



To the outside world Sarajevo is known for dramatic events rather than for its rich multi cultural heritage. The assassination that started the First World War occurred only a few blocks away from the hotel where I am staying while presenting a seminar for the country's insurance supervisors. As I gaze

at the hills surrounding the city while I ponder each new day, two indelible images of more recent dramatic events come to mind. They are lingering televised pictures of these same hills. One dates from February 1984, the euphoria of the 14th Winter Olympics. The other features the artillery and sniper fire from these hills during the awful 1992-95 siege of Sarajevo. Like the half-full, half-empty glass, which picture dominates on any given day reveals my current assessment of Bosnia and Herzegovina's prospects.

It is no wonder that I vacillate, for there is both good news and bad news. Since the Dayton Accord ended the war, life has returned to normal in most respects. Europe's oldest system of electric trams smoothly carries people to work every day. In the evening couples and families stroll nonchalantly in the Bascarsija, the old Turkish market section. Throughout the country reconstruction, partly funded by \$14 billion in foreign assistance, is far along, and the economy has been growing. A currency board pegs the currency to the Euro, keeping inflation low. The reformed banking sector functions smoothly, and ATMs dispense cash as needed. Because of the municipal elections taking place while I am here, posters appear everywhere. Sarajevo seems like most other European cities.

Most of the bad news is political, dealing with the bizarre governmental structure. Thankfully, the Dayton Accord ended the war. Another good thing about it was . . . ? There is no way to complete that sentence; the Dayton Accord created a constitutional monstrosity in Bosnia and Herzegovina. While preserving the country's territorial integrity, it allowed the warring factions to control distinct areas until they could agree on the structure of a democratic central government. In the interim the United Nations holds ultimate authority, exercised through the Office of the High Representative, which is due to shut down any day now, as soon as the conditions are met. Although there is a tri-partite presidency, parliament, and council of ministers at the state level, the creation of a real state-level government for the entire country has been a slow process. Ongoing reforms have led to the creation of a single, multi-ethnic military under state-level command, as well as a state-level taxation administration that collects a nationwide value-added tax. Despite this progress, ordinary functions of government like infrastructure, health care, and education fall to the two entities: the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS). Thus different laws, regulations, and procedures often apply in these two different parts of the country.

My assignment is to guide these two distinct insurance markets through this constitutional thicket toward a "single economic space," increasingly integrated with the European and global economy. Each entity has its own supervisory agency, and until recently, the two entities' insurance laws were totally different. It was not possible for a company from one entity to conduct insurance in the other entity.

Letter from Sarajevo

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To coordinate supervision in the two entities, as well as to conform the insurance laws of Bosnia and Herzegovina to European Union Insurance Directives, the state-level Insurance Agency of Bosnia and Herzegovina began work in April 2007. The State Agency harmonizes entity-level legislation and the supervisory work of the entities' agencies, collects statistics at the state level, and represents the country in international relations. Accordingly, the State Agency quickly joined the International Association of Insurance Supervisors and the International Insurance Foundation. It published 2006 and 2007 editions of *Statistics of the Insurance Market in Bosnia and Herzegovina*. Results come slowest in its principal area of responsibility, coordinating the entity-level supervision. Its greatest feat of coordination so far is newly harmonized licencing regulations, which now allow "inter-entity" business—an insurer from one entity

can have a branch operating in the other entity after obtaining permission from each entity's supervisory agency.

At the request of the State Agency and under the auspices of USAID's Partnership for Advancing Reforms in the Economy, the International Insurance Foundation organized the Seminar on "Global Standards of Insurance Supervision." The 36 participants include employees of the State Agency, the FBiH Supervisory Agency, the RS Supervisory Agency, the Policyholder Protection Funds of each entity, and a few private sector representatives. As outsiders, we cannot possibly sort out the political divide complicating the supervisory framework. We can, however, point these diverse organizations toward a common benchmark, the IAIS Core Principles of Insurance Supervision. The Seminar drilled home the importance of the Core Principles with frequent reminders that the IMF/World Bank Financial Sector Assessment uses the Core Principles to evaluate the country's insurance supervision.

Fortunately my colleague in this endeavor, André Swanepoel, contributes an insider's knowledge, gained serving during the formative years on the IAIS Executive Committee and chairing its Emerging Markets Committee. Since retiring as South Africa's top insurance supervisor, André has devoted much of his time to helping other countries build their supervisory capacity. During this Seminar his 40 years of insurance experience elucidated many aspects of the Core Principles in detail. Using the IAIS Questionnaire, André led the group through an objective self-assessment of the country's observance of the Core Principle on licensing. This day, with representatives of both entities together in one room discussing the implementation of a global standard, I was definitely hopeful about the country's prospects.



On the other hand, the underdeveloped insurance market is not playing its full role of protecting assets, stabilizing income, and encouraging investment. In planning the Seminar André Swanepoel and I visited each of the supervisory agencies to learn more about market conditions. In Banja Luka (where the RS supervisory agency is located) as well as in Sarajevo, we heard similar stories. Insurance companies are thinly capitalized, and their financial reporting is unreliable. Accounting standards are weak, but outside the control of the supervisors. Most companies are out of compliance with the investment limitations, some egregiously so.

Since the country's only reinsurer receives mandatory cessions for the next 5 years, supervisors do not focus on reinsurance adequacy. The RS allows its insurers exceptions to the reinsurance monopoly although the Supervisory Agency does not yet have a basis for evaluating reinsurers.

Intermediaries must be licensed, but companies encourage them to begin selling before the license has been processed. Thus consumers do not know who is licensed to sell insurance and who is not.

A design flaw threatens the sustainability of the FBiH Policyholder Protection Fund. Like an unsatisfied judgment fund, the Fund compensates accident victims when the responsible party is uninsured. Like a guarantee fund, it compensates claimants of insolvent insurance companies. Because these two functions are mixed, the Fund cannot establish a proper actuarial basis. Worse, the liquidation procedure takes place under the court system, not under the purview of the insurance supervisor. Meanwhile, claims against one insurer, which may or may not actually be insolvent, are rapidly depleting the Protection Fund.



These are only some of the problems that surfaced during the Seminar. When I asked what consumer problems the country has, the response was "What problem don't we have?"

When I asked whether they knew of any unlicensed insurers selling products in Bosnia and Herzegovina, the floodgates opened. Nearly everyone in turn explained how certain Austrian and German insurers exploited the disintegration of Yugoslavia to market their products. Their reputation stemmed from Bosnia's historic ties with Austria. Regardless of which entity they came from, all the Seminar participants regarded this situation as a major affront, draining the country of premiums. Despite their profound chagrin, they did not mention the implication that insurance consumers in Bosnia and Herzegovina evidently do not accord a higher value to transactions with legitimate, supervised insurers than with unsupervised insurers. Obviously it will take considerable effort to instill confidence in Bosnian consumers and to raise the level of insurance supervision to that of EU Member States.

Clearly the present supervisory authorities lack the necessary legal powers to exercise their responsibilities fully. In some cases they may also lack the necessary courage or experience. It is up to them to protect policyholders and assure the overall integrity of the insurance market. As we reminded them, in a voluntary market without sound supervision, few people would buy insurance. Notably, more than half of the insurance purchased in Bosnia and Herzegovina is compulsory.

Since his return to South Africa required him to leave the Seminar a day early, André Swanepoel said a special farewell. Thanking the participants for the opportunity to visit Bosnia and Herzegovina and to learn more about it, he said:

I have great sympathy for you. My country too has been torn from within and struggled to bring reconciliation. In such circumstances people are often asked "Why don't you leave," and the answer is "Because I want to help my country." I hope you will help your country.



In Sarajevo a mosque, a Catholic cathedral, an Orthodox cathedral, and a synagogue stand within 500 meters of each other. Locals boast about this evidence of the city's multi cultural past, enriched by influences from all directions at this crossroads of civilizations. Although still open, all the houses of prayer now seem underutilized, for Bosnia and Herzegovina needs an abundance of prayers.

Not only must it bind up the nation's wounds, it must establish a just and lasting peace. Once again it must be open to the world and learn to take the best from each corner. The Stabilization and Association Agreement with the European Union, which Bosnia and Herzegovina signed in June, provides new channels for cooperation and assistance. Eventual membership in the European Union promises a brighter future, but many more reforms are needed to fulfil that aspiration. In the judgment of the High Representative, "Reforms in Bosnia and Herzegovina have slowed down, despite commitments from all political parties to ensure fast progress on the EU agenda."

During my time in Sarajevo, the International Monetary Fund issued its latest report on Bosnia and Herzegovina's economy. Like me, the IMF report is ambivalent. Bosnia and Herzegovina's national income compares well to neighboring countries, in line with other transition economies, taking account of the time lag resulting from the war. Its growth rate, however, falls short. Bosnia and Herzegovina risks falling behind, rather than catching up with other transition economies and the rest of Europe. Accelerated structural reforms are critical to encouraging private investment and stimulating growth.

The insurance market also risks falling behind. The supervisory agencies recognize most of their problems and are moving in the right direction, but they are not moving fast enough. They must intensify international cooperation and adopt best practices quickly. As the economy grows and opens more to Europe, the holes in the supervisory framework will become craters, and irresponsible players will exploit them savagely if they are not filled.

Some may say that Bosnia and Herzegovina is but a small, faraway country, but I will return whenever asked to help it implement global standards of insurance supervision. Sound supervision will be good for the people there, and it will be good for the global insurance market as a whole. As events in Sarajevo have proved more than once, what happens in small, remote places still touches us all.

*Robert Gibbons
Executive Director and President
International Insurance Foundation*

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