffected by the decision can complain to the FBiH-ISA. The ISA has the power under certain conditions to force a portfolio transfer. The approval is granted once the FBiH-ISA is convinced that the insurers accepting the business will not be impaired and that policyholders are well protected (articles 64-65 of the LICPI).

Market Exiting

80. The liquidation process of insurance companies is well established in three laws. The procedures for liquidation of a company are prescribed by the Law on Liquidation Proceedings, the Law on Bankruptcy Proceedings and the Law on Insurance Companies in Private Insurance. The liquidation of an insurer is initiated by the FBiH-ISA. In the case of insolvent insurers or insurers in

insurance company not licensed shall be sentenced to imprisonment from one to three years and penalty fee in the amount of KM 10,000." The enforcement of these penalties needs the cooperation of the police.

violation of legal provision, the FBiH-ISA can start the liquidation process by revoking the license. This decision is made by the director. Once the decision to revoke the license is made, the FBiH-ISA appoints a provisional administrator and special liquidation of the insurer is declared, served on the company and published in the Official Journal of the FBiH and the Official Gazette of the RS, if a company conducted business in RS through a branch office. All powers of the management of a company and other persons authorized to represent all bodies of a company cease on the date when the decision on the appointment of the provisional administrator is published in the Official Journal of the FBiH. The provisional administrator submits a request within five days from his/her appointment to the competent court to initiate liquidation proceedings and to appoint the liquidator. Upon the appointment of the liquidator, the provisional administrator monitors the progress of the liquidation, gives his/her opinion about the issues related to liquidation, submits written information to the FBiH-ISA on the progress of liquidation once in two months, and performs all the duties requested to perform by the Supervision Agency. It also submits a report to the agency upon the conclusion of the special liquidation. There are no provisions about the duration of the process. Bankruptcy may not be opened against a company prior to the conclusion of the special liquidation proceedings. It is recommended to introduce the requirement to expedite the special liquidation, and to remove the liquidator that unduly delays concluding the special liquidation proceedings.

81. Policyholders' rights and entitlements have a high legal priority. When a company reaches the stage of special liquidation, the policyholders have a priority claim on all of company assets. This privilege gives them priority over all other creditors. Life policyholders rank before nonlife policyholders in the creditors priorities (article 70 of the LICPI).

82. The MTPL Protection Fund participation in the payment of traffic accidents claims of the insured in liquidation needs legal clarification. The law on the MTPL provides the obligation for the Protection Fund to pay the claims covered under the MTPL policy issued by an insurer under special liquidation. However, practice has proven that there is legal ambiguity as to whether the payment should be done ahead of the liquidation proceeding and then having the Protection Fund as a creditor, or only after the liquidator has transferred the assets to the Protection Fund. It is recommended to remove any legal ambiguity so that the Protection Fund pays insured victims of traffic accidents for any claims against an insurer under special liquidation immediately.

D. Prudential Framework

83. The prudential framework is described in this section. The focus is on the risk sensitivity of the solvency regime, the market consistent valuation of assets and liabilities and the investment requirements. The ICPs 14–17 contain the key standards that are relevant for this section.

84. The valuation of insurers' assets and liabilities is performed in accordance with standard No. 4 of the International Financial Reporting Standards (IFRS). IFRS prescribes an economic valuation of assets and liabilities that reflects the risk-adjusted present values of their cash flows. The standard addresses recognition, de-recognition and measurement of assets and liabilities. The insurer has to keep insurance liabilities in its statement of financial position until they are

discharged, cancelled, or expired, and to present insurance liabilities without offsetting them against related reinsurance assets. The valuation of assets and liabilities is undertaken on consistent bases. The value of technical provisions and other liabilities does not reflect the insurer's own credit standing. In addition, the estimation, valuation and recognition of individual balance and off-balance positions is regulated in detail by the Instructions on the valuation of balance sheet and off-balance sheet items (Official Journal of the Federation of Bosnia and Herzegovina, 73/13) and the Instructions on Amendments to the Instructions on the valuation of balance sheet and off-balance sheet items (Official Journal of the Federation of Bosnia and Herzegovina, 104/13). The most significant off-balance sheet items include the collection of dubious claims under granted loans and recourse claims.

85. Insurers are required to set up the basic technical reserves. For life business, the mathematical reserves are determined by the technical note. The maximum discount interest rate is 5 percent. For the nonlife sector and group life business, the following reserves are required, unearned premium reserve, outstanding claims reserve and incurred but not reported claims (IBNR). Basic rules apply to set up the reserves. The unearned premiums are set up on a pro rata basis. The claims reserves are set in full amount, or at the discretion of the supervisor in case of a court dispute. The rulebook allows reserves for catastrophic risk, but not the accounting standards. Only 20 percent of the technical provisions are allowed to be discounted for corporate tax income. An actuarial opinion on the correctness and sufficiency of the technical reserves is required on an annual basis. MTPL table of benefits for disability are not in place. It is recommended to modify the corporate income tax law to allow for a full recognition of the technical provisions as expenses. However, this should be done without loss of income for the government.

86. The supervisor establishes requirements that are applicable to the investment activities of the insurer. The LICPI grants the FBiH-ISA the power to regulate the investment activities for solvency purposes (article 57). The FBiH-ISA has issued the corresponding rulebook on the level and the manner of funds' investment of the company and requires internal company documents governing the field of investment that provide the admissibility and limits of the assets to cover technical provisions, mathematical reserve and the guarantee fund for solvency purposes. The article 3 of the rulebook takes into consideration the security, diversification, matching of liabilities and liquidity aspects required for the investments. The admissible assets and their limits are published on the webpage of the FBiH-ISA and have been updated on a regular basis. Foreign investments are allowed after approval by the FBiH-ISA. Related parties investments are not allowed for capital requirements. The FBiH-ISA approves the type of investments for assets in excess of the minimum guarantee fund that are not used to cover technical provisions or the mathematical reserve.

87. The requirements regarding diversification, liquidity, and the permissible securities for the assets to cover technical provisions, mathematical reserves and the minimum guarantee fund are set out in the Rulebooks. In accordance with the rulebooks on investments, the following assets are admissible and cannot exceed the indicated limits. The limits for the life reserves on less

liquid assets are higher than for nonlife and the admissible assets to cover the minimum guarantee fund are only liquid assets (50 percent in bank deposits):

Type (form) of Investment	Nonlife. Allowed Percent	Life Mathematical Reserve. Allowed Percent
Securities issued or guaranteed by BiH, the entities, Brcko District	50% and up to 20 % in securities issued by the same issuer and for the same purpose	50% and up to 20 % in securities issued by the same issuer and for the same purpose
Bonds and other debt securities traded in the organized securities market in BiH	35%, and up to 10% per one issuer	35%, and up to 10% per one issuer
Bonds and other debt securities not traded in the organized securities market in BiH, if issued by a legal entity with a seat in BiH	5%, and up to 1% per one issuer	N/A
Shares traded in the organized securities market in BiH	30%, and up to 5% per one issuer	25%, and up to 5% per one issuer
Shares not traded in the organized securities market in BiH, if issued by a legal entity with a seat in BiH, which recorded a positive financial result in the financial statements of the last two years	5%, and up to 1% per one issuer	N/A
Loans secured by a lien registered on real estate, if the lien is registered in the land register in BiH, and if the value of the loan does not exceed 40% of the value of the real estate estimated by a court certified appraiser	10%, and up to 2% per one debtor	10%, and up to 2% per one debtor
Loans secured by securities under article 9, Item a) and b) of the rulebook	20%, and up to 2% per one debtor	20%, and up to 2% per one debtor
Loans secured by guarantees issued by banks with a seat in BiH, which recorded a positive financial result in the financial statements of the last two years	20%, and up to 2% per one debtor	20%, and up to 2% per one debtor
Loans in the amount of surrender value based on life insurance contract	N/A	In line with the terms of the insurance contract

88. Having over half of the insurance sector assets in bank deposits creates a relevant exposure to the banking sector that needs to be monitored. The FBiH-ISA requires insurers to hold at least 50 percent of the minimum guarantee fund in bank deposits. Total exposure of the insurance sector assets to the banking sector is KM 460 million. It becomes relevant for the insurance supervisors to have access to the relevant information on the financial condition of the banks. The power to order changing the bank used for the deposits based on the financial condition of the bank is a mitigating factor; however, the access to the relevant information on the financial condition of the bank needs to be improved. It is recommended establishing a formal channel of information with the banking sector supervisor to gain timely information on the financial soundness of all banks holding insurance sector assets above the threshold.

89. The capital regime follows Solvency I. Pursuant to the provisions of the articles 50, 54 and 55 of the LICPI set forth capital requirements and additional obligations of the company to ensure the maintenance an adequate capital position. The Rulebook on the Amount and Method of Investment for Covering of the Technical Reserves and Minimal Guarantee Fund stipulates that a company must ensure the amount of investments equal at least the amount of calculated technical reserves. The articles further stipulate the regulatory capital adequacy requirements for fulfilling the obligations to the insured and the requirements that an insurance company should obtain capital resources to meet regulatory capital requirements that follow Solvency I.⁴ The Rulebook on the Elements and Control of the Solvency Margin and the Rulebook on Manner of Appraisal of the Balance and Off-balance Items of the Insurance Companies regulates the method of calculation and control related to available capital and solvency margin of an insurance company.

90. The required solvency margin is determined by the minimum guarantee fund. Given the low premium written by the industry, with a few exceptions, the solvency requirements have been determined by the minimum guarantee fund that cannot be less than:

- KM 2 million if the insurance company engages in one or more types of the following insurance activities: vehicle owners or users motor third party liability insurance, aviation third party liability insurance, vessel owners or users marine third party liability insurance, general liability insurance, credit insurance and surety insurance;
- KM 2 million if the insurance company engages in one or more types of the following insurance activities: accident insurance, health insurance, motor CASCO insurance, railway rolling stock CASCO insurance, aircraft CASCO insurance, sea, lake and river vessels hull damage, goods in transit insurance, fire and other natural perils insurance, financial loss insurance and travel insurance;
- KM 1 million if the insurance company engages in the insurance activities of other perils to property and/or legal protection insurance;
- KM 3 million if the insurance company engages in life insurance; and
- KM 3 million if the company engages only in reinsurance activities.

91. The capital regime should begin introducing risk sensitive elements. The current framework that follows Solvency I is not risk sensitive and, as such, is not following the best international practices. A gradual incorporation of risk elements into the solvency framework is recommended. Introducing credit risk capital surcharges on the assets as well as differentiated factors, depending on the line of business that apply to the premium and claims calculation, could be the starting point.

92. A solvency margin adequacy ratio below 100 percent triggers supervisory action. The actual solvency margin adequacy ratio for an insurer is required to be at least 100 percent. In the event that this ratio falls below 100 percent, the FBiH-ISA must apply a selected set of enforcement

⁴ The calculation is based on the maximum of the amounts calculated by applying factors to the premium and to the claims but cannot be lower than the minimum guarantee fund.

measures and sanctions against the insurer in accordance with the LICPI. Once a risk sensitive solvency regime and the early warning system are in place the development of a ladder of intervention based on capital levels should be introduced together with a corresponding set of prompt corrective actions.

E. Risk Management and Governance

93. Governance, internal controls, and risk management are the areas examined in this section. The relevant ICPs are ICP 7–8.

94. The basic requirements on the governance structure are defined in the LICPI and the Federation Company Law. Under the Federation Company Law, article 239, insurers should establish the shareholders assembly, appoint the director, the board of directors and have an auditing body. Further governance requirements are established in the Federation Company Law.

95. The Federation Company Law sets further governance requirements for insurers. Provisions of articles 246, 269, 313 and 314 of the Federation Company Law prescribe the roles and responsibilities entrusted to the board of directors, management and the persons in control functions of a joint stock company. Article 304 and 305 of the Federation Company Law establishes the responsibilities of the board of directors of a joint stock company that can only be transferred by the shareholders assembly or by the company's bylaws. In particular the board of directors is responsible for:

- supervising the work of the management;
- approving reports of the management of operations based on semi-annual and annual financial statements, with a balance sheet and an income statement and an audit report;
- submitting to the general meeting an annual report on the business operations of the joint stock company, which has to include an auditor's report, a report on the work of the supervisory board and of the audit committee, and a business plan for the coming business year;
- approving asset purchase, sale, replacement, leasing and other asset transactions, directly or via subsidiaries in the course of a business year, whose value ranges from 15 percent to 33 percent of the book value of the total assets of a joint stock company;
- appointing chairpersons and members of the remuneration committee and the appointments committee;
- setting up ad hoc commissions and determining their composition and tasks; and
- convening the general assembly meeting.

96. The executive board is responsible for implementation of company's strategy. Pursuant to article 275 of the Federation Company Law, the executive board shall implement decisions of the board of directors and manage the business of the company and shall act as legal representative jointly of the company, unless stated in the founding act or the statute that only certain executive directors may represent the company.

97. The internal audit function must be established and the audit functions are subject to explicit requirements set by law. The Federation Company Law in its article 285, defines the audit committee as a body of a company; all insurance companies are obliged to comply by virtue of their legal status. The audit committee carries out audits of the semi-annual and annual financial statements and audits of financial operations of a joint stock company at the request of shareholders holding at least 10 percent of voting shares. Complementing this requirement, the FBiH-ISA has established, under the Rulebook on Internal Audit, in an insurance company the obligation of a company to organize the internal audit function as autonomous and independent in the performance of its tasks, reporting to the company's audit committee.

98. The FBiH-ISA has issued further regulation on the internal audit function. The rulebook on the internal audit stipulates that internal audit is to perform continuous and comprehensive monitoring of all the company's business activities, to analyze and evaluate these activities, draw up expert opinions, give recommendations and advice for the purpose of:

- implementing laws and bylaws, as well as the regulations governing the operations of the company;
- identifying risks and assessing the management of risks to which the company is exposed or can be expected to be exposed;
- improving the company's organization and system of work;
- improving the process of making business decisions;
- ensuring the functioning of the IT system; and
- evaluating the system of internal controls and making recommendations for its improvement.

Internal audit controls and evaluates:

- the conduct of insurance business in accordance with the Law on Insurance Companies in Private Insurance and regulations adopted pursuant to it;
- suitability and implementation of risk management policies and procedures in line with the principles of going concern operations and stability;
- accounting procedures and organization of accounting tasks, including the organization and management of the IT system; and
- reliability, validation and accuracy of financial data and information and other activities aimed at improving the company's operations.

99. The corporate governance requirement for insurers lack qualitative elements. The LICPI has minimal quality governance requirements and the Federation Company Law governance requirements mandate only the board to be responsible for establishing adequate internal control processes including independent internal audit function and risk management systems consistent with the insurer's risk management strategies. The following areas could be improved:

- the board structure with the corresponding committees, governance standards, board composition and knowledge, and assessment of the effectiveness of the board;
- the remuneration policy of board members and senior management;

- duties of individual board members including acting in the best interests of the insurer and policyholders; and
- timely and effective communication with the FBiH-ISA and relevant stakeholders (including policyholders) on the governance structure of the insurer.

100. Basic risk management requirements are stipulated in the regulation. For the purposes of risk management, the FBiH-ISA has passed the following bylaws:

- The rulebook on the elements of the solvency margin (FBiH Official Journal 55/13) which defines the calculation of capital and the guarantee fund, the calculation of the solvency margin, the method for determining capital adequacy, reporting for calculation purposes and controls of capital and the margin.
- The rulebook on the level and manner of funds investment (FBiH Official Journal 64/13, 66/13 and 96/13), which regulates investment of companies' funds, investment principles, types of assets in which funds may be invested and the level of individual investments, as well as the reporting.
- The rulebook on liquidity (FBiH Official Journal 24/13) regulates the method for determining and monitoring liquidity of a company and reporting.
- The Law on Insurance Companies and internal company regulations that determine retention establish the obligation to transfer excess risk to reinsurers or otherwise.

101. Internal controls and business processes are required to be established to obtain an operating license. Pursuant to the provisions of articles 47 and 35 of the LICPI, the obligation of the insurance company to accompany the business license application with business policy acts prescribed by the Decision on Documents that have to be enclosed with the License Application Form, is stipulated. The article 7 of the Decision on Documents prescribes the mandatory documents of business policy, namely:

- general, special and supplementary insurance terms and premium rates;
- decision on technical bases in insurance;
- decision on criteria, the method of determination and table of maximum retention and the total amount of retention;
- rulebook on the conditions and manner of depositing and investing funds of the company;
- rulebook on maximum rates of loading for expenses of management;
- rulebook on the formation and the method of calculation for unearned premiums;
- rulebook on the formation and the method of calculation of mathematical reserves;
- rulebook on the formation and the method of calculation of provision for outstanding losses;
- rulebook on the formation and use of reserves for profit sharing (life insurance);
- rulebook on the formation and use of reserves for bonuses and rebates;
- rulebook on the conditions and manner of exercising recourse;
- rulebook for handling compensation claims; and
- rulebook on the use of loss prevention funds.

102. The actuarial function is well defined. The LICPI article 20 sets out that actuarial tasks of insurers are to be carried out by certified actuaries. For every company it is mandatory to appoint an actuary. The rulebook on the actuary prescribing requirements for acquiring and revocation of the title of the certified actuary, the type and content of the document confirming it. The certified actuary is responsible in particular for the following:

- make an assessment of the annual accounts and the annual report on operations of the company; carry out general or special examinations of the company in accordance with orders issued by the Supervision Agency;
- make an assessment of business documents of the company, their use and the manner in which they are implemented;
- make an estimate of the situation of funds, their placement and security;
- carry out actuarial tasks in the activity of life insurance;
- carry out other supervisory, advisory and control operations at the request of the company or under an order issued by the Supervision Agency; and
- certify by signing the official documents of the company concerning mathematical reserves, and confirm that they are consistent with the law.

The FBiH-ISA has not offered actuarial examinations for the last seven years. It is recommended offering regularly the examination to become an appointed actuary.

103. No explicit and detailed requirements for an insurer to have as part of its overall corporate governance framework, effective systems of risk management and internal controls that address all relevant risks are in place. Explicit rules on the monitoring of the investment limits and capital requirement are in place but the regulation is not comprehensive regarding the effectiveness of such risk management systems, nor is it required to prove their effectiveness. There is a scope for developing regulation and implementing the requirements in the area of risk management and internal controls Strengthening the existing regulation in the following areas is recommended:

- Scope of internal controls. To be effective, internal controls should be comprehensive, covering the insurer's key business, IT and financial processes. Key control functions should minimally include the internal audit and actuarial function, the risk management function. Each key control function should be led by a person suitable for the position, have sufficient independence from business units and adequate resources, and have access to the board and provide regular reports to the board.
- Duties of key control functions:
 - Risk management should assess risks on an enterprise-wide basis. There should be defined risk appetite, documented approval processes and authorities, established risk strategy, and escalation and reporting procedures.
 - Internal audit should assess the adequacy and effectiveness of an insurer's policies and procedures, and the documentation and controls of these. It should also evaluate the reliability and integrity of management information.

- Compliance function should be introduced to advise on compliance with laws, regulations and internal policies and procedures. Compliance procedures should be integrated in work processes.
- Regulation on outsourcing should be enacted to require: (a) board approval of outsourcing of material functions or activities, (b) due care and diligence in selecting the outsourcing providers, (c) written documentation of the outsourcing arrangements, and (d) periodic review of such arrangements.

F. Reinsurance

104. This section covers reinsurance regulation and supervision. Reinsurance is not widely used and mainly placed with the local reinsurer. The relevant principle is contained in ICP 13.

105. Current reinsurance regulation provides basic guidelines only. The regulatory framework provides only basic guidelines for reinsurance stating that insurers should reinsure the portion of the risk that they cannot retain. The documents accompanying the application for a license to operate prescribe that the business plan of the insurance company must include a program of envisaged reinsurance with tables of maximum retention by lines of insurance. An internal rulebook on reinsurance must be adopted by the insurer and submitted to the FBiH-ISA.

106. The supervisory agency supervises basic conditions of reinsurance contracts. Pursuant to article 17 of the LICPI, the supervision activity is to control of the identity of the counterparty – reinsurer as well as the terms and conditions on which the reinsurance has been concluded and the proportion of the risk ceded. On an annual basis, the FBiH-ISA receives all reinsurance contracts together with basic data including reinsured premiums and claims.

107. Reinsurers need a license to operate. The FBiH-ISA needs to approve the use of foreign reinsurers that are not licensed in the FBiH. The supervisory agency will not refuse to approve a license to work as a reinsurance company, if the applicant fulfills internationally acceptable standards for sound conduct of reinsurance business. The limitation from this paragraph will not apply to reinsurance companies with a license to operate in BiH. Licensing requirements to operate in the BiH as a reinsurer are equivalent to those that apply to insurance companies which are applicable to the reinsurance business.

108. Reinsurance regulation and supervision should be enhanced. The reinsurance regulation should consider the following enhancements on reinsurance supervision and regulation:

- The financial stability of reinsurers should be analyzed annually and not only during a license assessment;
- Risk transfer requirements on the reinsurance contracts should be specified;
- Cash call clause should be included for catastrophic events; and
- Prohibition of side letter to guarantee the integrity of the contracts should be implemented.

G. Market Conduct and Consumer Protection

109. This section discusses the relevance of market conduct for the stability of the sector.

The existing market conduct requirements on insurers, brokers and insurance intermediaries are covered in this section. In addition, the public disclosure requirements, prevention of insurance fraud and compliance with AML-CFT requirements are discussed. The ICPs 18 to 22 contain the relevant principles.

110. Insurance intermediation requires a license. Insurance and reinsurance intermediation can only be carried out by legal entities (brokers and agents) or by physical persons (agents) only after obtaining a license that is issued by the FBiH-ISA (article 2 paragraphs 2 and 3 of the Law on Intermediation in Private Insurance (Official Journal of the Federation of Bosnia and Herzegovina nos.: 22/05 and 8/10) (LoIPI). The licensing process for insurance intermediation includes fit and proper conditions, and requires brokers to carry error and omissions insurance. The capital requirement for a broker is KM 200,000 (article 7 and 9 of the LoIPI). Those involved in insurance intermediation have to pass an exam. Different exams apply to agents and brokers. The exam is prepared by the FBiH-ISA. Agents working full time for an insurer are not required to be licensed. It is recommended requiring the insurance intermediation license for any person engaged in insurance intermediation independently of any working arrangements.

111. Every independent intermediary and broker is registered on the web page of the FBiH-ISA. Pursuant to provisions of article 3 of the LoIPI, the obligation of insurance intermediaries to register with the FBiH Agency as a prerequisite for the commencement of insurance activities and operations is prescribed. At the end of 2013, the FBiH-ISA had registered 165 agents, an important reduction from the 240 registered agents in 2009. Only 5 brokers were registered and active in 2013, including the FBiH Postal Service.

112. Intermediaries are subject to continuous supervision. The provisions of article 12 and 13 of the LoIPI grant the authority to the FBiH-ISA for supervisory of intermediaries. Accordingly, brokers and independent agents are required to submit semi-annually and annually reports that include their financial statements, intermediated premiums, and earned commissions. In addition, the requirement to have licenses renewed every two years subjects the intermediaries to additional controls regarding the license and fit and proper requirements. Several insurance intermediaries have had their licenses suspended and not renewed due to the reduction of active agents. The FBiH-ISA has the power to conduct onsite inspections. The FBiH-ISA has so far carried out three onsite inspections. Once all intermediaries are licensed, the onsite inspections of agents selling for an insurer should be incorporated into the comprehensive onsite inspections procedures.

113. Brokers are not bound to disclose conflicts of interest or to segregate clients' moneys. Agents and brokers may collect money for voluntary insurance, but there are no specific safeguards. However, only one case of fraud by an agent collecting money on behalf of the insurer has been known to the FBiH-ISA. The FBiH-ISA has taken the appropriate actions and revoked the agent's license. It is recommended to require brokers to segregate funds that belong to policyholders and to disclose conflict of interests.

114. Complaints concerning the insurance sector are handled by the FBiH-ISA. Equipped with one person in this department, the FBiH-ISA responds to consumer complaints if there are clear violations of existing regulations like a payment of claims outside the stipulated period. Disputes on the amount of the payment cannot be considered and are rejected. Policyholders have then only the option to go to court. The FBiH-ISA is recommended increasing its resources dedicated to consumer protection.

115. The code of business ethics provides the standards for the insurers' conduct of business. The standards adopted in 2009 by the assembly of the Association of Insurers cover rules of behavior for the insurance companies in the procedures for contracting insurance policies. It also covers procedures for settling insurance claims and requests for benefit payments; the rules of the internal complaints procedure; good business practices, rules of the insurance profession in relation to consumers. Violations of the code are handled by a court of honor. The court of honors has the power to issue a reprimand, public reprimand, expulsion from the Association and filing complaint to the FBiH-ISA against the violating insurer. The participation of the FBiH-ISA in the court of honor sessions is recommended.

116. The Code of Business Ethics contains basic elements covering clients' treatment. In particular, the Code stipulates that when treating clients insurers should:

- Prior to concluding an insurance contract provide prospective policyholder and/or insured person with accurate data and, at his/her request, inform him/her fully and accurately of its status, financial, organizational, staffing and other capabilities for providing insurance services and its ability to underwrite risks in (re) insurance coverage, in particular major risks.
- Prior to concluding an insurance contract, fully and accurately inform clients of the insurance terms and conditions, premium rates, coverage options and the manner of exercising their rights and fulfilling their obligations under the insurance policy and any other matter pertaining to the provision of personal and property insurance services and shall adjust insurance coverage to the needs of each client.
- Prepare insurance terms and conditions and premium rates by employing clear and comprehensible language and avoiding any expression that may be used or construed in a different and/or ambiguous manner or be misleading to its clients. Such insurance terms and conditions and premium rates shall in no event contain any provision that is deemed aggravating or unfair under the Consumer Protection Act. This may be contrary to the principle of conscientiousness and integrity and may cause significant imbalances in contractual rights and obligations of the contracting parties to the detriment of any contracting party as a result of abuse by the company of its position as a party with greater "power."
- Comply with the terms of registered insurance conditions and premium rates, particularly in regard to the reduced premium incentives from the insurance premium or increased insured amounts and premium payment requirements different from those prescribed.
- Ensure equality and equal treatment of all clients.

- Undertake any such measure as may be required for their clients to exercise their rights as simply and as expediently as possible and for any disagreement or dispute to be settled, wherever possible, amicably, out of court and by avoiding any unnecessary costs and paperwork.
- During claims processing and compensation and payment of insured amounts, act professionally, efficiently and fairly, and, in particular, avoid any delay and/or failure to pay the uncontested portion of a claim, always bearing in mind the social function of the insurance industry, which is particularly emphasized in compulsory liability insurance.
- Respond to all complaints from their clients with due attention and expedience, respecting the rights and interests of their clients.
- Act in accordance with the rules of its internal complaints procedure, which should contain the following elements:
 - Each client must receive from the company a written response to any written complaint;
 - With reference to oral complaints or complaints sent by e-mail, each client must receive a response in the same form, and if any oral complaint is reiterated, such complaint must be recorded and the company shall ultimately respond thereto in writing;
 - The final response to a complaint lodged by a client in writing and a complaint sent by e-mail must contain legal advice on the possibility of continuation of the procedure under the existing mechanism for out-of-court dispute settlement;
 - Each client must receive the final response to a written complaint and a complaint sent by e-mail no later than the expiry of any such period as may be stipulated by the company's internal rules of business conduct (and in no event later than 45 days), and if such client, in his/her written complaint and/or complaint sent by e-mail, refers to facts or documents not available to the company, such period shall commence as of the date on which the client furnishes to the company all such evidence as may be required to establish such facts or delivers thereto all such documents as may be referred to in his/her complaint and as may be required for the company to provide its final response to the complaint; and
 - If the company is not able to respond within said period, it shall serve the client with written notice thereof, stating the reasons for such delay.

117. Consumer protection regulation needs to be enhanced and adequate resources allocated to its supervision. The FBiH-ISA has one person partly dedicated to dealing with consumer complaints and there is no alternative but going to court to settle disputes. The Code of Conduct adopted by the Insurance Association is a good step in protecting consumers. The regulation requires pre-contractual information in a clear and accurate form and disclosures of conflict of interests by intermediaries, the term to pay claims is regulated to be no more than 14 days or 30 days depending on the line of business. It is recommended moving consumer protection to the next level by:

- Issuing regulation that requires insurance companies to take into account the interests of different profiles of clients in the development and marketing of insurance products.

- Imposing insurance specific requirements on the insurance companies and intermediaries to promote products and services in a way that is clear, fair and not misleading should be implemented by the FBiH-ISA.
- Developing regulation on the fair treatment of customers, as the Law on Obligations does not regulate, in detail, the elements related to the fair treatment of insurance customers.
- Issuing regulation requiring insurers and intermediaries to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture
- Appointing an ombudsperson as required by the LICPI
- Once appointed allowing the ombudsman to adjudicate small amount claims, or establishing a small claims court system.
- Boosting the FBiH-ISA resources dedicated to consumer protection to promote consumer protection proactively.

118. Market discipline is weak with basic public disclosure requirements and low financial literacy. Following IFRS requirements, insurers are required to publish financial and income statements together with the auditor's opinion in an abbreviated form. The FBiH-ISA has not issued additional disclosure requirements for insurers. It is recommended issuing a rulebook on public disclosure that enhances the information about insurers to the public. Among other items, the following should be disclosed in the annual report:

- general information on the insurance company, including information about the owners of qualifying holdings in the insurance company, members of the management board, the executive board and the audit committee;
- description of the business environment and the position of the insurance company in the FBiH insurance market;
- information on insurance claims per type of insurance (number, amount and status or reported and settled claims, number and amount of provisioned claims as of 31 December of the previous year and of the year for which the report is submitted);
- mortality and morbidity data (per insurance product);
- details on contracts concluded for life insurance, that include number of active policies at the start of the accounting period, number of newly issued policies, number of canceled policies, etc.
- analysis of the ratio between the costs of implementing insurance and overhead allowance;
- analysis of approved bonuses and discounts;
- liquidity indicators, cost ratio, claims ratio and combined ratio;
- other indicators of business efficiency of insurance companies;
- important business events in the period between the end of the business year and the date of submitting the financial report;
- assessment of the expected future development of the insurance company;
- most important research and development activities;
- aims and policies of the insurance company regarding risk management, together with risk protection policies for each planned transaction that needs protection; and
- exposure of the insurance company to the price risk, credit risk, market risk, currency risk, liquidity risk and other risks present in the business operations of the insurance companies,

- rules of corporate governance that have been applied.

In order to improve market discipline, it is recommended to put more efforts into public education on insurance matters. A national strategy to raise financial literacy of the population in insurance matters should be developed. This effort will require the participation of all stakeholders and consideration should be made if the Insurance Agency should take the lead on this initiative.

119. The involvement of the FBiH-ISA in insurance fraud prevention is needs based.

Insurance fraud is a codified as a crime.⁵ Current regulation does not require insurance companies and intermediaries to take effective measures to deter, prevent, detect, report and remedy fraud in insurance. A centralized database for MTPL claims should be established to combat fraud and at the same time to apply properly bonus-malus pricing.

120. The analysis of large claims can provide supervisory insights to detect fraud. The FBiH-ISA is recommended implementing such a regular analysis, as well as encouraging insurers to publish information on fraud deterrence. The corresponding regulation that requires insurers and intermediaries to take effective measures to deter, prevent, detect, report and remedy fraud in insurance should be enacted and the formal analysis of large claims implemented in the supervisory process.

121. The FBiH-ISA has since June 2014 been the designated AML-CFT supervisor in the insurance and pension sector. While the mandate is new, the FBiH-ISA has been requiring insurers to monitor possible AML-CFT activities in the past and has adopted guidelines for risk assessment and the implementation of the Law on the Prevention of Money Laundering and Terrorist Financing. With very limited resources and basically no training, the FBiH-ISA is recommended increasing its engagement in this area. It is also encouraged to increase training and add resources to accelerate the level of understanding of the supervision and enforcement of AML-CFT regulation in the FBiH-ISA.

H. Market Structure and Industry Performance

122. The insurance sector remains small (Table 6). In 2013, the assets of the insurance sector amounted to KM 799 million, accounting for 5.11 percent of financial sector assets or 4.7 percent of GDP. The assets of the sector have been growing on average of 3.3 percent per year for the last four years, resulting in an increase of 17 percent between 2009 and 2013.

123. The insurance premium average growth rate has been six percent since 2009. Total premium in 2013 amounted to KM 387, an increase of 6 percent from 2012 (4 percent for nonlife and 16 percent life). The nonlife segment collects over 78 percent of the insurance premium of

⁵ Article 302 of the Criminal Code of the FBiH: *Whoever, with an aim of collecting insurance money from an insurer, destroys, damages or hides the object insured against destruction, damage, loss or theft and subsequently reports the damage, shall be punished by a fine or imprisonment for a term not exceeding two years.*

which 56 percent relates to the mandatory motor third party liability insurance (MTPL). The life premium share in total premium has been increasing. In 2009, life premium accounted for 18 percent of the total insurance premium and in 2013 accounted for twenty two percent, but in absolute terms remains small with KM 86 million.

**Table 6. Federation of Bosnia and Herzegovina:
Insurance Sector Assets, Technical Reserves,
Own Funds and Gross Premium 2009–2013**
(In KM million)

	2009	2010	2011	2012	2013
Total assets					
Nonlife	460.77	422.73	441.63	444.28	432.82
Life	223.28	237.97	274.74	318.73	366.25
Total assets	684.05	660.70	716.37	763.01	799.07
Technical reserves					
Nonlife	233.84	233.00	237.58	252.12	257.75
Life	173.81	189.87	225.67	265.03	309.14
Total TP	407.65	422.87	463.25	517.15	566.89
Own funds					
Nonlife	149.66	139.97	147.44	146.74	145.23
Life	40.39	41.75	39.45	43.04	47.16
Total	190.04	181.72	186.89	189.78	192.40
Premium					
Nonlife	277.31	282.38	287.00	288.46	300.13
Life	61.56	65.46	69.77	74.60	86.70
Total	338.87	347.84	356.77	363.06	386.83

Source: Authorities.

124. The number of insurers has dwindled as the insurers have been liquidated since 2009.

At the end of 2013, 13 institutions were licensed in the FBiH, compared with 16 in 2009 (Table 7). Five companies are nonlife companies while seven are composite insurers providing both nonlife and life, and there is one reinsurer. Nine branches of insurers licensed in FBiH are operating in the RS and account for around eight percent of the market. The FBiH-ISA is responsible for the market conduct of these branches. Seven of the 13 insurers are domestically owned, and six by foreign capital. Only 5 brokers were licensed in 2013 and 165 agents are servicing the market.

**Table 7. Federation of Bosnia and Herzegovina:
Number of Registered Insurance Undertaking and Intermediaries, 2009–2013**

	2009	2010	2011	2012	2013
Insurers					
Life (long-term)	1	1	1	1	0
Non-life (general)	6	6	6	6	5
Composite (life and non-life)	8	8	7	7	7
Reinsurance	1	1	1	1	1
Total	16	16	15	15	13
Insurance intermediaries					
Agents	240	230	205	142	165
Brokers	4	5	6	6	5

Source: Authorities.

125. The nonlife insurance segment shows low concentration but in life sector three insurers account for almost 80 percent of the market in FBiH. Thirteen insurers of which eight have more than five percent market share serve the nonlife sector (Table 8). The low concentration in this sector indicates a high level of competition. This has probably driven some insurers to offer technically insufficient premiums for MTPL and accident insurance. In the life segment, the top three insurers account for 78 percent of the market. The remaining 22 percent is shared between four composite local insurers (Table 9).

**Table 8. Federation of Bosnia and Herzegovina:
Market Share of Top 10 Nonlife Insurers, 2013**

Insurer	Total premium (Percentage share of the industry)
Sarajevo	20.53
Euroherc	14.89
Bosna-Sunce	13.91
Croatia	11.51
Triglav	9.08
Uniqa	8.05
VGT	7.69
Zovko	5.53
ASA	3.60
Camelija	2.97
Total	97.77

Source: Authorities.

**Table 9. Federation of Bosnia and Herzegovina:
Market Share of the Life Insurers, 2013**

Insurer	Total assets (Percentage share of the industry)
Grawe	31.74
Merkur BH	24.24
Uniqa	21.88
Croatia	8.26
Triglav BH	5.53
Sarajevo osigur.	4.31
BSO	4.04
Total	100.00

Sources: Authorities.

126. The main driver of the nonlife segment is mandatory insurance. With almost 56 percent of the business coming from the mandatory MTPL and an additional 15.5 percent related to motor insurance, the nonlife business has benefited from the mandatory insurance. The remaining 28.5 percent is mainly distributed among property and accident and health insurance. Other lines of business account only for 2.7 percent of premium. This distribution of lines of business has not changed significantly over the last three years. The development of voluntary insurance and of the life sector, that currently has KM 86 million in premium, mainly in participating endowments, remains a challenge (see Table 10).

**Table 10. Federation of Bosnia and Herzegovina:
Nonlife Insurance Products**
(In percentage of total premium)

	2011	2012	2013
Motor	17.83	16.52	15.50
Property	16.47	15.99	14.92
Liabilities (including MTPL)	53.47	54.79	55.95
Accident and health	11.68	11.16	10.93
Others	0.56	1.53	2.70
Total	100.00	100.00	100.00

Source: Authorities.

127. Asset composition is predominantly in bank deposits, real estate and receivables. Investments account for 82 percent of the assets of which over 66 percent are held in bank deposits and cash. Real estate investments and receivables are about the same and make up 28 percent of assets. The lack of liquid markets has driven insurers to match their liabilities with liquid assets, resulting in large bank deposits and cash held as assets. This applies to both nonlife and life insurers.

As life insurance generates long-term liabilities, the demand for long-term assets to match the liabilities will increase. Currently, life insurers are using real estate and government bonds for this purpose.

128. Liquidity risk is not systemic. With 54 percent assets held in bank deposits and cash, the insurance sector is not exposed as a whole to liquidity risk; however, a few insurers have an important percentage of their assets in real estate and could be unprotected from liquidity crunches especially if using excessive valuation for the real estate. The composition of the assets of the non-life and life sectors over the last five years are shown in Tables 11 and 12, respectively

**Table 11. Federation of Bosnia and Herzegovina:
Assets of the Nonlife Insurance Sector, 2009-2013**
(In million KM)

	2009	2010	2011	2012	2013
Total assets	460.77	422.73	441.63	444.28	432.82
Intangible assets	2.06	2.62	3.93	3.66	3.51
Investments	289.30	266.08	278.42	286.08	296.78
<i>of which:</i>					
Government securities	0.00	0.61	2.78	2.85	7.09
Corporate securities	1.67	4.31	0.00	0.00	0.00
Equities	15.60	16.05	16.35	16.27	18.48
Real estate and real-estate related	122.74	88.86	94.74	96.55	101.35
Cash and bank balances	87.53	86.69	96.61	107.71	128.09
Receivables	107.01	88.08	93.31	82.62	64.09
Intra-group/related company receivables	0.00	0.00	0.00	0.00	0.00
Reinsurance recoverables	27.70	29.96	31.01	38.71	39.61
Other assets	34.70	35.99	34.96	33.22	28.84

Source: Authorities.

**Table 12. Federation of Bosnia and Herzegovina:
Assets of the Life Insurance Sector, 2009-2013**
(In million KM)

	2009	2010	2011	2012	2013
Total assets	223.28	237.97	274.74	318.73	366.25
Intangible assets	0.59	0.63	0.63	0.86	1.10
Investments	211.25	227.00	264.52	307.09	355.37
<i>of which:</i>					
Government securities	0.00	2.50	7.42	10.37	16.98
Corporate securities	0.71	1.78	0.00	0.00	0.00
Equities	8.85	3.24	2.79	4.47	3.37
Real estate and real-estate related	11.11	10.51	8.34	9.39	9.37
Cash and bank balances	172.86	193.52	226.79	261.70	300.55
Investments supporting unit-linked	0.00	0.00	0.00	0.00	0.00
Receivables	8.06	5.59	4.98	4.94	2.57
Intra-group/related company receivables	0.00	0.00	0.00	0.00	0.00
Reinsurance recoverables	1.61	2.53	2.23	2.74	3.17
Other assets	1.78	2.22	2.37	3.10	4.04

Source: Authorities.

129. The usage of reinsurance is low but effective. With only less than 16 percent of the premium reinsured, an important part of the insurance risk is retained by the sector (Table 13). The MTPL does not require a large amount of reinsurance since the largest claims are covered by the green card guarantee fund with the retention as high as 96.6 percent. Around 50 percent of property business is retained. Property policies offer flood and earthquake protection as an additional coverage. Notwithstanding the low usage of reinsurance, the reinsurance programs appear to be effective. Noting that the green card accident is automatically covered by its guarantee fund, of the top 10 claims with one exception, between 56 and 90 percent of the claims were reinsured (Table 14).

Table 13. Federation of Bosnia and Herzegovina: Retention Ratio
(In percentage of the written premium)

	2011	2012	2013
Motor	77.09	80.24	80.64
Property	46.11	53.97	50.52
Liabilities (including MTPL)	95.83	96.41	96.58
Accident and health	91.43	92.69	89.42
Others	79.36	87.06	23.56
Average	83.69	86.39	84.48

Source: Authorities.

**Table 14. Federation of Bosnia and Herzegovina:
Top Ten Claims and the Reinsurance Participation**

Damage Description	Amount (In KM)	Reinsurance share (In percent)
Hydroelectric power plant -breakage	2,967,648	90
Fire	2,808,921	56
Property-burglary, robbery	2,054,623	76
Accident green card	1,653,002	0
Fire	1,650,000	85
Property -burglary, robbery	1,584,096	85
Accident abroad	1,372,743	58
Accident -tourists, income	1,349,170	85
Electricity	1,012,500	90
Property-fire	987,227	85

Source: Authorities.

130. The insurance sector has been profitable. Over the last five years, the nonlife sector has shown positive returns on equity (ROE) that amounts, on average, to 5.61 percent. The life sector ROE has improved recently, increasing to 6.92 percent in 2013. Investment returns in the nonlife segment have been very low, explaining by a larger share of real estate investments than the life segment (Table 15). The profits have been eroded by high costs and are partly supported by liberal valuation of real estate and loans. As the combined ratios (net claims and expenses over net premium, but without reinsurance commission) are above or close to 100 percent, companies can only generate profits through investment yields (Table 16). The corporate tax of 10 percent supports net profits notwithstanding that only 20 percent of the technical provision in nonlife can be deducted as expenses.

**Table 15. Federation of Bosnia and Herzegovina: Return on Equity
and Investment Income of the Insurance Sector**

(In percentage, 2009-2013)

	2009	2010	2011	2012	2013	Average
Nonlife						
Investment income	2.78	2.73	2.50	3.43	2.84	2.86
ROE (after tax)	7.06	5.74	4.53	6.07	4.63	5.61
Life						
Investment income	4.51	5.05	4.82	4.64	4.57	4.72
ROE (after tax)	0.04	0.78	7.89	7.48	6.92	4.62

Source: Authorities.

**Table 16. Federation of Bosnia and Herzegovina:
Technical Provisions**
(As a percentage of premium in nonlife)

	2009	2010	2011	2012	2013
Gross premiums	112.03	113.68	121.05	128.12	127.13
Technical provisions	98.73	99.50	105.82	114.59	120.46
Ratio	88.13	87.53	87.42	89.43	94.75
Combined ratio 1/	1.07	1.11	1.00	0.93	0.98

Source: Authorities.
1/ The reinsurance commission is not considered.

131. Five companies accounting for 40 percent of the nonlife market have solvency margins that are close to requiring supervisory measures. Currently one insurer, accounting for 4 percent of the market, is insolvent. Four insurers, accounting for just below 36 percent of the market, have solvency ratios between 100 percent and 110 percent. However, the resilience of the sector could be even worse given that Solvency I requirements do not fully allocate capital according to the risks. The fragmented nonlife insurance market, with premiums well distributed among the participants, has increased competition. In some cases this has led to insufficient premium for the risks assumed. Market participants bypass regulation that fixes not only the tariff but also the commissions by assuming additional non-regulated expenses for instance in the areas of administration and servicing. The solvency ratios of the nonlife insurers are shown in Table 17.

**Table 17. Federation of Bosnia and Herzegovina:
Nonlife Insurers' Solvency Position 2013-June 2014**
(In percent)

Insurer	Solvency ratio 2013	Solvency ratio 2014Q2
1	-71	-40
2	97	108
3	103	101
4	105	105
5	112	109
6	114	122
7	127	126
8	127	131
9	140	144
10	143	149
11	244	224
12	529	552

Source: Authorities.

I. Table of FSAP Recommendations for the Federation of Bosnia and Herzegovina

Recommendations and Authority Responsible for Implementation	Priority	Timeframe¹
The appointment of the FBiH-ISA director should follow according to the law (FBiH Government).	High	Immediately
The new insurance law in the FBiH should be approved if it shows improved convergence towards the EU insurance directives (BiH-IA and FBiH Parliament).	High	Immediately
It is recommended to include the FBiH-ISA in the SCFS to gain a complete overview of the financial sector in matters of stability. (Government/ Parliament).	Medium	Near Term
It is recommended introducing in the law the position of the Deputy Director and as the market grows to consider a full time Experts Council for the FBiH-ISA (Government/Parliament).	High	Immediate
It is recommended acquiring the centralized IT system (FBiH-ISA).	High	Immediately
A centralized claims database for MTPL should be created (FBiH-ISA).	High	Immediately
It is recommended to update the law to allow only the FBiH-ISA to be sued as an institution, but not the staff. If that appears not to be possible, the law should be at least clear on the ISA as the responsible for providing for the costs of defending law suits that are initiated against their staff. In addition, the legal protection should cover all FBiH-ISA staff (Parliament).	High	Near Term
The creation of a Coordinating Committee among the financial sector supervisors should be established in the FBiH. The Committee should incorporate a formal regular channel of information sharing with the banking sector supervisor to gain timely information on the financial soundness of all banks holding insurance sector assets above a threshold (FBiH-government).	High	Near Term
A consolidated supervisor at entity level in the long term could be a better channel than the Coordinating Committee for cross sector cooperation. In the long-term, consideration should be made to the establishment of an integrated supervisor (FBiH-ISA and government).	Medium	Medium Term
It is recommended considering outsourcing the IT with a dedicated in house resource to constantly monitor it (FBiH-ISA).	High	Near Term
It is recommended creating an internal audit function (FBiH-ISA).	High	Immediately
It is recommended developing an early warning system. In addition, the introduction of stress testing at the company level and market wide is recommended. Capacity building in this area will be required (FBiH-ISA).	High	Near Term
It is recommended introducing in the law a comprehensive group	High	Near Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe ¹
supervision framework together with the required training for its supervision (Parliament).		
As the market develops further, a macroprudential supervision framework should be introduced. Consideration to assign the development of macroprudential tools and their usage to the Insurance Agency should be evaluated and the implementation power should be granted the ISAs (State government).	Medium	Medium Term
It is recommended requiring fit and proper for all governance board members and the internal auditor (FBiH-ISA).	High	Near Term
It is recommended conduct interviews with the candidates for control functions to gain a stronger opinion of their fit and proper (FBiH-ISA).	Medium	Medium Term
It is recommended introducing requirements similar to licensing requirements for the application for the approval of the acquisition of insurance shares over 50 percent (FBiH-ISA).	High	Medium Term
It is recommended clarifying the interplay between the different laws, including the role of the Protection Fund in the MTPL business that applies in winding up an insurer (Parliament).	Medium	Near Term
It is recommended updating the solvency regime by a gradual incorporation of risk elements into the solvency framework. Credit risk capital surcharges on the assets, and then differentiated factors depending on the line of business that apply to the premium and claims calculation could be the starting point (FBiH-ISA).	High	Near Term
It is recommended that once a risk sensitive solvency regime and the early warning system are in place, the development of a ladder of interventions based on capital levels with the corresponding prompt corrective actions should be introduced (FBiH-ISA).	High	Medium Term
A revision of the liquidity ratio that excludes assets dedicated to cover the technical provision is recommended (FBiH-ISA).	High	Near term
The FBiH-ISA is recommended allocating sufficient resources and using appropriate IT systems to produce timely offsite reports for all insurers. Any decision making meeting where the conditions of the insurers are discussed should be documented (FBiH-ISA).	High	Immediately
The development of an inspection' manual is recommended. Market wide targeted actuarial reviews should be regularly carried out, and the frequency of onsite inspections of intermediaries increased (FBiH-ISA).	High	Immediately
It is recommended introducing a process that allows tracking the initial finding of the inspectors as well as the possible changes the report made before it was submitted to the insurers (FBiH-ISA).	High	Immediately
It is recommended revising the amount of fines to levels that	High	Medium Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe ¹
become effective tools to deter unwanted mechanism (Parliament and FBiH-ISA).		
It is recommended removing any legal ambiguity so that the Protection Fund pays immediately victims of traffic accidents who were insured by the insurer under special liquidation (Parliament).	High	Medium Term
<p>It is recommended updating governance requirements in the following areas:</p> <ul style="list-style-type: none"> • the board structure with the corresponding committees, governance standards, board composition and knowledge, and assessment of the effectiveness of the board. • remuneration policy of board members and senior management; • duties of individual board members including acting in the best interests of the insurer and policyholders; • timely and effective communication with the RS-ISA and relevant stakeholders (including policyholders) on the governance structure of the insurer (FBiH-ISA). 	High	Medium Term
<p>It is recommended strengthening the existing regulation in the areas of internal controls, risk management and corporate governance requirements on insurers:</p> <ul style="list-style-type: none"> • Scope of internal controls – To be effective, internal controls should be comprehensive, covering the insurer’s key business, IT and financial processes. Key control functions should at a minimum include the internal audit and actuarial functions, the risk management function. Each key control function should be led by a person suitable for the position, have sufficient independence from business units and adequate resources, and have access to the board and provide regular reports to the board. • Duties of key control functions: • Risk management should assess risks on an enterprise-wide basis. There should be a defined risk appetite, documented approval process and authorities, established risk strategy, and escalation and reporting procedures. • Internal audit should assess the adequacy and effectiveness of an insurer’s policies and procedures, and the documentation and controls of these. It should also evaluate the reliability and integrity of management information. 	High	Medium Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe ¹
<ul style="list-style-type: none"> Compliance function should be introduced to advise on compliance with laws, regulations and internal policies and procedures. Compliance procedures should be integrated into work processes. Regulation on outsourcing should be enacted to require: (a) board approval of outsourcing of material functions or activities, (b) due care and diligence in selecting the outsourcing providers, (c) written documentation of the outsourcing arrangements, and (d) periodic review of such arrangements (FBiH-ISA). 		
<p>It is recommended enhancing reinsurance supervision and regulation:</p> <ul style="list-style-type: none"> The financial stability of reinsurers should be analyzed annually. Risk transfer requirements on the reinsurance contracts should be specified. Cash call clause should be included for catastrophic events Prohibition of side letter to guarantee the integrity of the contracts should be implemented (FBiH-ISA). 	Medium	Near Term
<p>It is recommended offering the actuarial examination to become appointed actuaries on a regular basis (FBiH-ISA).</p>	Medium	Near Term
<p>It is recommended to modify the corporate income tax law to allow for a full recognition of the technical provisions as expenses. However, this should be done without loss of income for the government (Government).</p>	Medium	Medium
<p>It is recommended introducing corporate governance requirements for insurance intermediaries according to their size and complexity independently of the legal form under which they operate (FBiH-ISA).</p>	Medium	Medium Term
<p>It is recommended requiring brokers to segregate funds that belong to policyholders and to disclose conflict of interests (FBiH-ISA).</p>	Medium	Medium Term
<p>The participation of the FBiH-ISA in the sessions of the Court Of Honor of the Insurance Association is recommended (FBiH-ISA).</p>	Medium	Immediately
<p>It is recommended appointing an Ombudsperson having adequate resources and actively promoting the use of the ombudsperson function (FBiH-ISA).</p>	High	Near Term
<p>It is recommended moving consumer protection to the next level by:</p> <ul style="list-style-type: none"> Issuing regulation that requires insurance companies to take into account the interests of different profiles of clients in the development and marketing of insurance 	High	Near Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe ¹
<p>products.</p> <ul style="list-style-type: none"> • Imposing insurance specific requirements on the insurance companies and intermediaries to promote products and services in a way that is clear, fair and not misleading. • Developing regulation on the fair treatment of customers, as the Law on Obligations, does not regulate in detail the elements related to the fair treatment of insurance customers. • Issuing regulation requiring insurers and intermediaries to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture • Increasing resources for the ombudsperson to allow for stronger and intensive insurance education programs. • Granting decision-making power to the ombudsperson to adjudicate small amount claims, or establishing a small claims court system. • Boosting the FBiH-ISA resources dedicated to consumer protection to initiate needed activities in this area, like developing jointly with other stakeholders an insurance literacy strategy and actively implementing supervision of fair treatment of customers. <p>(FBiH-ISA and Government/Parliament).</p>		
<p>A comprehensive strategy to increase the insurance literacy of the public needs to be developed. Collaborating with the industry in this area will be beneficial and the role of the Insurance Agency in leading this initiative should be evaluated (Government).</p>	High	Near Term
<p>It is recommended introducing regulation that requires insurers and intermediaries to take effective measures to deter, prevent, detect, report and remedy fraud in insurance. The formal analysis of large claims should be implemented in the supervisory process (FBiH-ISA).</p>	Medium	Near Term
<p>A centralized database for MTPL claims should be established to combat fraud and at the same time to apply properly bonus-malus pricing (FBiH-ISA).</p>	Urgent	Near Term
<p>It is recommended publishing also regulations in draft form before they are approved, thus allowing for an additional channel to get comments from the public (FBiH-ISA).</p>	High	Immediately
<p>The public disclosure requirements need to be enhanced following the IAIS principles (FBiH-ISA).</p>	High	Near Term
<p>It is recommended increasing the training and resources in the FBiH-</p>	High	Near Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe ¹
ISA to speed up the level of understanding the supervision and enforcement of AML-CFT regulation (FBiH-ISA).		
It is recommended establishing quality control committees for auditing work (Chamber of auditors).	Medium	Immediately
¹ "Immediate" is within one year; "near-term" is 1–3 years; "medium-term" is 3–5 years.		

THE REPUBLIKA SRPSKA INSTITUTIONAL, REGULATORY, AND MARKET STRUCTURE

A. The Supervisor

132. This section covers the supervisory objectives powers and responsibilities. The pertinent ICPs are ICP 1 and ICP 2 which cover the set up and mandates of the supervisor as well as its operational independence. Aspects of ICP 3 and ICP 25 related to the exchange of information, and ICP 26 related to cooperation in crises are also discussed.

133. The objectives of the supervisor are clearly set in the legislation. Article 6 of the LIC states that the RS-ISA shall monitor the application of laws and bylaws in the insurance field, voluntarily capitalized pension insurance and other regulations. The RS-ISA is also mandated to regulate the insurance activity, create market confidence, prevent and deter financial crime, educate the public and protect consumers in the areas of its competence.

134. The provisions of article 5, paragraphs 1, 2 and 4 of the law stipulate the establishment of the insurance supervision agency of the RS (RS-ISA). The RS-ISA was created as an independent and non-profit institution of the RS accountable for its operations to the National Assembly of the RS. The RS-ISA has regulatory and supervisory functions and it issues and revokes licenses for insurers and intermediaries. The RS-ISA is run by a director that is appointed for a term of 4 years responding to an appointed board for 5 years. The appointments' procedures and dismissal reasons for the board and director are stated in the LIC. The board is not a fulltime board. It is responsible for issuing regulation, approving the budget and approving the financial activities and market overview reports. All supervisory decisions are taken by the director. The law does not provide for a deputy director position, and an acting director is appointed by the director before any leave is taken. The lack of a formal deputy director can create a legal gap in supervision during the absence of the director. It is recommended introducing in the law the position of deputy director and as the market grows to consider a full time managing board for the RS-ISA.

135. The RS-ISA publishes externally audited annual financial statements and reports to the assembly on a regular basis. It is subject to audit by the Supreme Office for the RS public sector audit, but has not been audited as of today. The internal audit is outsourced to suitable professionals or by ad-hoc commissions set up by the director. The establishment of an internal

audit department is anticipated during the coming year. The decisions of the RS-ISA can be appealed to the administrative court and this has happened.

136. The RS-ISA is organized into five departments and has a staff of 26. The RS-ISA operates with the following departments Department of Actuarial Affairs, Department for Financial and Accounting Supervision, Department of Legal Affairs and Licensing, Office for Consumer Protection, Secretariat and Cabinet of the Director. Operation manuals have been developed that describe the processes and systems in place. Each position has a description of the qualification requirements, tasks and responsibilities. A code of ethics exists and has to be signed by every employee. On an annual basis, a working plan which covers all agency's activities is adopted. Its web page publishes relevant market information as well as all regulations, including those subject to consultation, and other reports.

137. The funding is sufficient for the RS-ISA to discharge its obligations, but the basis may create conflicts. The RS-ISA is funded through licensing fees (10 percent of the funds) and through industry levies that are linked to the premium (90 percent). Any changes of the percentage of the levies against premium need government approval but are first presented to the MoF. The budget has been increasing in recent years and the operations are run with surplus that is kept within the RS-ISA as a reserve to support operational continuity and stability. The linkage of the levies to the premium can create misalignments between the cost and efforts since the companies that underprice the market even below claim cost, and should require more supervisory attention, will be contributing less to the costs of supervision. It is recommended to consider a revision of the basis to determine the levies while taking account of the types of insurance provided by an insurance company.

138. The legal protection of RS-ISA staff needs to be strengthened. The employees of the RS-ISA enjoy adequate legal protection when carrying out their duty pursuant to the regulations governing the insurance field, unless it is proved that a certain act or omission was committed intentionally or due to gross negligence.⁶ However, the law has not defined who bears the defense costs for the RS-ISA employees with regard to court proceedings for actions undertaken in good faith during the performance of duties, provided that they have not worked contrary to the law. It is recommended updating the law to allow the RS-ISA only to be sued as an institution and not the staff. If that appears not to be possible, at least the law should be clear on the RS-ISA as the responsible party for providing for the costs of defending law suits that are initiated against its staff.

139. The confidentiality of the information gathered by the RS-ISA is well protected, but auditing the outsourced IT system should be carried out regularly. The provisions of article 18 of the Law deal with the protection of confidentiality of information held by the RS-ISA, including all

⁶ Article 10, paragraph 8 of the LIC regulates that: *"The members of the Management Board, the Director and the employees shall not be liable for any damage arising from the performance of their duties within the regulations governing the insurance field, unless it has been proved that a certain act or omission was committed intentionally or by gross negligence."*

confidential information held by the RS-ISA, and propose penalties for disclosure of confidential information.⁷

140. The IT system is protected by up-to-date security procedures and a detailed outsourcing contract is in place. The external IT provided is a large international IT company that uses modern procedures to protect the IT system. RS-ISA has plans to develop an in-house IT department. The IT provider will be audited by an external professional in the coming year. It is recommended having the outsourced IT constantly monitored by an in-house expert.

141. A Coordination Committee for the financial sector supervisors has been established in the RS. The Committee for the Coordination of Financial Sector Supervision (CCFSS) was established in 2009 with the Act on the Committee for the Coordination of Financial Sector Supervision. The CCFSS purpose is to institute cooperation and coordination between the three supervisory authorities (banking, insurance and securities in both entities), thus allowing adoption of a uniform strategy and guidelines for the supervision of the sector. Members of the committee are from the highest level of each institution: the Minister of Finance, the Chairperson of the Securities Commission, the director of the Banking Supervision Agency, and the director of the Insurance Supervision Agency.

142. The Coordination Committee is supported by several working subcommittees.

Coordination between supervisory authorities includes cooperation in areas that are common to the supervisory authorities, within the boundaries of their powers and activities, and includes:

- Creating and implementing a unique strategy and guidelines in the area of regulation and supervision of the financial sector;
- Initiating the harmonization of regulations with the market requirements, international standards and EU regulations;
- Annual planning of activities and monitoring the implementation of signed agreements;
- Identifying potential problems and detecting crisis situations in order to avoid negative consequences;
- Taking stands and proposing measures to strengthen and improve financial sector supervision;
- Providing access to information and exchange of information necessary in the process of the supervision of financial organizations;
- Exchange of information in the licensing process;
- Exchange of information about facts and events pertaining to related parties that may have an impact on a situation or action that is subject to inspection by another supervisory authority;
- Providing the information needed for the resolution of specific issues and decision-making;

⁷ For instance, article 18 of the LIC states: "All persons who are currently employed or who have been employed in the RS-ISA, as well as the auditors and experts hired by the RS-ISA, shall have the obligation of professional secrecy. None of the confidential information received during the performance of their duties may be disclosed to any other person or authority, except in total and cumulative form such that the identity of the individual insurance companies cannot be identified, without prejudging cases covered by criminal law."

- Organization of joint inspections;
- Provision and exchange of information on irregularities identified by the supervisory authority during an inspection, if the observed irregularities are relevant to the work of other supervisory authorities;
- Organizing and ensuring protection of the rights of users of services of the financial sector; and
- Other joint activities that contribute to a stronger coordination and implementation of financial sector supervision.

The Committee meets at least once every three months or more often, if necessary. The Committee acts as an advisory body which considers and evaluates relevant issues and potential measures to preserve the stability of the financial sector.

143. The Coordination Committee deals with sector-wide issues, including systemic risks.

The Committee acts as an advisory body to the regions involved in the process of maintaining the stability of the financial sector in each region. Pursuant to the constitutional and statutory powers and regulatory documents of The Coordination Committee, the Coordination Committee coordinates its members, as well as other key players involved in the process of maintaining the stability of the financial sector of the region. In case of significant changes in circumstances and turbulences on the financial market, the Coordination Committee is required to inform the Government and the People's Assembly of the corresponding entity on the situation and to propose the stabilizing measures. Communication can be shared, but this happens on a needs basis. It is recommended to establish a regular and formalized information sharing process to enhance cooperation and allow all financial sector supervisors to gain access to supervisory data on a timely basis.

B. Supervision

144. This section covers the quality and effectiveness of supervision. The pertinent principles are: (i) ICP 9 that looks into general aspects of offsite and onsite supervision; (ii) ICP 10 about the preventive measures available and used by the supervisor, and (iii) ICP 11 that evaluates the enforcement ability of the supervisor. There is no group supervision framework in place as required by ICP 23. Macroprudential supervision is also discussed below (ICP 24).

Offsite Supervision

145. The RS-ISA obtains a wide range of information to perform offsite supervision:

- data recorded in the register of insurance companies;
- financial statements and the annual business report, with the opinion of a certified actuary and of organs in the insurance company who perform oversight, with explanation;
- audit report with management letter;
- work program and reports of internal audit;
- report on implementation of the coinsurance and reinsurance policy, with the opinion of certified actuary;

- business plan, articles of association and other general acts and their amendments;
- adopted business policy acts, as well as all amendments to these acts, regarding which a certified actuary previously has provided his or her opinion;
- notice of the appointment or change of certified actuary and internal auditor, as well as notice of employment or change of actuary and internal auditor;
- notice of convening the shareholders' meeting and the records from the shareholders' meeting; and
- other information, reports and data defined by the regulations governing the field of insurance.

146. Extensive information and data with a frequency determined by the RS-ISA is available to the supervisor. Data in the format as determined by the RS-ISA is required from insurers and intermediaries on a monthly, quarterly, and annual basis. For this purpose, the RS-ISA has issued a series of reporting guidelines to standardize the collection of data:

- Rulebook on the Method, Content and Deadlines for Submission of Reports, Notices and Other Information of Insurance Companies;
- Rulebook on the Form and Content of Supervisory and Statistical Reports of Insurance and Reinsurance Companies;
- Decision on the Form and Content of Supervisory Statistical Reports of Protection Fund of the RS;
- Rulebook on the Amount and Method of Investment for Covering of the Technical Reserves and Minimal Guarantee Fund of Insurance Companies;
- Rulebook on Elements and Control of Solvency Margin of Insurance Companies;
- Rulebook on Method of Calculation of the Capital and Capital Adequacy of Insurance Companies;
- Rulebook on Manner of Assessment and Monitoring of the Liquidity of the Insurance Companies; and
- Rulebook on Manner of Appraisal of the Balance and Off-balance Items.

Current insurance legislation does not contain requirements with regard to outsourcing. The inclusion in the regulation on the reporting of outsourced activities is recommended.

147. The RS-ISA is transitioning its reporting requirements into electronic records. After one year of parallel testing receiving both electronic records as well as paper records. As of 2015, the data reporting will be exclusively electronic. In addition, the calculation of certain ratios will then be done automatically as will be the data quality controls.

148. Material changes affecting the supervised entity are required to be promptly reported. Article 14, paragraph 6 of the LIC, prescribes the obligation of an insurance company to report on all material changes or incidents that may affect its position or clients promptly. For instance liquidity or solvency ratios below the regulatory requirements and reasons that would lead to license withdrawals need to be reported.

149. The offsite supervision process uses the reports received from the insurers for:

- verification of compliance by insurers with the requirements of the regulation;
- identification of risks and negative trends in the business of insurers;
- performing qualitative and quantitative analysis of the activities of insurers;
- starting a timely intervention in the operations of insurers whose financial condition does not meet the established requirements or shows signs of deteriorating; and
- deciding on an extraordinary onsite inspections.

150. The RS-ISA has started compiling financial indicators and is working towards developing an early warning system. The insurers' resilience condition is analyzed by looking at trends and outliers of a few ratios and raw data. The RS-ISA is in the process of introducing CARMEL analysis (Appendix B). The RS-ISA is recommended to develop an early warning system by introducing a set of robust indicators, both quantitative as well as qualitative, that are calibrated to the market conditions. In addition, the introduction of stress testing at the company level and market wide is recommended to complement the current practices of its offsite analysis. Capacity building in this area is required.

151. Offsite supervision triggers supervisory actions when necessary. Findings and recommendations, potential risks and proposals for the elimination of these risks, and recommendations with regard to compliance with the requirements established under the legislation are prepared based on the analysis. These records are discussed with the RS-ISA experts' group composed of senior management. If necessary, additional information from the company is required; measures can be imposed or an extraordinary onsite inspection is initiated.

Onsite Inspections

152. The RS-ISA adopts an annual plan for regular onsite supervision. The plan includes insurance companies, subsidiaries of insurance companies from the FBiH, insurance intermediaries and the Protection Fund. The plan defines the entity, subject matter and period of supervision, as well as the persons in charge for supervision. Where necessary, the plan is revised during the course of the year. In addition, the RS Agency has adopted an internal Instruction on Conducting Regular and Exceptional on site supervision, and a number of methodologies for different business segments of the insurance company that standardize and unify supervisory procedures. In recent years, the number of onsite inspections has increased from 11 in 2011, 15 in 2012, to 27 in 2013. The use of external experts for internal inspections, if needed, is provided by the LIC. Regular targeted actuarial assessment of the technical provisions is recommended.

153. Rules on initiating and conducting on site supervision of an insurance company are regulated by the Rulebook on Supervision of the Participants at the Insurance Market. RS Agency issues a decision to initiate the supervision in which it determines the subject, the date and the persons who will conduct the supervision. Regular onsite supervision is performed based on the previously issued Annual Plan of regular supervisions. The onsite inspection is guided by a series of internal documents and a comprehensive inspection manual that covers all relevant areas and is constantly being updated and enhanced as needed. The RS-ISA has adopted the following methodologies for conducting supervisions:

- Methodology for Supervision of the Implementation of Reinsurance and Co-insurance Policies in Insurance Companies;
- Methodology for Supervision of Investment for Covering of the Technical Reserves and Minimal Guarantee Fund of Insurance Companies;
- Methodology for Supervision of Liquidity of Insurance Companies;
- Methodology for Supervision of Advance Payments, Receivables and Placements of Insurance Companies;
- Methodology for Supervision of Provisions for Damages of the Companies for Nonlife Insurance; and
- Methodology for Supervision of Resolving Claims for Damages and Claims for Payment of Sums Insured.

154. Onsite inspections can lead to preventive and corrective measures, if deemed necessary. Upon conclusion of the onsite supervision, the RS-ISA interviews the management and/or the significant owners of the inspected insurance company regarding all the relevant findings and results of the inspection, as well as the need to introduce preventive or corrective measures. Once imposed, the implementation of the supervisory measures is followed up on a regular basis. Following article 54, paragraph 10 of the law: *“an insurance company is within the set deadline obliged to eliminate the illegalities and irregularities, to comply with the additional measures and to submit a report to RS Agency, as well as documents and other evidence indicating that the illegalities and irregularities are eliminated, or that it acted in accordance with additional measures.”*

Supervisory Powers and Available Tools

155. The RS-ISA has a set of preventive and corrective measures to address the deterioration of in insurers’ financial conditions and to correct potential regulatory breaches. The provisions of article 54 of the LIC stipulate the authority of the RS-ISA to take prompt corrective measures in the event that the insurance company does not operate in a manner that corresponds to the solid business practices or regulatory conditions. A set of procedures or corrective measures is established, which includes implementation of early intervention, if necessary, in proportion to the severity of problems within an insurance company. The RS-ISA, if deemed necessary, can issue orders to an insurer or intermediary to eliminate the illegalities and irregularities; it can prohibit dividend payments, other measures include the license revocation.

156. Regulatory irregularities trigger the issuance of an order to remove them. The following irregularities will trigger an order:

- work on the important position is performed by a person for whose appointment the insurance company did not provide consent, or a person for whom RS Agency ordered a measure of dismissal;
- an insurance company does not meet the requirements for all or certain insurance operations;
- an insurance company violates the rules on risk management, as well as rules on liquidity and solvency;

- an insurance company violates the rules on keeping business records, preparing financial statements, audit, internal audit;
- an insurance company violates the rules on reporting and informing RS Agency;
- an insurance company violates the rules on appointment of authorized auditor and certified actuary;
- an insurance company does not respect the adopted business policy acts; and
- an insurance company does not respect other provisions set forth in the regulations governing the field of insurance.

157. Violating prudential indicators will trigger remedial actions. Violations of liquidity or solvency ratios, capital adequacy requirements, rules on forming funds to cover technical and mathematical reserves, investment rules for covering the technical and mathematical reserves, reinsurance rules, or any imposed restrictions will trigger additional measures to be imposed on the insurance company:

- an order requiring the insurance company to adopt: an action plan to meet the requirements of capital adequacy, improve liquidity and solvency, provision of investment funds to cover technical and mathematical reserves, improvement of the billing process of receivables due, which at least includes the assessment of costs, and a detailed assessment of revenues and expenditures from direct insurance, balance draft, assessment of required financial resources and their sources, reinsurance policy and program;
- an order requiring the management board to convene a general meeting of shareholders regarding a decision on a capital increase;
- temporary or permanent prohibition to conclude new insurance contracts in some or all types of insurance;
- prohibition of certain types of financial transactions or financial transactions with certain legal entities or natural persons;
- prohibition for insurance company to conduct business with certain shareholders, director, executive directors, board members or affiliated companies;
- prohibition or restriction on disposal and investment of funds to cover technical reserves or funds to cover mathematical reserves and other assets of the insurance company;
- an order requiring the insurance company to change the type of insurance operations, suspend the implementation or modification of the terms and tariffs of insurance, changes in capital structure, proper valuation of items in the balance sheet, improvement of information systems, the proper keeping of documents and strict records and other measures necessary for realization of the rules on limiting risks and measures to improve risk management processes;
- an order requiring the insurance company to remove directors, executive directors, executive board members and members of the company organs who conduct supervision, and to appoint other persons on these positions;
- an order requiring measures to protect the rights of insured persons;
- an order requiring measures of reorganization; and

- Whenever an insurance company does not meet capital adequacy requirements, such insurance company is required to submit a plan for short-term financial recovery, which will resolve the deficiencies, to RS Agency for approval.

158. The supervisor has effective means to address management and governance

problems. The provisions of article 54, article 58, article 60 and article 62 of the LIC grant the RS-ISA the power to require insurance companies to replace or limit the powers of the board members, top management, key persons holding supervisory positions, major owners and external auditors if they severely or repeatedly hinder supervision.

159. Measures that are aimed at protecting the financial condition of the insurance company are available and used by the RS-ISA. Article 13 of the LIC provides the RS-ISA with the power to restrict the scope of the insurance activities performed by a company. The restriction in this article may relate to the overall economic activity of the company or to any individual part. In addition, the RS-ISA may impose a prohibition on payment of dividend (article 52a paragraph 4 of the LIC) if the company:

- does not meet the requirements for capital adequacy established in the provisions which regulate the field of insurance;
- does not meet the prescribed liquidity and solvency requirements, or would endanger the liquidity or solvency by the pay out; and
- fails to act upon the orders of the RS-ISA.

160. To protect policyholders, the RS-ISA has the power to impose interim management.

The provisions of article 12 and 67a of the law provide for the RS-ISA the rights to introduce an interim management in the insurance company which fails to meet the prudential and other requirements, the interim management can only be removed by order of the RS-ISA. The RS-ISA may adopt a decision on introducing extraordinary management in the insurance company if it establishes, among other conditions, the following extreme conditions:

- further business activities of the insurance company could endanger its liquidity or solvency, that is, the security of insurers and other beneficiaries of insurance contracts; and
- the insurance agency has hidden from the RS-ISA, the authorized actuaries and authorized auditors, the business books, documents, records or property of the company, or has denied access to those books by authorized persons;

161. Administrative fines are imposed by the RS-ISA to deter unwanted behavior. The provisions of Articles 72 through 78 of the LIC prescribe the pecuniary sanctions against insurance companies, the responsible person in the insurance company—directors, as well as other persons (auditor and actuary) in case of violation of legal regulations. The fines are proportionate to the established violation, or according to the violation, from KM 10,000 to KM 200,000 for the insurance company, or from KM 2,500 to KM 20,000 for the responsible persons in the insurance company. There is a list of actions that trigger fines with the corresponding range of the allowed fine amounts for the following incidents of the insurer:

- false information to obtain a license;
- deceiving advertisement;
- misleading advertisement; compilation of reporting statements by an insurer (reinsurer) that results in a misrepresentation of the indicators contained therein or information about compliance with prudential requirements and/or other mandatory standards;
- auditor or actuary makes a false statement, false claims assessment;
- fails to comply with the orders of, or makes a false statement to, the RS-ISA;
- invests the assets contrary to the legal provisions; and
- hinders the authority to perform an inspection.

162. The fining mechanism encourages fast payment and does not hinder effective supervision. The RS-ISA fines are always set at the minimum value of the allowed range, and if accepted by the fined parties, are reduced in half. The fine can be challenged in the minor misdemeanors courts that will decide within a few months. If the fine is challenged, it is up to the court to decide on the final amount to be paid. This amount could be up to the maximum amount allowed for the given violation. There is a unique register for monetary sanctions at the state level in which the RS-ISA enters information on imposed monetary sanctions. The tax administration of the RS monitors the collection and performs compulsory enforcement of monetary sanctions.

163. The RS-ISA may withdraw the license of an insurer or broker under certain circumstances when policyholders' interests are severely affected. The provisions of article 29 paragraph 3, 4, and 5 of the law provide for authorization for the RS-ISA to withdraw the license in the following situations:

- if the license has been issued on the basis of incorrect and/or untrue data;
- if within the given deadlines, the insurance company has failed to enforce the orders of the RS-ISA for removal of irregularities or implementation of additional or other measures, thus ceasing to fulfill the conditions for carrying out insurance activities, or if the conditions under which the license has been issued no longer exist or have changed to such an extent that the RS-ISA would not issue a license taking into consideration the new circumstances;
- if the insurance company frequently violates its obligations towards the Green Card Bureau of Bosnia and Herzegovina or the Protection Fund of any entity; and
- if the extraordinary management has failed to bring stability and liquidity to the insurance company.

164. The RS-ISA power to withdraw the license of an insurer or broker is a powerful enforcement tool. The RS-ISA may also withdraw the license of the insurance company if, following the adoption of a resolution by the RS-ISA for removal of the irregularities or a resolution for undertaking additional or other measures, the insurance company still:

- violates the provisions of Article 55 to 58 of this Law and the secondary regulations of the RS-ISA related to the prescribed technical and mathematical reserves and investment of assets of the company;

- fails to meet the requirements for capital adequacy and solvency margin in accordance with articles 49, 52, 52a, 53 and 53a of this law and the secondary regulations of the RS-ISA;
- performs activities for a certain type of insurance for which it has not obtained a work permit;
- fails to apply the adopted insurance conditions and the premium tariffs when making offers, arrangements and conclusion of insurance contracts, as well as other acts of the business policy;
- violates the rules on risk management, the rules on liquidity and solvency management and maintenance, prohibition on payment of a dividend;
- violates the rules on keeping the business books, the rules on drafting the financial statements, audit and internal audit;
- violates the obligation for timely and true reporting to and notification of the RS-ISA;
- violates the rules on appointment of an authorized actuary and an authorized auditor;
- fails to enforce entirely, or on time, the additional measures for realization of the rules on risk management and insurers' protection, as well as measures from the plan on short-term financial recovery;
- violates the provisions on appointment and dismissal of persons with significant positions as outlined article 60 of the law;
- violates the provisions on qualifying holding from articles 61 and 62 of the law;
- fails to cover the losses in the manner prescribed in the law;
- fails to enable the performance of supervision by the RS-ISA, the performance of an audit by an authorized auditor and the performance of actuarial activities by an authorized actuary in the prescribed manner;
- transfers or accepts a portfolio without the approval of the RS-ISA;
- violates the regulations on protection of insurers, beneficiaries of insurance contracts, that is, third parties that have suffered damages, that is, if it fails to pay out compensation on damages and fails to meet other obligations arising out of the insurance contract; and
- provides false data regarding its business operations or data which may mislead the insurers, policyholders, beneficiaries of insurance contracts, that is, third parties who have suffered damages.

Group Supervision

165. Regulation does not have a framework for group supervision. The RS-ISA has special limits and reporting requirements on related party transactions but a framework to effectively supervise groups is missing. Notwithstanding the existence of financial groups, consolidated supervision is not carried and only ad hoc supervisory information is exchanged among the pertinent supervisors. It is recommended developing a comprehensive group supervision framework together with the required training for the RS-ISA staff. Basic group supervision should be introduced in the short term.

Macprudential Supervision

166. Macroprudential supervision is limited to market wide analysis of observed trends affecting the insurance sector. The RS-ISA has performed market wide analysis on the MTPL business and carried out market wide inspections based on findings in a few insurers. The supervisory actions have led to regulatory changes. Macroprudential tools have not been developed nor market wide stress tests are required and there is no framework to define systemic risk in the sector. As the insurance sector develops, consideration should be given to introduce a macroprudential supervision framework. The RS-ISA should be included into the SCFS. In addition, consideration to assign the development of macroprudential tools and their usage to the Insurance Agency should be evaluated and the implementation power should be granted to the ISAs.

C. Market Entry and Exit

167. Entering and exiting the market are covered in this section. Licensing, including the fit and proper requirements that apply to holders of control functions and owners of insurance companies as well as the portfolio transfer regulation and control of insurers (ICP 4-6) are analyzed. The market exiting regulatory provisions and supervisory practices (ICP 12) complete the aspects covered.

Licensing and Entry Controls

168. The licensing procedures are comprehensive. Insurance activity is a regulated activity and insurers and insurance intermediaries need a license to operate (Article 3 paragraphs 1 to 4 and 6 of the LIC). Licensing requirements are transparent and are published on the RS-ISA webpage and the Official Gazette. The licensing requirements include a three year business plan that is analyzed with respect to its viability, funding sufficiency, and systems availability to support the operations of the plan. The internal controls and operational procedures for the insurer are also required. Source of capital and identity of the owners are tracked and checked for propriety. The mechanism to setup tariffs and the reinsurance agreements are also analyzed before the license can be granted. If complete documentation is presented, the RS-ISA has 60 days to issue the license. Insurance intermediaries need to pass an exam and then be registered to receive a license. In addition to the exam, to be registered the required capital, evidence of the propriety of the person and the existence of a valid error and omission insurance policy are required. The registered intermediary is listed in the RS-IA web page. The license for intermediaries needs to be renewed on a bi-annual basis, when evidence of propriety and the additional requirements like capital and the error and omissions policy are checked again. Not all existing intermediaries comply with regulation at time of renewal and their licenses are not renewed.

169. Unlicensed insurance activity is penalized. The provisions of article 75 of the LIC stipulate penalties for persons who undertake insurance activities without a license: *"The person who, without being licensed or authorized, manages the insurance company in the RS or engages in the insurance activity without being licensed for or operates in any way against the provision of this Law, or as the representative of authorized person signs or mediates in signing insurance contract in the RS by the*

insurance company not licensed shall be sentenced to imprisonment from one to three years and penalty fee in the amount of KM 25,000.” The enforcement of these penalties needs the cooperation of the police.

170. Fit and proper requirements for control functions are in place. The provisions of Article 60 paragraphs 1 to 6 of the LIC state the fit and proper requirements:

“(1) Persons on key positions in insurance companies must be persons of high respect and moral, with satisfactory qualifications and management experience.

(2) Persons sentenced for embezzlement and fraud in professional services, misuse of their positions, forgery, use of the forged documents, theft of the public or private property, giving false statements, giving or receiving bribery, or any other legally anticipated criminal offence regarding the conduct of their professional duty, as well as persons who were members of the management board of a bankrupt insurance company or the insurance company whose license was revoked due to the violation of the law cannot be nominated for directors, executive directors, authorized representatives or actuaries of insurance company. Persons who were members of the management board of a bankrupt insurance company or the insurance company whose license was revoked can be nominated for key positions mentioned hereof on expiry of 5 years.”

171. The scope of control functions needs to be expanded. A key position in an insurance company is considered to be the position of the CEO and other executive directors, members of the company supervisory bodies, associate managers, interim managers and dissolution trustees as well as the appointed actuary. Members of the governance board appointed by the Shareholders Assembly are not subject to approval by the RS-ISA. It is recommended imposing fit and proper requirements on all governance board members and the internal auditor. This will allow the RS-ISA to supervise the board better and remove any board member if necessary.

172. The assessment of fit and proper is carried out based on documentation. Interviewing the candidates for control functions is recommended to gain a stronger opinion of the fit and proper of the candidates who are performing or will perform control functions. During the interviews, the knowledge of the insurance regulation pertinent to the position should be assessed.

173. Any one intending to acquire shares in an insurer that would make the person a qualified shareholder (10 percent of the shares or voting rights) requires the approval of the RS-ISA. The propriety conditions and additional conditions that apply to control functions are required to be fulfilled by candidates that want to purchase shares above 10 percent of the voting rights (article 61 paragraphs 1 of the LIC). The RS-ISA approval is also required when the thresholds of 20 percent, 33 percent and 50 percent are breached. While the opportunity to request evidence of propriety and check on the additional requirement that the shareholder needs to meet every time one of the thresholds is crossed are an important supervisory tool, in addition, mandated process equivalent to assessing a new license application should be established where the approval sought is to exceed the 50 percent threshold.

174. Supervisory actions are specified in the event of a violation of the approval requirement to acquire a qualified shareholding in an insurer but the enforcement faces legal impediments. The LIC stipulates that in the case that the approval is not granted, the RS-ISA can void the voting power of a qualified shareholder. This power, however, is not legally enforceable. The insurers' shares are subject to the securities law that states that the voting rights of shareholders of open shares, which are all insurers' shares can only be voided with a court order. Such a required court order however cannot be initiated by the RS-ISA, as it is not deemed at law to be an affected party; a condition that is necessary to start the legal action that would lead to voiding the shareholders' voting rights. The enforcement of the power granted to the RS-ISA with respect to voiding the voting rights of a non-approved qualified shareholder could however be enforced with a supervisory power to request the insurer to start the court process to void the voting rights of the non-approved qualified shareholder under the threat of severe supervisory actions. It is recommended incorporating the corresponding supervisory power into the legislation and also considering if the disposal of the shares acquired by a non-approved qualified shareholder could be enforced.

175. Portfolio transfers are well regulated. Any insurers intending to transfer a portfolio need the approval of the RS-ISA. Such intention is to be made public in the press for 2 weeks; policyholders that oppose the decision can complaint to the RS-ISA. The ISA has the power under certain conditions to force a portfolio transfer. The approval is granted once the RS-ISA has formed the view that the insurer(s) accepting the business will not be impaired and that policyholders are well protected (articles 63–64 of the LIC).

Market Exiting

176. There are forced and voluntary reasons to initiate liquidation of an insurer that the RS-ISA. Article 68 paragraph 1 of the LIC states the reasons for initiating the liquidation of an insurer:

- The RS-ISA revokes the license to operate as an insurance company;
- The registration of the insurance company is declared null and void by a final court decision;
- The assembly of the insurance company decides to cease operating as the insurance company.

177. Supervisory protective actions can be implemented without delay. The power granted to the RS-ISA to appoint a temporary administrator at the same time as the license is revoked allows for an immediate intervention in respect of the insurers' assets and activities (articles 67 and 67a of the LIC). Also, the RS-ISA appointed liquidator needs to report to the RS-ISA on a regular basis (article 67b). The aim of the procedures is minimizing the disruption of timely provision of services to the insured parties. Claim settlement has a high priority, within 5 days of initiated the liquidation, the liquidator has to start the claim settlement process (article 68 paragraph 10 of the LIC).

178. RS-ISA can initiate the liquidation process of insolvent or insurers that are in violation of the regulation. The provisions of article 29 paragraph 3, line 4 of the LIC prescribe the competence of the RS-ISA to revoke the license of the insurance company if the previously introduced emergency management has not brought the insurance company to stability and

liquidity. The provisions of article 67a paragraph 1 of the LIC prescribe the points at which the RS-ISA may adopt a decision to introduce emergency management in the insurance company:

- continuing the business operations of the insurance company could jeopardize its liquidity or solvency, i.e., the security of the insured parties and other beneficiaries of rights referred to in the insurance contract;
- the insurance company has concealed business books, documents, records or assets of the company from the RS-ISA, the certified actuaries and auditors, or has refused authorized persons access to these documents;
- the insurance company to which additional measures referred to in Article 54 paragraph 8 of this Law have been determined, has failed to initiate their implementation within the specified deadlines or has failed to implement them; and
- the insurance company, despite the implemented additional measures, has not met the capital adequacy requirements.

179. Policyholders enjoy a high priority on the assets of an insurer undergoing liquidation.

Article 70 of the LIC states the following with respect to the priority status of policyholders in case of liquidation:

- *(1) The beneficiaries of insurance indemnity, as well as their heirs, have privileged claims against the investments of the insurance company in relation to any other general or special privileged claims, with the exception of the costs of special liquidation process envisaged by Art. 68 to 70 of this Law, as well as the bankruptcy costs.*
- *(2) When the insurance company comes to the phase of special liquidation, the beneficiary of the insurance indemnity shall have privileged claims against all assets, whether they belong to the investments of the insurance company or not. This privilege shall give them an advantage over all other creditors, except for claims of costs referred to in paragraph 1 of this Article.*
- *(3) The privilege referred to in this Article shall consist in settling the claims of the insured and their heirs, including third parties that have direct claims from the insurer based on the insurance contract. Other creditors may be settled from the investments of the insurance company, only if the claims of the insured have been fully settled. The beneficiaries of nonlife insurance indemnity are first settled with investments of nonlife insurance funds, especially the category investments of insurance companies to which they refer their claims, in accordance with Article 56 of this Law and the regulation on the amount and manner of investments of insurance companies. The beneficiaries of life insurance indemnity are first settled with investments of life insurance funds, especially the category investments of insurance companies to which they refer their claims, in accordance with Article 56 of this Law and the regulation on the amount and manner of investments of insurance companies.*
- *(4) Seizure of assets covered by investments that are in the possession of insurance companies or third parties shall be allowed only in favor of the beneficiaries stated in this Article. The insurance company shall submit a copy of the decision on the seizure to the RS-ISA, otherwise the seizure shall be declared null and void."*

180. The four laws covering the liquidation proceeding of an insurer need harmonization.

The regulations on bankruptcy proceedings, the LIC on the liquidation of insurers, the Company Law and the Law on the MTPL Protection Fund apply to the bankruptcy or liquidation proceedings of insurance companies. The simultaneous application of the four laws could cause problems in concrete applications as certain proceedings according to these laws are not clearly delimited. There are also important gaps. For instance, the Protection Fund should be included as a creditor in the liquidation proceedings, and the law should provide for the open claims payments for MTPL claims before the liquidation starts. It is recommended to clarify the interplay between different laws, including the role of the Protection Fund.

D. Prudential Framework

181. This section describes the prudential framework. The focus is on the risk sensitivity of the solvency regime, the market consistent valuation of assets and liabilities as well as the investment requirements. The ICPs 14-17 contain the key standards that are relevant for this section.

182. The valuation of insurers' assets and liabilities is performed in accordance with standard No. 4 of the International Financial Reporting Standards (IFRS). IFRS prescribes an economic valuation of assets and liabilities that reflects the risk-adjusted present values of their cash flows. The standards addresses recognition, de-recognition and measurement of assets and liabilities. The insurer has to keep insurance liabilities in its statement of financial position until they are discharged or cancelled, or expire, and to present insurance liabilities without offsetting them against related reinsurance assets. The valuation of assets and liabilities is undertaken on a consistent basis. The valuations of technical provisions and other liabilities do not reflect the insurer's own credit standing. In addition, the valuation of individual positions is regulated in detail by the rulebook on the manner of assessment of balance and off-balance sheet positions of insurance companies. Only two insurers show an off-balance position in their annual reports.

183. Insurers are required to set up basic technical reserves. For life business, the mathematical reserves are determined by the technical note. The maximum discount interest rate is 5 percent. For the nonlife sector and group life business, the following reserves are required, unearned premium reserve, outstanding claims reserve and incurred but not reported claims (IBNR). Basic rules apply to setting up the reserves. The unearned premiums are set up on a pro-rata basis. The claims reserves are set in full amount, or as an average in case of a dispute using actuarial methods. There are no explicit reserves for catastrophic risk. An actuarial opinion on the correctness and sufficiency of the technical reserves is required on an annual basis.

184. The supervisor establishes requirements that are applicable to the investment activities of the insurer. The LIC grants the RS-ISA the power to regulate the investment activities for solvency purposes (article 56 paragraph 3). The RS-ISA has issued the corresponding Rulebook that provides for the admissibility and limits of the assets to cover technical provisions, the minimum guarantee fund and for solvency purposes. The rulebook takes into consideration the security, diversification and liquidity requirements for investments. The admissible assets and their limits are published on the webpage of the RS-ISA and have been updated on a regular basis. Foreign

investments are allowed within certain limits, after approval by the RS-ISA. Related parties investments have stricter limitations. The RS-ISA does not have explicit powers to restrict the scope of ownership in subsidiaries, or other type of investments that are not used to cover the technical provisions or the minimum guarantee fund. It is recommended regulating the type of investments that the insurers can undertake for all their assets using the prudent person principle, moving towards a total balance sheet supervisory approach.

185. The requirements regarding diversification, liquidity and the permissible securities are required for the assets to cover technical provisions, mathematical reserves and the minimum guarantee fund. In accordance with the rulebooks on investments, the following assets are admissible and cannot exceed the indicated limits. The limits for the life reserves on less liquid assets are higher than for nonlife and the admissible assets to cover the minimum guarantee fund are only the liquid assets:

Type (form) of investment	Nonlife Allowed %	Life Allowed %
Securities issued or guaranteed by BIH, the RS, BIH Central Bank and Funds referred to under Article 8 of the RS Investment and Development Bank Act	Without limit	Without limit
Securities issued or guaranteed by the BIH Federation and the Brčko District	Up to 50%	Up to 50 %
Bonds and other debt securities issued by a local authority in the RS or BIH	Up to 35%, and up to 10% per one issuer	Up to 40%, and up to 15% per one issuer
Bonds and other debt securities for which the local authority from Article 5 (1) (3) of the Rulebook has issued a guarantee	Up to 20%, and up to 5% per one issuer	Up to 20%, and up to 10% per one issuer
Bonds and other debt securities traded on official stock markets in the RS and BIH	Up to 20%, and up to 5% per one issuer	Up to 30%, and up to 5% per one issuer
Bonds and other debt securities traded on free stock markets in RS and BIH	Up to 10%, and up to 2% per one issuer	Up to 10%, and up to 5% per one issuer
Bonds and other debt securities which are not traded on an organized securities market in the RS and BIH, if their issuer is a legal entity headquartered in RS or BIH	Up to 5% , and up to 1% per one issuer	
Shares traded on official stock market in RS and BIH	Up to 30%, and up to 10% per one issuer	Up to 20%, and up to 10% per one issuer
Shares traded on free stock market in RS and BIH	Up to 10%, and up to 5% per one issuer	Up to 10%, and up to 5% per one issuer
Shares which are not traded on an organized securities market in RS and BIH, if their issuer is the legal entity headquartered in RS or BIH	Up to 10% , and up to 5% per one issuer	
Loans secured by property lien (mortgage)	Up to 20%, and up to 10% per one issuer	Up to 20% and up to 10% per one beneficiary

Table 18. Republika Srpska: Rulebook on Investments (continued)

Type (form) of investment	Nonlife Allowed %	Life Allowed %
Loans secured by securities from Article 5 (1) (1–4) of the Rulebook	Total up to 10% ,and up to 5% per one beneficiary	Total up 10%, and up to 5% per one beneficiary
Loans secured by a bank guarantee or loans to domestic banks in RS and BIH		
Loans in the amount of insurance surrender on the basis of a life insurance contract from the life insurance mathematical provision		Up to 25%, and up to 5% per one beneficiary
Real estate and other property rights (right of ownership, building right, right of use, etc.)	Up to 30% in one real estate or more real properties linked into one whole up to 15%	Up to 40%, and in one real estate or more real properties which are linked and form one whole up to 20%
Fixed term deposits in banks in RS and BIH	Up to 50%, and in one bank up to 20%	Up to 50%, and in one bank up to 20%
Stocks and shares of investment funds with public offering, which are headquartered in RS or BIH	Up to 30%, and in one investment fund up to 5%	Up to 30%, and in one investment fund up to 5%
Funds on the accounts of insurance companies	Up to 10%	Up to 10%
Total of funds invested in the country (<i>sum of investments under 1–14</i>)		
Securities issued by an EU member state, its central bank, international financial organizations or securities guaranteed by one of these entities	Sum of US1, US2 and US3 up to 20%, and per one issuer up to 5%	Sum of US1, US2 and US3 up to 20%, and per one issuer up to 5%
Bonds and other debt securities traded on an organized securities market in an EU member state, provided that their credit rating assessed by the credit rating agencies corresponds to Standard & Poor's rating of at least A, or the appropriate rating of Fitch-IBCA or Moody's		
Shares traded on an organized securities market in an EU member state, provided that they are listed on stock exchange at least over the past two years and that their minimum market capitalization at the moment of investment is 500 million Euro		
Unearned premium charged against re-insurer, co-insurer or retrocessionaires.	Up to 10%, and over 10% in accordance with the Agency's decision ¹	Up to 5%, and over 5% in accordance with the Agency's decision
Deferred costs of acquisition of insurance	Up to 10%, in accordance with the Agency's decision	

Table 18. Republika Srpska: Rulebook on Investments (concluded)

Type (form) of investment	Nonlife Allowed %	Life Allowed %
Provision for claims charged against re-insurer, co-insurer or retrocessionaires	In accordance with the Agency's decision	In accordance with the Agency's decision
¹ The decision is based on the reinsurer having investment rating from Standard & Poor's or Moody's.		

Table 19. Republika Srpska: Rulebook on Investments for the Guarantee Fund

Type (form) of investment	Guarantee fund Allowed %
Securities issued or guaranteed by BIH, the RS, BIH Central Bank and funds referred to under Article 8 of The RS Investment and Development Bank Act	Without limit
Fixed-term deposits in banks in RS and BIH	Without limit
Total invested funds in the country (sum of investments referred to under 1–2)	
Securities issued by an EU member state, its central bank, international financial organizations or securities guaranteed by one of these entities	Sum of US1, US2 and US3 up to 20%, and per one issuer up to 5%
Bonds and other debt securities traded on an organized securities market in an EU member state, provided that their credit rating assessed by credit rating agencies corresponds to Standard&Poor's rating of at least A, or the appropriate rating of Fitch-IBCA or Moody's	
Shares traded on an organized securities market in an EU member state, provided that they are listed on stock exchange at least over the past two years and that their minimum market capitalization at the moment of investment is 500 million Euro	
Total funds invested abroad (sum of investments under 4–6)	

186. Having over fifty percent of the insurance sector assets in bank deposits creates a relevant exposure to the banking sector that needs to be monitored. The RS-ISA requires liquid assets to cover the minimum guarantee fund that ultimately result in large bank deposits. Total exposure of the insurance sector assets is KM 127 million. It becomes relevant for the insurance supervisors to have access to the relevant information on the financial condition of the banks. It is recommended establishing a formal channel of information with the bank sector supervisor to gain timely information on the financial soundness of all banks holding above a threshold of the insurance sector assets.

187. The capital regime follows Solvency I. Pursuant to the provisions of the articles 52, 52a, 53 and 53a and 55 of the LIC, an insurance company is required to calculate technical and

mathematical reserves for all insurance contracts. The Rulebook on the Amount and Method of Investment for Covering of the Technical Reserves and Minimal Guarantee Fund stipulates that a company must ensure that the amount of investment is at least equal to the amount of calculated technical reserves. The articles further stipulate the regulatory capital adequacy requirements for fulfilling the obligations to the insured and the requirements that an insurance company should obtain capital resources to meet regulatory capital requirements, which follow Solvency I.⁸ The Rulebook on the Elements and Control of the Solvency Margin and the Rulebook on Method of Calculation of the Capital and Capital Adequacy of Insurance Companies regulates the method of calculation and control related to available capital and solvency margin of an insurance company.

188. The required solvency margin is determined by the minimum guarantee fund. Given the low premium written by the industry with one exception, the solvency requirements have been solely determined by the minimum guarantee fund that cannot be less than:

- KM 2 million if the insurance company engages in one or more types of the following insurance activities: vehicle owners or users MTPL insurance, aviation third party liability insurance, vessel owners or users marine third party liability insurance, general liability insurance, credit insurance and surety insurance.
- KM 2 million if the insurance company engages in one or more types of the following insurance activities: accident insurance, health insurance, motor CASCO insurance, railway rolling stock CASCO insurance, aircraft CASCO insurance, sea, lake and river vessels hull damage, goods in transit insurance, fire and other natural perils insurance, financial loss insurance and travel insurance.
- KM 1 million if the insurance company engages in the insurance activities of other damages to property and/or legal protection insurance;
- KM 3 million if the insurance company engages in life insurance; and
- KM 3 million if the company engages only in reinsurance activities.

189. The actual solvency margin (available capital) is divided into core capital and supplementary capital. The core capital is determined as the capital with the highest loss absorbing capacity. The amount of the insurance company supplementary capital cannot exceed 50 percent of core capital. The provisions of article 52a of the LIC state the calculation of core and supplementary capital:

- The core capital of an insurance company is calculated as the sum of the paid share capital items, except based on cumulative preference shares, capital reserves, except reserves related to cumulative preference shares, statutory and legal reserves and transferred net profit from previous years;

⁸ The calculation is based on the maximum of the amounts calculated by applying factors to the premium and to the claims but cannot be lower than the minimum guarantee fund.

- In the calculation of core capital, the sum mentioned in the previous paragraph is reduced by own purchased shares, intangible assets, losses from the current and previous years and other items which are prescribed by regulation;
- The supplementary capital is calculated as the sum of the paid share capital items, based on cumulative preference shares, capital reserves related with such shares, subordinated financial debt instruments and other items, which are prescribed by regulation; and
- In the calculation of insurance company capital, the sum of core capital and supplementary capital is reduced by:
 - the amount of qualified shares in other insurance and reinsurance companies, banks and other financial institutions;
 - the amount of subordinated debt instruments and other investments in legal entities, pursuant to the first item of this paragraph, which are taken into account in the calculation of their capital, and in which insurance company owns a qualified share; and
 - the amount of illiquid assets.

190. Illiquid assets have been defined by the RS-ISA. In line with the provisions of the Rulebook the illiquid assets shall include:

- investments in shares and other securities which are traded at over the counter market;
- investments in shares of stock exchange, clearing and depository institutions;
- receivables from payments to guarantee accounts of clearing and depository institutions, BiH Green Card Bureau and receivables from payments made for other purposes earmarked for mutual guarantees for multiple-persons liabilities;
- all receivables from insurance company shareholders with qualifying holdings and their related parties;
- mortgage and lien assets;
- the amount of receivables for which the value impairment was not calculated in line with the regulation of the Agency determining the method for valuation of balance and off-balance items of the insurance company; and
- all other types of assets which cannot be cashed in an easy and fast manner at the time when that is necessary in order to cover due liabilities.

191. The capital regime should be updated to introduce risk sensitive elements. While the amendments to the LIC in 2010–2012 have shown a major improvement in the solvency regime, the current framework that follows Solvency I is not risk sensitive and, as such, is not in line with best international practices. A gradual incorporation of risk factors into the solvency framework is recommended. Credit risk capital surcharges on assets, followed by the introduction of differentiated factors, depending on the business line, that apply to the premium and claims calculation, could serve as a good starting point.

192. A solvency margin adequacy ratio below 100 percent triggers supervisory action. The solvency margin adequacy ratio should be at least 100 percent. In the event that this ratio falls below 100 percent, the RS-ISA must use enforcement measures and sanctions against the insurer in

accordance with the LIC. Once a risk sensitive solvency regime and the early warning system is in place, the development of a ladder of intervention based on capital levels and a corresponding set of prompt corrective actions should be introduced.

E. Risk Management and Governance

193. Governance, internal controls, and risk management are the areas examined in this section. The relevant ICPs are ICP 7–8.

194. Minimal requirements on governance structure are present in the LIC. The provisions of Article 60 paragraph 9 of the LIC prescribe the mandatory bodies of insurance companies. According to the LIC, insurers should establish the shareholders assembly, the director, the board of directors and have an auditing body. Further governance requirements are established in the Company Law.

195. The Company Law sets further governance requirements for insurers. Provisions of articles 304, 305, 313 and 314 of the Company Law prescribe the roles and responsibilities entrusted to the board of directors, management and the persons in control functions of a joint stock company. Articles 304 and 305 of the Company Law establish the responsibilities of the board of directors of a joint stock company that can only be transferred by the shareholders assembly or by the company's bylaws. In particular, the board of directors is responsible for:

- managing the development of the company and the strategy and the oversight of the executive directors and the administration of the company;
- establishing or approving the business plan of the company;
- adopting the six-month financial statements of the company;
- the election and dismissal of executive directors, approval of the conditions in the contract that the company concludes with them and determining their remuneration; and
- bookkeeping and internal supervision of operations (jointly with the CEO).

196. The board composition is established in the Company Law. Article 313 of the Company Law states that a joint stock company may have one or more board members that are executive directors. The number of executive directors shall never constitute a majority on the board of directors. When a company has more than two executive directors, the board of directors has to appoint the CEO, and an executive board has to be established; the CEO or general director is the chairperson of the executive board. The board of directors may create the nomination and the remuneration committees, each having at least three members.

197. The executive board is responsible for the implementation of the company strategy. The executive board shall implement decisions of the board of directors and manage the business of the company and shall act as legal representative jointly of the company, unless stated in the founding act or the statute that only certain executive directors may represent the company.

198. The internal audit function must be established and the audit functions are subject to explicit requirements set by law. The provisions of articles 320 to 323 of the Company Law

prescribe the obligation of a joint stock company to provide for an internal audit function. For listed companies, an audit committee must be formed. The audit committee must have at least three members or an odd number of members.

The audit committee of a joint stock company shall:

- adopt a plan of internal audit;
- review the internal audit reports and make recommendations on the audit reports;
- report to the board of directors on the implementation of recommendations of the audit reports;
- report to the shareholders assembly on the accounting, the reports and the financial operations of the company and its affiliated companies;
- state its opinion on the proposal for the profit distribution to be adopted by assembly;
- report on the compliance of the company with the legal and the other regulatory requirements; and
- propose to the shareholders assembly the appointment of an independent auditor, if the company has an obligation to audit the financial statements.

The internal auditor of the joint stock company shall:

- control and report to the audit committee on the credibility and completeness of the financial statements of the company;
- control and report to the audit committee on the credibility and completeness of reporting to the shareholders on financial and other information;
- control and report to the audit committee on the agreements concluded between the company and the members of the board of directors, as well as with related parties in terms of this Law;
- control the compliance of the organization and the functioning of the company with the codes of conduct; and
- control the procedures for settling complaints of shareholders, members of the bodies of the company or other persons regarding items a) to d) of this paragraph.

The audit committee shall report to the shareholders of the joint stock company at each annual assembly and at an extraordinary meeting of the Shareholders Assembly when they find the reporting appropriate and necessary or when requested by the Board of directors.

While carrying out duties, the internal auditor may examine all the documents of the company, check their authenticity and the information they contain, require reports and explanations from the Board of directors and the employees and review the state of the company's assets.

The audit committee shall submit a special report to the shareholders assembly on the agreements concluded between the company and related persons in terms of this law.

If a closed joint stock company has an internal auditor, but no audit committee, the internal auditor shall perform the duties.

199. The corporate governance requirement for insurers lacks qualitative elements with strong dependence on the Company Law. The LIC has minimal governance requirements and the Company Law governance requirements mandate only the board to be responsible for establishing adequate internal control processes including an independent internal audit function and risk management systems consistent with the insurer's risk management strategies. There is room for improvement in the areas of:

- the board structure with the corresponding committees, governance standards, board composition and knowledge, and assessment of the effectiveness of the board;
- remuneration policy of board members and senior management;
- duties of individual board members including acting in the best interests of the insurer and policyholders; and
- timely and effective communication with the RS-ISA and relevant stakeholders (including policyholders) on the governance structure of the insurer.

200. Basic risk management requirements are stipulated in the regulation. The provisions of article 52a paragraphs 2 and 3 of the law indicate the obligations of an insurer to align the capital management, reinsurance and coinsurance policy and investment policy for covering technical reserves with the risks taken. The Rulebook on the Amount and Method of Investment for Covering of the Technical Reserves and Minimum Guarantee Fund of Insurance Companies and the Rulebook on Method of Calculation of the Capital and Capital Adequacy of Insurance Companies specify the obligation of the company to identify, measure and monitor the investment risk of the assets covering technical reserves of the insurer. The Rulebook on Manner of Assessment and Monitoring of the Liquidity of the Insurance Companies stipulates the obligations and procedures in the event of insolvency.

201. Internal controls and business processes are required to be established to obtain an operating license. Pursuant to the provisions of article 34 paragraph 2, item 5 of the LIC, the obligation of an insurance company to accompany the business license application with business policy acts prescribed by the Decision on Documents that Have to Be Enclosed with the License Application Form, is stipulated. The insurance company is obliged to provide at least the following business policy acts:

- General and special conditions of insurance and premium rates;
- Decision on Technical Basis of Insurance;
- Decision on Criteria, Determination Methods, Maximal Retention Table and Total Retention Amount;
- Rulebook on Conditions and Methods of Depositing and Investing of Company Assets;
- Rulebook on Maximum Rates of Expense Load;
- Rulebook on Formation and Calculation of Unearned Premiums;
- Rulebook on Formation and Calculation of Mathematical Reserves;
- Rulebook on Formation and Calculation of Claims Reserves;
- Rulebook on Formation and Use of Bonus and Discount Reserves (life insurance);

- Rulebook on Formation and Use of Settlement Reserves (nonlife insurance only);
- Rulebook on Conditions and Methods of Coinsurance and Reinsurance; and
- Rulebook on Conditions and Methods of Recourse.

202. The insurance company is required to have an appointed actuary, internal actuaries and to establish an internal audit function. No compliance position is mandatory. Pursuant to the provisions of article 20 paragraphs 1, 6 and 8 to 10 of the LIC, the insurance company is obliged to implement an effective actuarial function that is able to assess and give advice to the insurance company regarding, as a minimum, technical regulations, premiums and pricing, and compliance-related legal and regulatory requirements. The appointed certified actuary is an independent actuary whose appointment is approved by the RS Agency. The general meeting of an insurance company, in accordance with the provisions of article 20, paragraph 8 of the Law on Insurance Companies, is under an obligation to appoint a certified actuary. In keeping with the provisions of article 20, paragraph 8 of the Law on Insurance Companies, a certified actuary is under an obligation to provide opinions on various indicators, while a bylaw passed by the management board of the RS Agency provides for an obligation to provide opinions on the calculated technical provisions. Moreover, all insurance companies employ internal actuaries, being obliged to do so pursuant to the applicable regulations. Article 59, paragraph 9 of the law requires an insurance company to organize the internal audit as an independent activity. Internal audit must adopt a systematic and disciplined approach to evaluating and improving the effectiveness of risk management, supervision and governance. The document which will regulate the functioning of internal audit in the insurance company in more detail is currently under development.

203. No explicit and detailed requirements are in place for insurers to have risk management systems and internal controls that control all relevant risks as part of overall corporate governance framework. Explicit rules on the monitoring of the investment limits and capital requirement are in place, but regulation is not comprehensive about the effectiveness of such risk management systems, nor are insurers required to prove the effectiveness of the systems. There is scope for developing regulation and implementing the requirements in the area of risk management and internal controls. The RS-ISA is recommended to strengthen the existing regulation in the following areas:

- Scope of internal controls. To be effective, internal controls should be comprehensive, covering the insurer's key business, IT and financial processes. Key control functions should at the minimum include the internal audit and actuarial functions, the risk management function. Each key control function should be led by a person suitable for the position, have sufficient independence from business units and adequate resources, and have access to the board and provide regular reports to the board.
- Duties of key control functions:
 - Risk management should assess risks on an enterprise-wide basis. There should be a defined risk appetite, documented approval process and authorities, established risk strategy, and escalation and reporting procedures.

- Internal audit should assess the adequacy and effectiveness of an insurer's policies and procedures, and the documentation and controls of these. It should also evaluate the reliability and integrity of management information.
- A compliance function should be introduced to advise on compliance with laws, regulations and internal policies and procedures. Compliance procedures should be integrated in work processes.
- Regulation on outsourcing should be enacted to require: (a) board approval of outsourcing of material functions or activities, (b) due care and diligence in selecting the outsourcing providers, (c) written documentation of the outsourcing arrangements, and (d) periodic review of such arrangements.

F. Reinsurance

204. Reinsurance regulation and supervision is addressed in this section. Reinsurance is sparingly used due to the dominant MTPL business that is largely retained. The relevant principle is contained in ICP 13.

205. Current reinsurance regulation provides basic guidelines only. The regulatory framework provides only basic guidelines for reinsurance stating that insurers should reinsure the portion of the risk that they cannot retain. The provisions of article 52a paragraph 2 of the LIC prescribe the requirement that an insurance company transfers part of the risk to reinsurance if it cannot cover a portion of the assumed risks. The documents accompanying the application for a license to operate prescribe that the business plan of the insurance company must include a program of envisaged reinsurance with tables of maximum retention by lines of insurance. The insurance company must adopt an internal rulebook on implementation of the policy of reinsurance and coinsurance, with acceptable models of assessment of the maximum possible loss, which is submitted to the RS-ISA.

206. The RS-ISA supervises reinsurance contracts. On an annual basis, the RS-ISA receives all reinsurance contracts that are in force. The RS-ISA monitors the reinsurance contracts controlling the identity of the other parties – the reinsurers, controlling the conditions and provisions under which the reinsurance has been concluded and controlling the rate of ceded risk. Further, the RS-ISA is authorized to control the reinsurance contracts, as well as to examine the credit ratings of reinsurers and retrocessionaires, and has the ability to prohibit the conclusion of reinsurance contracts with a foreign reinsurer. Investment grade from Standard and Poor's or Moody's is required to allow reinsurance receivables as admitted assets to cover technical provisions.

207. Reinsurance regulation and supervision should be enhanced. A rulebook that would regulate in detail the rules of reinsurance, i.e., the transfer of risk and the internal methodology that would standardize the procedure of supervision of reinsurance is being prepared. This rulebook should consider the following enhancements on reinsurance supervision and regulation:

- The financial stability of reinsurers should be analyzed annually.
- Registration of foreign reinsurers should be started with basic information and a contact person in the home supervisory agency.

- Risk transfer requirements on the reinsurance contracts should be specified.
- Cash call clause should be included for catastrophic events.
- Prohibition of side letter to guarantee the integrity of the contracts should be implemented.

G. Market Conduct and Consumer Protection

208. The relevance of market conduct for the stability of the sector is the topic of this section. The existing market conduct requirements on insurers, brokers and insurance intermediaries are covered in this section. In addition, the public disclosure requirements, prevention of insurance fraud and compliance with AML-CFT requirements are examined. ICP 18 through ICP 22 contain the respective principles.

209. Insurance intermediation requires a license. Insurance and reinsurance intermediation can only be carried out by legal entities (brokers and agents) or by physical persons (agents) only after obtaining a license that is issued by the RS-ISA (Article 2 paragraphs 2 and 3 of the Law of Intermediaries). The licensing process for insurance intermediation includes fit and proper requirements, and requires brokers to carry error and omissions insurance. The capital requirement for a broker is KM 200,000. Those involved in insurance intermediation have to pass an exam. The exam and training material is prepared by the RS-ISA. There are four types of examination, for all lines of business, for nonlife, for life and for MTPL. The training material has not been changed since it was developed. It is recommended to update, on a regular basis, the training material to cope with new developments in insurance intermediation.

210. Every intermediary is registered in the web page of the RS-ISA. Pursuant to the provisions of article 3 of the LoI, the obligation of insurance intermediaries to register with the RS Agency as a prerequisite for the commencement of insurance activities and operations is prescribed. At the end of 2013, the RS-ISA had registered 134 physical persons as insurance intermediaries of which 20 established limited liability entities, 7 insurance intermediation companies, including Pošte Srpske (RS Postal Service) and 4 branches of intermediation companies from the FBiH. In addition, the RS-ISA registered 58 insurance brokers, 3 brokerage companies from the RS (2 banks and 1 brokerage company) and 2 branches of brokerage companies from the FBiH. The RS-ISA organizes training sessions and exams as needed. The last examination was carried out in May 2014, the next planned examination will take place on November 15th. Foreign reinsurance brokers are not registered and there are no legal requirements for their activity. It is recommended including the registration requirement of foreign and reinsurance brokers in the regulation to gain oversight of the total insurance activities.

211. Intermediaries are subject to ongoing supervision. The provisions of article 20 and 21 of the LoI grant the authority to the RS-ISA for ongoing supervision of intermediaries. There are reporting requirements that include the financial statements, intermediated premium, and earned commission. In addition, the requirements to have their license renewed every two years provides for an occasion to supervise the intermediaries at least on the compliance with a valid license and fit and proper requirements. In 2013, the largest intermediaries were inspected and during the onsite inspection of insurers, the supervision of their agents is included. Insurance intermediaries have

been fined, and in some occasions, licenses have been suspended and not renewed. The Company Law regulates the basic rules of corporate governance of joint stock companies and limited liability companies, the legal forms necessary to operate as an insurance intermediary. It is recommended to introduce corporate governance requirements for insurance intermediaries according to their size and complexity independently of the legal form used to operate.

212. Brokers are bound to disclosure requirements that include conflict of interests and to segregate clients' moneys. Brokers need to ensure transparency of all legal and economic relations with insurance companies, which could affect their impartiality. Further, brokers are required to give notice to individuals who seek services of insurance or reinsurance about any legal or financial dependence on an insurance company or reinsurance company, including any ownership of stocks or shares in these companies, which could affect the individual's freedom to choose the insurance or reinsurance for risks placing (Article 16 of the LoI (Official Gazette No. 17/05, amended in Official Gazette No. 106/09). Article 18 of the same law states the requirements to keep clients' payments on a special account segregated from the owner's accounts.

213. Elements of fair treatment are included in the regulation. Article 16 paragraphs 1 to 5 of the LoI state the obligation of a broker to protect the interests of the policyholder. For the purpose of fulfilling the obligations, the insurance broker, among other obligations, is to:

- prepare a proper risk analysis and appropriate coverage principles,
- prepare an assessment of the financial ability of insurance companies to cover risks on the basis of technical information available to the broker,
- provide assistance for the duration of the insurance contract, at the occurrence of the insured event and provide that the insured takes all legal actions necessary to protect and enforce a contract of insurance in the time required to execute these legal actions.

In addition, it is required that brokers when providing advice to a client prior to the conclusion of an insurance contract, ensure that such advice is appropriate, taking into account the circumstances disclosed by the client.

214. Complaints against the insurance sector are handled by the RS-ISA through its Department for Consumer Protection. Equipped with one person in this department, the RS-ISA responds to consumer complaints if there are clear violations of existing regulation. It also submits the complaints to the Ombudsperson.

215. An independent ombudsperson operates within the RS-ISA. With the infrastructure support of the RS-ISA, an independent ombudsperson was appointed in 2008 by the RS-ISA board for a period of 3 years with the possibility of one reappointment. With an annual budget based on the insurance premium of 0.05 percent, the ombudsperson started operating in 2009. The scope of work of the Ombudsman includes:

- providing information on the rights and obligations of consumers and providers of services in insurance;

- monitoring and proposing activities for improving relations between consumers and providers of services in insurance;
- investigating activities in the insurance market *ex officio* or on the basis of objections, complaints, information, and other submissions, for the purposes of protecting the rights and interests of consumers and users of services in insurance;
- reviewing submissions of consumers of insurance services, as well as applications for information provision, providing responses, recommendations, and opinions, and proposing measures for resolution of submissions;
- intermediating in peaceful resolution of contentious relations between consumers and providers of services in insurance;
- providing guidelines or recommendations for the application of good business practices and standards of the profession in the operations of providers of services in insurance;
- proposing to the Management Board of the Agency adoption of enactments from his or her scope of competence in the area of protection of rights and interests of consumers and users of services in insurance;
- independently, or in cooperation with other bodies and organizations, organizing and implementing training on the benefits and risks relating to services in insurance with the objective of counseling consumers and users of services in insurance, and the public;
- independently, or in cooperation with other entities, preparing and publishing information and other educational materials, with the objective of educating consumers and users of services in insurance, and the public; and
- undertaking other actions within the area of protection of the rights and interests of consumers and users of services in insurance.

216. Within the resources constraints, several actions have been carried by the

Ombudsperson. The Ombudsperson has no direct staff and relies on the support of the RS-ISA to perform its mandate. Notwithstanding the shortage of resources, since the establishment of Ombudsperson, 474 written complaints have been processed and more than 1400 oral complaints handled. The majority of the complaints correspond to MTPL insurance, which is the dominant line of business. Table 20 provides information on the complaints received in 2012. General recommendations are published including two information bulletins that were published during 2012: Motor Vehicle Insurance and What you need to Know about Insurance. Detailed statistics per company on the complaints received and handled is not published. The publication of such statistics is recommended.

Table 20. Republika Srpska: Structure of Complaints
(By type of insurance in 2012)

Type of insurance	No. of complaints	Percentage share
Liability insurance for motor vehicles	35	68.63
Motor vehicle insurance (kesko) - risk	7	13.73
Insurance against fortuity and accidents	4	7.84
Insurance against damage on property	3	5.88
Insurance against third party liability	1	1.96
Health insurance	1	1.96
Total	51	100.00

Source: Authorities.

217. The Ombudsperson has issued a Code of Ethics that applies to all insurance companies.

The main aim of the Code of Business Ethics is to ensure protection of the insured and the beneficiaries of entitlements under insurance contracts, rebuilding trust in the insurance business and building a culture of insurance in the RS. The Code of Business Ethics for insurance companies in RS determines the general ethical principles and standards of professional conduct for insurance companies and identifies behavior not permitted or conduct contrary to good business practices and professional standards. Insured persons and third injured parties have the right to contact the Ombudsperson in insurance regarding any treatment by insurance companies and insurance intermediaries, which are contrary to the code.

218. The Code of Business Ethics provides the standards for the insurers' conduct of business.

The standards cover: rules of behavior for the insurance companies in the procedures for contracting insurance policies; procedures for settling the insurance claims and requests for benefit payments; the rules of the internal complaints procedure, and a clear definition of behaviors that are not in accordance with the regulations, good business practices, rules of the insurance profession in relation to the consumers of insurance services. The Code thus promotes and stimulates:

- legality and transparency of the insurance companies' operations;
- affirmation of good business practices;
- awareness of the population on the advantages of insurance services;
- development of mutual confidence between insurance service providers and beneficiaries;
- insurance market development based on fair treatment; and
- development of alternative/out-of-court settlement of insurance disputes.

219. The wide mandate of the Ombudsperson requires significant additional resources. It is recommended providing for significant additional resources including staff to enhance independence, actively promote the use of the Ombudsperson function, and to allow for a proper discharge of the mandate.

220. Consumer protection in insurance is developing. The RS-ISA has a dedicated department dealing with consumer protection issues, an ombudsperson has been established within the RS-ISA that is focusing on mediation and education as well as improving fair treatment of consumers in insurance through a code of ethics. The regulation requires pre-contractual information in a clear and accurate form and disclosures of conflict of interests by intermediaries, the term to pay claims is regulated to be no more than 14 days or 30 days; and at a high level, the coordination committee has, as its current topic, consumer education in financial matters. All companies apply the code of ethics developed by the ombudsperson and have established internal policies and procedures for claims handling. It is recommended to move consumer protection to the next level by:

- Issuing a regulation that requires insurance companies to take into account the interests of different profiles of clients in the development and marketing of insurance products;
- Imposing insurance specific requirements on the insurance companies and intermediaries to promote products and services in a way that is clear, fair and not misleading;
- Developing a regulation on the fair treatment of customers similar to the EU framework for insurance contracts, as the Law on Obligations does not regulate, in detail, the elements related to the fair treatment of insurance customers. Issuing a regulation requiring insurers and intermediaries to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture;
- Increasing resources for the ombudsperson that will allow for stronger and more intensive insurance education programs;
- Granting decision making power to the ombudsperson to adjudicate small amount claims, or establishing a small claims court system; and
- Boosting the RS-ISA resources dedicated to consumer protection to initiate activities needed in this area, like developing jointly with other stakeholders an insurance literacy strategy and actively implementing the fair treatment of customers' business.

221. Following IFRS, comprehensive disclosure requirements are in place for insurers, however market discipline is weak due to the lack of financial literacy. Following IFRS requirements and RS-ISA regulations, insurers are required to publish comprehensive annual reports in their web-pages (Article 2, item 2, of the rulebook on reporting). Among other items, the following should be disclosed in the annual report:

- general information on the insurance company, including information about the owners of qualifying holdings in the insurance company, members of the management board, the executive board and the audit committee;
- description of the business environment and the position of the insurance company in the RS insurance market;
- information on insurance claims per type of insurance (number, amount and status or reported and settled claims, number and amount of claims provisioned as of 31 December of the previous year and of the year for which the report is submitted);
- mortality and morbidity data (per insurance product);
- details on contracts concluded for life insurance, that include number of active policies at the start of the accounting period, number of newly issued policies, number of canceled policies, etc.,

- analysis of the ratio between the costs of implementing insurance and overhead allowance;
- analysis of approved bonuses and discounts;
- liquidity indicators, cost ratio, claims ratio and combined ratio;
- other indicators of business efficiency of insurance companies;
- important business events in the period between the end of the business year and the date of submitting the financial report;
- assessment of the expected future development of the insurance company;
- most important research and development activities;
- aims and policies of the insurance company regarding risk management, together with risk protection policies for each planned transaction that needs protection;
- exposure of the insurance company to price risk, credit risk, market risk, currency risk, liquidity risk and other risks present in the business operations of the company; and
- rules of corporate governance applied.

The level of disclosure appears to provide sufficient transparency on the insurers' operations. To improve market discipline what is missing is the ability of market participants to understand the published information. The RS-ISA is recommended increasing its effort to educate the public on insurance matters. Collaborating with the industry in this area will be beneficial and the leadership in this initiative by the BiH-IA should be evaluated.

222. The involvement of the RS-ISA in fraud prevention is needs based. Current regulation does not require insurance companies and intermediaries to take measures to deter, prevent, detect, report and remedy fraud in insurance. Insurance fraud is codified as a crime (article 240 of the Criminal Code of the RS). The RS-ISA monitors a claims database for the MTPL. A centralized claims database for MTPL should be established.

223. The analysis of large claims can provide supervisory insights to detect fraud. The RS-ISA is recommended implementing such a regular analysis, as well encouraging insurers to publish information on fraud deterrence. A regulation that requires insurers and intermediaries to take measures to deter, prevent, detect, report and remedy fraud in insurance should be enacted. Also, the formal analysis of large claims should be implemented in the supervisory process.

224. The RS-ISA has been a designated AML-CFT supervisor in the insurance and pension sector since June 2014. Despite the new mandate several actions have been carried out. In the insurance sector, the nonlife sector is not required to comply with the AML-CFT requirements. Consequently, only three companies and a few intermediaries have to be supervised for compliance with AML-CFT regulation. The RS-ISA has enforced compliance by requiring internal controls, including nominating a compliance officer, and the management of AML-CFT risks according to regulations. However, no additional resources have been allocated to the RS-ISA for this task. It is recommended to increase the training and resources in the RS-ISA to strengthen the level of understanding, oversight as well as the enforcement of AML-CFT regulations.

H. Market Structure and Industry Performance

225. The insurance sector in the RS is small but has been growing at an average of eight percent in last five years. With assets of only 4.3 percent of GDP, the insurance sector assets remain small. At the end of 2013, total assets amounted to KM 323 million, about 40 percent increase from 2009 (Table 21). In 2013, the total premium collected by the nonlife segment was KM 127 million, or about 80 percent of the total insurance premium. MTPL accounts for 72 percent of the total nonlife premium. The life premium has been increasing from 10 percent of the total insurance premium in 2009 to around 20 percent at the end of 2013, but remains insignificant at KM 13 million.

Table 21. Republika Srpska: Insurance Sector Assets, Technical Reserves, Own Funds and Gross Premium 2009–2013

(in KM million)

	2009	2010	2011	2012	2013
Total assets					
Nonlife	208.01	216.96	217.35	243.61	257.25
Life	25.48	32.97	41.29	54.03	66.26
Total assets	233.48	249.93	258.63	297.63	323.51
Technical reserves					
Nonlife	98.73	99.50	105.82	114.59	120.46
Life	16.30	21.26	27.36	35.29	46.27
Total TP	115.03	120.76	133.18	149.88	166.72
Own funds					
Nonlife	89.43	99.14	89.87	99.35	107.87
Life	7.71	8.48	11.75	15.65	15.74
Total	97.15	107.62	101.62	115.00	123.61
Premium					
Nonlife	112.03	113.68	121.05	128.12	127.13
Life	7.95	8.93	10.29	11.56	13.07
Total	119.98	122.61	131.34	139.68	140.20

Source: Authorities.

226. The number of insurers has remained fairly constant in the last five years with only one entrance in 2013. At the end of 2013, 12 institutions were licensed to provide insurance in the RS, compared with 11 in 2009 (Table 22). Nine companies are nonlife companies while three are composite insurers providing both nonlife and life insurance. Seven branches of insurers licensed by the FBiH are operating in the RS and are accountable for about 12 percent of the FBiH insurance market. The RS-ISA is responsible for the market conduct of these branches. Eight of the 12 insurers are domestically owned, one by a financial sector entity, and one by the state. All four foreign

owned insurers are owned by financial sector entities. The number of brokers has increased significantly from 5 licensed brokers in 2012 to 58 in 2013. This trend is continuing and the number of licensed brokers is expected to reach at least 80 by end-2014.

	2009	2010	2011	2012	2013
Insurers					
Life (long-term)					
Non-life (general)	8	8	8	8	9
Reinsurance					
Captive					
Fraternal benefit societies					
Others* life and non-life	3	3	3	3	3
Total	11	11	11	11	12
Insurance intermediaries					
Agents					
Private persons	163	143	129	145	134
Legal entities	10	10	6	7	7
Brokers					
Private persons				5	58
Legal entities					3
Source: Authorities.					

227. The nonlife sector shows no concentration and in life one player dominates. The nonlife sector is basically served by ten insurers of which seven have more than ten percent market share (Table 23). The absence of concentration in this sector indicates a high level of competition. This has driven some insurers to offer technically insufficient premiums for MTPL and accident. In the life sector, Grawe has the dominant market share of 86 percent. The remaining 14 percent is shared between two composite local insurers (Table 24).

Table 23. Republika Srpska: Market Share of Nonlife Insurers, 2013

Insurer	Total premium (Percentage share of the industry)
Jahorina osiguranje a.d.	17.5
Dunav osiguranje a.d.	13.57
Drina osiguranje a.d.	13.3
Bobar osiguranje a.d.	11.95
Brčko - gas osiguranje d.d.	11.05
Nešković osiguranje a.d.	10.43
Krajina osiguranje a.d.	7.18
Triglav osiguranje a.d.	6.39
Osiguranje Aura a.d.	4.68
Mikrofin osiguranje a.d.	3.94
Grawe	0.01
Total	100

Source: Authorities.

Note: None of the insurance companies has monopoly in particular line of business.

Table 24. Republika Srpska: Market Share of the Life Insurers, 2013

Insurer	Total assets (Percentage share of the industry)
Grawe osiguranje	85.89
Jahorina osiguranje	7.73
Dunav osiguranje	6.38
Total	100

Source: Authorities.

228. The main driver of the nonlife sector is mandatory insurance. With almost 73 percent of the business coming from the mandatory MTPL and an additional 7.5 percent related to motor insurance, the nonlife business has benefited from the mandatory insurance. The remaining 20 percent is distributed among property and accident and health. This distribution of lines of business has not changed in the last three years. The development of voluntary insurance and of the life sector that currently has KM 13 million in premium mainly in participating endowments remains a challenge (see table 25).

Table 25. Republika Srpska: Nonlife Insurance Products
(In percentage of Total Premium)

	2011	2012	2013
Motor	7.71	7.66	7.50
MTPL	73.65	70.67	72.72
Property	10.54	13.68	10.46
Liabilities (all except MTPL)	0.52	0.56	0.75
Accident and health	7.22	7.08	7.71
Others	0.36	0.34	0.85

Source: Authorities.

229. Asset composition is predominantly in bank deposits, real estate and receivables.

Investments account for 56 percent of the assets of which over 55 percent is held in bank deposits or cash and 10 percent in government bonds. Real estate investments and other real estate assets account for 30 percent of the assets. Receivables make up 17.7 percent and DAC 8.2 percent of assets. The composition of the asset portfolio for the non-life sector between 2009 and 2013 is shown in table 26 and the life sector in table 27. The lack of liquid investment markets has driven insurers to match their liabilities with liquid assets, resulting in large bank deposits and cash held as assets. This applies to both nonlife and life insurers. As life insurance develops with long-term liabilities, the demand for long-term assets to match the liabilities will increase. Currently, life insurers are using real estate and government bonds for this purpose. DAC as an asset has been increasing.

230. Liquidity risk is not systemic. With 45 percent of illiquid assets on average, the insurance sector is not exposed as a whole to liquidity risk; however, a few insurers have an important percentage of their assets in real estate and could be exposed to liquidity crunches specially if using excessive valuation for the real estate. The increase in DAC is a warning sign that needs special attention and could indicate insufficiency of technical premium.

**Table 26. Republika Srpska:
Assets of the Nonlife Insurance Sector, 2009-2013**
(In million KM)

	2009	2010	2011	2012	2013
Total assets	208.01	216.96	217.35	243.61	257.25
Intangible assets	2.83	2.15	1.77	1.83	1.97
Investments	91.30	110.72	109.83	126.34	143.87
<i>of which:</i>					
Government securities	0.65	2.75	2.82	8.51	13.43
Corporate securities	0.00	0.00	0.00	0.13	0.05
Equities	11.73	12.27	7.12	3.48	4.45
Real estate and real-estate related 1/	20.31	27.39	30.85	38.92	45.63
Cash and bank balances	58.60	68.31	69.04	75.30	80.30
Receivables	36.00	31.79	26.11	41.11	30.98
Intra-group/related company receivables	11.72	8.00	11.12	11.86	10.80
Reinsurance recoverables	0.08	0.69	1.53	0.86	5.89
Other assets	66.08	63.61	66.98	61.61	63.75
<i>of which:</i>					
Other real estate than investment	35.75	40.10	42.55	31.61	30.78
Differed acquisition costs (DAC)	9.17	7.57	9.19	14.71	19.07
Facilities, equipment and advances	9.27	9.74	9.74	11.57	9.65
Non balance assets	10.51	4.77	4.21	2.80	2.80
Other	1.38	1.44	1.29	0.92	1.44

Source: National authorities.

1/ Real estate which are only used as investments

**Table 27. Republika Srpska:
Assets of the Life Insurance Sector, 2009-2013**
(In million KM)

	2009	2010	2011	2012	2013
Total assets	25.48	32.97	41.29	54.03	66.26
Intangible assets	0.00	0.00	0.01	0.13	0.10
Investments	23.71	29.78	37.08	42.10	54.23
<i>of which:</i>					
Government securities	10.08	13.11	14.23	14.99	18.12
Corporate securities	0.69	0.00	0.00	0.00	0.00
Equities	0.03	0.03	0.03	0.03	0.03
Real estate and real-estate related	0.00	0.00	0.00	0.00	0.00
Cash and bank balances	12.91	16.64	22.82	27.08	36.08
Investments supporting unit-linked	0.00	0.00	0.00	0.00	0.00
Receivables	0.93	2.20	3.21	8.71	9.00
Intra-group/related company receivables	0.00	0.00	0.00	0.00	0.00
Reinsurance recoverables	0.10	0.13	0.13	0.20	0.17
Other assets	0.73	0.86	0.87	3.01	2.86
<i>of which:</i>					
Other real estate than investment	0.25	0.22	0.08	0.24	0.00
Differed acquisition costs (DAC)	0.44	0.62	0.76	2.34	2.47
Facilities, equipment and advances	0.04	0.03	0.03	0.25	0.23
Non balance assets	0.00	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.17	0.16

Source: Authorities.

231. The usage of reinsurance is low but effective. With only less than 12 percent of the premium reinsured, most of the insurance risk is retained by the sector (table 28). The MTPL does not require a large amount of reinsurance since the largest claims are covered by the green card guarantee fund. Here the retention is as high as 91.3 percent. Property is not well developed and flood and earthquake protection is an additional coverage that is infrequently bought. Notwithstanding the low usage of reinsurance, the reinsurance programs appear to be effective. Noting that the green card accident is automatically covered by its guarantee fund, of the top 10 claims with one exception, between 62 and 100 percent of the claims were reinsured (Table 29).

Table 28. Republika Srpska: Retention Ratio
(In percentage of the written premium)

	2011	2012	2013
Motor	99.88	99.86	99.68
MTPL	97.41	97.44	91.30
Property	73.61	51.87	64.95
Liabilities (all except MTPL)	88.62	90.75	63.51
Accident and health	99.19	99.36	91.34
Others	89.44	67.12	63.31
Average	95.15	91.39	88.73

Source: Authorities.

Table 29. Republika Srpska:
Top Ten Claims and the Reinsurance Participation

Insurance type and damage description	Amount (In KM)	Participation of reinsurers (In percent)
MTPL (Zelena karta)	1,513,328	67
MTPL (Zelena karta)	1,315,369	63
Osiguranje imovine	1,035,231	85
Osiguranje imovine	1,032,864	100
MTPL	947,979	78
MTPL	858,090	81
Osiguranje imovine	702,935	83
MTPL	617,575	68
MTPL	601,464	28
MTPL	511,533	0

Source: Authorities.

232. The insurance sector has been slightly profitable. Over the last five years, the nonlife sector has shown small but positive return on equity (roe) that amount on average to 2.71 percent. The life sector roe has been declining since 2009 from 3.26 percent to 1.25 percent in 2013. Returns on investments show 5.7 percent for nonlife and 6.1 percent for life (table 30). The profits have been eroded by the high costs shown in the financial statements and are partly supported by increased DACs and liberal valuations of real estate and loans. The technical provision as a percentage of premiums in nonlife has significantly increased in 2013 probably reflecting deterioration of the claims experience (table 31). The combined ratios (net claims and expenses over net premium, but without reinsurance commission) are above or close to 100 percent, indicating the need for investment' yields to show profits. The corporate tax of 10 percent supports net profits

notwithstanding that only 20 percent of the technical provision in nonlife can be deducted as expenses.

Table 30. Republika Srpska: Return on Equity and Investment Income of the Insurance Sector
(In percentage, 2009-2013)

	2009	2010	2011	2012	2013	Average
Nonlife						
Investment income	4.91	6.90	3.95	8.48	4.29	5.71
ROE (after tax)	0.28	3.32	2.77	4.35	2.82	2.71
Life						
Investment income	5.48	5.65	5.79	6.91	6.19	6.01
ROE (after tax)	3.26	3.33	2.42	2.34	1.25	2.52

Source: Authorities.

Table 31. Republika Srpska: Technical Provisions
(As a percentage of premium in nonlife)

	2009	2010	2011	2012	2013
Gross premiums	112.03	113.68	121.05	128.12	127.13
Technical provisions	98.73	99.50	105.82	114.59	120.46
Ratio	88.13	87.53	87.42	89.43	94.75
Combined ratio 1/	1.07	1.11	1.00	0.93	0.98

Source: National authorities.
1/ The reinsurance commission is not considered.

233. Five companies accounting for 40 percent of the nonlife market have solvency margins that are close to the point at which they will require supervisory measures. The solvency positions in the nonlife companies for 2013 and 2014 are shown in table 32. Currently, one insurer accounting for 3.7 percent of the market is insolvent and two insurers accounting for 13.3 percent of the market have solvency ratios of 100 percent. Five insurers accounting for 23 percent of the market have a solvency ratio between 101 percent and 110 percent. The resilience of the sector could be even worse given that Solvency I requirements do not fully allocate capital according to the risks assumed. The fragmented nonlife insurance market with premium well distributed among the participants has increased competition. This has led in some cases to insufficient premium for the risks assumed. Market participants bypass regulation that fixes not only the tariff but also the commissions by assuming additional non-regulated expenses, for instance in the areas of administration and servicing.

**Table 32. Republika Srpska:
Nonlife Insurers' Solvency Position (2013-June 2014)**

Insurer	Solvency ratio	
	2013	Solvency ratio 2014Q2
1	1.04	1.06
2	1.08	1.08
3	1.19	1.30
4	1.28	1.00
5	1.30	1.35
6	1.47	1.69
7	1.63	1.74
8	1.79	0.74
9	2.46	2.25
10	2.49	2.20
11	2.68	1.41
12	n.a.	1.00

Source: Authorities.

I. Table of FSAP Recommendations for the Republika Srpska

Recommendations and Authority Responsible for Implementation	Priority	Timeframe 1/
It is recommended establishing a regular and formalized information sharing process to enhance cooperation and allow all supervisors to gain access to supervisory data in a timely basis (Coordinating Committee).	High	Immediate
In the long-term, consideration should be made to the establishment of an integrated supervisor (RS-ISA and government).	Medium	Medium Term
It is recommended including the RS-ISA in the SCFS to gain a complete overview of the financial sector in matters of stability (Government/ Parliament).	Medium	Near Term
It is recommended introducing in the law the position of the Deputy director and as the market grows to consider a full time managing board for the RS-ISA (Government/ Parliament).	High	Immediate
It is recommended considering a revision of the basis on which fees are determined, taking into consideration the line of business (Government/ Parliament).	Medium	Near Term
It is recommended updating the law allowing the RS-ISA only to be sued as an institution and not the staff. If that appears not to be possible, at least the law should be clear on the RS-ISA as the responsible agency for providing for the costs of defending law suits that are initiated against its staff (Government/ Parliament).	High	Near Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe 1/
It is recommended having the outsourced IT constantly monitored by an in-house expert (RS-ISA).	High	Immediate
It is recommended creating the internal audit function (RS-ISA).	High	Near Term
Market wide targeted actuarial reviews should be regularly carried out. (RS-ISA).	High	Immediately
It is recommended developing an early warning system. In addition, the introduction of stress testing at the company level and market wide is recommended. Capacity building in this area will be required (RS-ISA).	High	Near Term
It is recommended introducing basic group supervision implementing secondary regulation as stipulated in article 71 (RS-ISA) and article 72 (FBiH-ISA) of the corresponding LIC.	High	Near Term
It is recommended introducing in the law a comprehensive group supervision framework together with the required training for its supervision (Government/ Parliament).	High	Near Term
It is recommended introducing a macroprudential supervision framework as the market further develops (RS-ISA).	Medium	Medium Term
Consideration to assign the development of macroprudential tools and their usage to the BiH-IA should be evaluated and the implementation power should be granted the ISAs.	Medium	Medium Term
It is recommended requiring fit and proper for all governance board members and the internal auditor (RS-ISA).	High	Near Term
It is recommended introducing interviews for the candidates for control functions to gain a stronger opinion of their fit and proper (RS-ISA).	Medium	Medium Term
It is recommended introducing requirements similar to those applied for new licenses for the assessment of applications to increase shareholdings to over 50%.	High	Medium Term
It is recommended incorporating the supervisory power to void the voting rights of a non-approved qualified shareholder, also to consider if the disposal of the shares acquired by a non-approved qualified shareholder could be enforced (Government/Parliament).	High	Medium Term
It is recommended clarifying the interplay between the different laws, including the role of the Protection Fund in the MTPL business, that apply in winding up an insurer (ISAs).	Medium	Near Term
It is recommended regulating the type of investments that the insurers can undertake for all assets using the prudent person principle, moving towards a total balance sheet supervisory approach (RS-ISA).	High	Near Term
It is recommended updating the solvency regime by a gradual incorporation of risk elements into the solvency framework. Credit risk capital surcharges on the assets, and then differentiated factors depending on the line of business that apply to the premium and claims calculation could be the starting point (RS-ISA).	High	Near Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe 1/
It is recommended that once a risk sensitive solvency regime and the early warning system are in place, the development of a ladder of intervention based on capital levels with the corresponding prompt corrective actions should be introduced (RS-ISA).	High	Medium Term
<p>It is recommended updating governance requirements in the following areas:</p> <ul style="list-style-type: none"> • the board structure with the corresponding committees, governance standards, board composition and knowledge, and assessment of the effectiveness of the board. • remuneration policy of board members and senior management; • duties of individual board members including acting in the best interests of the insurer and policyholders; • timely and effective communication with the RS-ISA and relevant stakeholders (including policyholders) on the governance structure of the insurer (RS-ISA). 	High	Medium Term
<p>It is recommended to strengthening the existing regulation in the areas of internal controls, risk management and corporate governance requirements on insurers:</p> <ul style="list-style-type: none"> • Scope of internal controls – To be effective, internal controls should be comprehensive, covering the insurer’s key business, IT and financial processes. Key control functions should minimally include to the internal audit and actuarial function, the risk management function. Each key control function should be led by a person suitable for the position, have sufficient independence from business units and adequate resources, and have access to the board and provide regular reports to the board. • Duties of key control functions: • Risk management should assess risks on an enterprise-wide basis. There should be defined risk appetite, documented approval process and authorities, established risk strategy, and escalation and reporting procedures. • Internal audit should assess the adequacy and effectiveness of an insurer’s policies and procedures, and the documentation and controls of these. It should also evaluate the reliability and integrity of management information. • Compliance function should be introduced to advise on compliance with laws, regulations and internal policies and procedures. Compliance procedures should be integrated in work processes. • Regulation on outsourcing should be enacted to require: 	High	Medium Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe 1/
(a) board approval of outsourcing of material functions or activities, (b) due care and diligence in selecting the outsourcing providers, (c) written documentation of the outsourcing arrangements, and (d) periodic review of such arrangements (RS-ISA).		
<p>It is recommended enhancing reinsurance supervision and regulation:</p> <ul style="list-style-type: none"> • The financial stability of reinsurers should be analyzed annually. • Registration of reinsurers should be started with basic information and a contact person in the home supervisory agency • Risk transfer requirements on the reinsurance contracts should be specified • Cash call clause should be included for catastrophic events • Prohibition of side letter to guarantee the integrity of the contracts should be implemented (RS-ISA). 	Medium	Near Term
It is recommended updating, on a regular basis, the training material to cope with new developments in insurance intermediation (RS-ISA).	Medium	Medium Term
It is recommended including in the regulation the registration requirement of foreign and reinsurance brokers to gain oversight of the total insurance activities (RS-Government)	Medium	Medium Term
It is recommended introducing corporate governance requirements for insurance intermediaries according to their size and complexity independently of the legal form used to operate (RS-Government).	Medium	Medium Term
It is recommended providing for significant additional resources including staff to enhance independence, actively promote the use of the Ombudsperson function, and to allow for a proper discharge of the mandate (Government/Parliament).	High	Near Term
Detailed statistics per company on the complaints received and handled by the Ombudsperson should be published (Ombudsperson).	High	Immediately
<p>It is recommended moving consumer protection to the next level by:</p> <ul style="list-style-type: none"> • Issuing a regulation that requires insurance companies to take into account the interests of different profiles of clients in the development and marketing of insurance products. • Imposing insurance specific requirements on the insurance companies and intermediaries to promote products and services in a way that is clear, fair and not misleading. • Developing regulation on the fair treatment of customers, as the Law on Obligations does not regulate in detail the elements related to the fair treatment of insurance customers. • Issuing a regulation requiring insurers and intermediaries to 	High	Near Term

Recommendations and Authority Responsible for Implementation	Priority	Timeframe 1/
<p>establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture</p> <ul style="list-style-type: none"> • Increasing resources for the Ombudsperson to allow for stronger and intensive insurance education programs. • Granting decision making power to the Ombudsperson to adjudicate small amount claims, or establishing a small claims court system. • Boosting the RS-ISA resources dedicated to consumer protection to initiate activities needed in this area, like developing jointly with other stakeholders an insurance literacy strategy and actively implementing fair treatment of customers' supervision (RS-ISA and Government/Parliament). 		
It is recommended increasing the effort to educate the public on insurance matters. Collaborating with the industry in this area will be beneficial (RS-ISA).	High	Near Term
It is recommended introducing regulation that requires insurers and intermediaries to take effective measures to deter, prevent, detect, report and remedy fraud in insurance and the formal analysis of large claims implemented in the supervisory process (RS-ISA, Parliament).	Medium	Near Term
A centralized database for MTPL claims should be established to prevent fraud (RS-ISA).	Urgent	Near Term
It is recommended increasing the training and resources in the RS-ISA to speed up the level of understanding the supervision and enforcement of AML-CFT regulation (RS-ISA)	High	Near Term
It is recommended facilitating the establishment of quality control committees for the auditing work (Chamber of auditors).	Medium	Immediately
1/ "Immediate" is within one year; "near-term" is 1–3 years; "medium-term" is 3–5 years.		

Appendix I. Progress on 2006 FSSA Recommendations

2006 Main Recommendations	Implementing Agency	Status of Implementation
Issue the necessary technical regulations as soon as possible.	Insurance agencies	Implemented. The bylaws on solvency, technical provisions and the guarantee fund have been issued. Both entities have implemented Solvency I regimes.
Set up a mechanism to enforce and to supervise the tariff for compulsory Motor Third Party Liability insurance.	Insurance agencies	Not implemented. A project to liberalize tariffs is in advanced stage.
Upgrade the institutional structure and enforcement capacity of insurance supervision in both entities.	Insurance agencies	Implemented. The budget and the staff have been increased. Operational infrastructure has been established. The powers of the ISAs have been regulated in bylaws and used.

Appendix II. Report on Indicators of Prompt Liquidity

PG	Description	Synthetic account	Stock on the day
1	Monetary funds on business accounts in domestic currency	241, 242	
2	Monetary funds on foreign currency accounts (according to exchange rate at the date of calculation)	244, 245	
3	Cash in hands (both in local and foreign currencies)	243, 246	
4	Demand deposit	232	
5	Share of Loan Commitments Unused	88	
6	Term deposits maturing within 7 days, except deposits used to cover technical provisions	033, 034, 035, 038	
7	Extended loans maturing within 7 days or shares of loans (annuity) maturing within the following seven days, corrected for adjusted value	03	
8	Securities and shares that can be immediately converted to cash, i.e., maturing within 7 days.		0
8.1.	Graded until maturity date	036	
8.2.	Graded as available for sale	037	
8.3.	Graded by fair value in Income statement	236	
8.4.	Shares	030,031, 032	
9	Receivables maturing within 7 days secured with appropriate instruments (bill of exchange, bank guaranteed, mortgage, lien etc.	20	
10	Expected earnings from insurance premium, i.e., reinsurance in the following 7 days, given the average daily earnings in the previous years, as of the incorporation date, if no data available for previous year.		
11	Expected earnings from reinsurance share in claims maturing within 7 days		
I	TOTAL LIQUID ASSETS (1 TO 11)		0
12	ST financial liabilities due	42	
13	Due liabilities related to claims and insurance contracts	43	
14	Due liabilities for premium and specific liabilities	44	
15	Due liabilities for wages and allowances	45	
16	Other due liabilities from operations	46	
17	Due liabilities for taxes and contributions	47	
18	ST financial liabilities maturing within 7 days	42	
19	Liabilities related to claims and insurance contracts maturing within 7 days	43	
20	Liabilities for premium and specific liabilities maturing within 7 days	44	
21	Liabilities for wages and allowances maturing within 7 days	45	
22	Other liabilities from operations maturing within 7 days	46	
23	Liabilities for taxes and contributions maturing within 7 days	47	
II	TOTAL LICBILITIES DUE (12 TO 23)		0
III	LIQUIDITY COEFFICIENT (I/II)		0

Appendix III. CARMEL Analysis¹

Group label	Indicator	Subgroup	Nonlife insurance
C	Premium in retention / Total capital	C1	
	Total capital minus losses / Total assets	C2	
	Total capital minus losses / Technical reserves	C3	
	Guarantee Fund / Solvency margin	C4	
A	Intangible investment + real estate + receivables / Total assets	A1	
	Receivables for premium / Total invoiced premium	A2	
	Share in capital / Total assets	A3	
	Coverage of technical reserves with stipulated forms of assets	A4	
	Coverage of technical reserves with stipulated forms of assets 1	A5	
R	Earned premium in retention / Total earned premium	R1	
	Technical provisions in retention / Average settled claims in retention over the past 3 years	R2	
	Technical provisions in retention / Average premium in retention over the past 3 years	R3	
M	Total contracted premium / number of employees	M1	
	Total assets / Number of employees	M2	
	Costs of earnings / Premium in retention	M3	
E	Earned claims in retention / Earned premium in retention	E1	
	Insurance acquisition costs / Earned premium in retention	E2	
	Investment profit / Earned premium in retention	E3	
	Combined 1 - E1 + E2 indicator	E4	
	Combined 2 - E1 + E2 - E3 indicator	E5	
	Net result / Average total capital	E6	
	Net result / Number of employees	E7	
	Net result / Total assets	E8	
Net result / Total income	E9		
L	Cash and cash equivalents / Short-term liabilities	L1	
	(Operating assets - stocks) / Short-term liabilities	L2	
	Liquid assets / Short-term liabilities)	L3	
¹ As of December 31, 2013.			

Appendix IV. Calculation of Liquidity Ratio

No	Date (to be filled in for every workday)	Day	
	Description	Account (synthetic)	Standing
1	Funds in the transaction account		
2	Funds at foreign currency accounts		
3	Cash in hand		
4	Demand deposits		
5	Term deposits that are unconditionally withdrawn		
6	Securities that can be cashed immediately		
7	TOTAL LIQUID ASSETS (1–6)		
8	Obligations due under insurance contracts		
9	Obligations due from financing activities		
10	Other obligations due		
11	TOTAL OBLIGATIONS DUE (8–10)		
	Liquidity ratio (7/11)		