LEGISLATIVE NEWS

Establishment of a Branch by Foreign Insurance Companies in Georgia (Review of Changes introduced to the Law of Georgia on Insurance)

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The changes introduced to the law on Insurance on 29 December 2004[1] aim at quite a progressive objective – the liberalization of the Georgian insurance market, which is fully compatible with the principles of modern international economic order and could be considered as a step in line with current globalization processes in the world. In particular, the new law repealed the provision prohibiting foreign insurance companies from carrying out direct insurance service in Georgia. Upon the enactment of the law, companies established abroad will have the right to carry out their activity in Georgia through locally established branches.

It goes without saying that the admission of foreign companies to the Georgian insurance market, be it through a subsidiary, branch or share participation in local companies, will facilitate the further development of the sector and should be considered as a step forward. The presence of foreign companies in the local market, especially of companies established in countries where the insurance institute has existed for centuries and has a great experience and tradition of this kind of activity, is accompanied by many positive factors. Foreign presence brings with it innovation and transfer of know-how, while at the same time it gives access to additional financial sources, improves insurance rules, fosters greater diversification of business, expands capacity so that a steep growth in demand will not be held back by the small size of the domestic insurance sector, broadens the scope of products offered and increases financial stability.[2]

However the unrestricted admission of foreign companies to the market, if it is not accompanied with relevant licensing and supervisory standards, may cause quite severe consequences. In this respect our insurance legislation has shortcomings. There are no fit and proper criteria set for the members of an insurance company's management and qualifying shareholders; the amount of minimum share capital set for companies is quite low (GEL 500 000 for non-life insurance and 600 000 for life insurance); companies are entitled to carry out both life and non-life insurances simul-

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[1] Sakartvelos Sakanonmdeblo Mazne no. 6, 19.01.2005.

[2] OECD Insurance and Private Pensions Compendium for Emerging Economies, Book 1, Part 1:1)b, Detailed Principles for the Regulation and Supervision of Insurance Markets in Emerging Economies, 1997, 6.

taneously; the standards of prudential supervision over companies need considerable improvement; the supervisory body has no right to inspect the companies on site and apply sanctions on them. Such deficiencies of the licensing and supervisory regulations can not ensure effective, stable and financially secure functioning of the insurance market, its protection against unfair and unqualified persons; neither can it avoid use of insurance companies for criminal purposes such as money laundering. However, all these problems are pressing not only with regard to foreign companies but equally apply to local companies too. Consequently, for the facilitation of further proper development of the insurance market it would be reasonable to regulate these issues in the legislation first, and only then open the doors to foreign companies.

Most-Favoured-Nation Treatment for OECD Member States

One of the significant features of the changes is that the right to provide insurance and reinsurance services in Georgia through branches is granted only to the foreign insurance and reinsurance companies which are registered and granted a licence in one of the OECD member-states. One should presume that when solving the issue this way the authors of the law were guided with the opinion that generally the laws of the member-states of this organisation impose quite strict requirements on the persons willing to carry out insurance activity. This is true with regard to strict standards of market access (licensing) as well as to prudential supervision by a competent authority while carrying out the activity. Therefore, the fact that the company is established on the territory of one of these countries and possesses an insurance licence granted by the competent authority is the guarantee that the company is reliable both in financial and managerial terms. However, the law ignores the international commitments assumed by Georgia upon the accession to the WTO and because of this goodwill – to protect insurance market against unreliable and unfair participants – may lead to absolutely different, unforeseeable consequence.

Georgia joined the WTO in June 2000 and together with other agreements of this organisation accessed the General Agreement on Trade in Services (GATS). GATS defines the principal rules on trade in services among member-states and the insurance activity as one of the types of financial services falls within its scope. Article II of GATS provides for one of the fundamental principles of the Agreement regarding "most-favoured-nation treatment". According to this principle each member shall accord immediately and unconditionally to services and service suppliers of any other member, a treatment no less favourable than that it accords to like services and service suppliers of any other country.

Consequently the law, which entitles only the companies registered in OECD member-states to provide insurance and reinsurance services through its branch on the territory of Georgia, contradicts the GATS's principle on "most-favoured-nation treatment". Pursuant to Article 6 of the Georgian Constitution, GATS as an international treaty concluded by Georgia shall prevail over the national law and the right granted to OECD

member-states will automatically apply to all members of the WTO. If the law aimed to restrict the access of foreign companies to the Georgian insurance market on certain grounds, the only lawful solution would be on grounds of registration in WTO member-states.

However, this would not be a proper approach. At present the WTO has 148 members many of which may have insurance regulatory standards that are even lower than those in Georgia. Thus liberalisation of our insurance market without proper licensing and regulatory standards may turn out to be unjustifiable for this sector.

Licensing Conditions for the Branch of a Foreign Insurance Company

Paragraphs 13 and 14 of Article 22 of the law define the conditions to be met by a foreign company to be granted a licence for providing insurance service on the territory of Georgia through its branch. The essential conditions provided for by the law may be summarised as follows. Namely, the establishing company should possess a licence for carrying out insurance in the home country and should deposit in a commercial bank in Georgia either cash or debt securities the amount of which shall be determined in accordance with the minimum charter capital set for the insurance companies registered in Georgia.

It is interesting to review these requirements in the light of international standards set in this field. Pursuant to the principles set by the International Association of Insurance Supervisors (IAIS)[3], of which the State Insurance Supervisory Service of Georgia is also a member, before granting a licence the supervisory authority must be provided with the documents which at least contain the following data:

a) name and address of the place of incorporation;
b) types of insurance which the company proposes to write;
c) confirmation from the home supervisory authority that the insurer is authorised to carry on the types of insurance business proposed;
d) information from the home supervisory authority that the insurer is solvent and meets all the regulatory requirements in the home jurisdiction;
e) name and address of the branch and the name of authorised agent;
f) on licensing of foreign company's branch should apply the requirements applicable to host company's licensing to the extent reasonable in terms of the status of the branch.

From this list the law meets the requirements only of paragraphs a), c) and e). As for other documentation, their submission is required by the law either vaguely or not at all.

For example, information concerning the types of insurance the company proposes to write through the branch (paragraph b) is not explicitly stated in the law. Maybe the latter

could be read from the provision of subparagraph b) of paragraph 13 of Article 22 that refers to the information on the "scale of activities". However, since "the scale of activities" is a very vague expression that could be interpreted in various ways (e.g. as a territorial or structural scope or any other characteristic) and will definitely cause problems during its practical application, it would be reasonable if the law explicitly stipulated that the information on the classes of insurance the company proposes to write through the local branch to be included in the licensing application. Moreover, according to paragraph 3 of Article 22, "the licence shall explicitly state the type of insurance that the insurer is entitled to carry out". On this fact depends the amount to be deposited under the law by a foreign company's branch.

As for the requirement of paragraph d) of IAIS standards, this is equally important for taking the decision on issuance of a licence by the host supervisory authority to the foreign company's branch. There may be a situation when a company holds a licence issued by the home supervisory authority, but for the time given in such a financial state or noticed in systematic violation of regulatory requirements and so issuance of a licence to its branch may turn out to be unjustifiable. It is rather important that a host supervisory authority for licensing of a branch has full information on the company's financial state and fulfilment of legislative requirements in good faith and not from the report submitted by the company (as provided for by Article 22.14.c) but from a reliable and impartial source, such as the home supervisory authority.

In general, when it comes to international insurance companies, it is very important to subject the licensing procedure to consultation between the host and home supervisors. As the principles of IAIS suggest, for the effective monitoring of cross border insurance operations, the home and host supervisory authorities must closely cooperate both at the time of licensing of the branch and in the process of supervision over the activities of the company and its foreign branch. The host supervisors shall be obliged to check that the home supervisor of the immediate insurance parent has no objection before granting a licence. This process might give an opportunity to a home supervisor which disapproves of its insurer's plans to establish abroad to make its reasons known to the host supervisor and perhaps recommend that the host supervisor refuse a licence. Where a host supervisor is unable to obtain a positive reply from a home supervisor, or a qualified response is received it should consider either refusing the application, increasing the intensity of supervision or imposing conditions on the grant of a licence.[4]

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[3] IAIS Insurance Core Principles and Methodology, 2003, 15.

[4] Principles Applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Business Operations, 1999, 5.

It is obvious that the State Insurance Supervision Service of Georgia will not be able to solve properly the issue of granting licence to a foreign company's branch and its successful supervision without receiving relevant information from the home supervisor and without close cooperation with it. Thus, it would be expedient if the law provided for the obligation of consultations. Moreover, similar provisions exist in Georgia in the banking field. Namely, pursuant to Article 4.5 of the law on the Activity of Commercial Banks, a licence shall be issued to the foreign bank's branch only after the conduct of consultations between the National Bank of Georgia and the relevant supervisory authority of a foreign country and if the National Bank considers the results of the consultation as satisfactory.

Finally, we will focus on the last paragraph f) of the IAIS standards stating that on licensing of a foreign company's branch should apply the requirements applicable to a host company's licensing to the extent reasonable in terms of the status of the branch. The system of licensing of local companies applicable in Georgia needs significant improvement. However, even among these minimum standards, there are regulations the application of which on licensing of branches would be reasonable. Specifically, the wording of paragraph 8 of Article 22 of the law which was in effect before the changes were made to the law, provided for the duty to submit a three-year business plan by a company seeking a licence.[5] On the basis of this article the Insurance Supervision Service drafted a normative act[6] which regulates in detail the information and data to be contained in the business plan. Apparently it is unjustified to oblige the branch to submit the business plan containing the same amount of information as required from the newly established legal person, though it is possible to require the branch to submit a business plan with changed contents. To illustrate which data the business plan submitted by the branch should contain, we can refer to the Directive of the European Council 2002/83/EC on Life Assurance. Chapter V of the Directive regulates licensing of branches established within the Community and belonging to undertakings whose head offices are outside the Community. As per the Directive, the scheme of operations (business plan) of the branch shall contain the following data:

- the nature of the commitments which the undertaking proposes to cover;
- the guiding principles as to reinsurance;
- the state of the undertaking's solvency margin and guarantee fund;
- estimates relating to the cost of setting up the administrative services and the organisation for securing business and the financial resources intended to meet those costs.

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[5] Since this amendment aimed at the regulation of licensing of only foreign company branches, we should presume that the repeal of this requirement from the present version of the Law is just a mechanical mistake. We hope that this shortcoming will be corrected soon and the obligation to submit a business plan by a licence-seeking company will be restored in the Law on Insurance.

[6] Order no. 32 of the Head of State Insurance Supervision Service of Georgia on the approval of the basic information of business plan for future three years after the launching of insurance undertaking by insurer, reinsurer and founder of non-state pension scheme.

and in addition shall include, for the first three financial years:
– a plan setting out detailed estimates of income and expenditure in respect of direct business, reinsurance acceptances and reinsurance cessions;
– a forecast balance sheet;
– estimates relating to the financial resources intended to cover underwriting liabilities and the solvency margin.[7]

Moreover, the plan should demonstrate satisfactorily that the company will be able to maintain a sound financial condition and meet its obligations at all times during the first years. The supervisor should be able to examine the projections to determine whether they are realistic. It may be necessary to require a review of assumptions, an increase of organization fund or equivalent, a different method for the calculation of premiums, or a different reinsurance policy. If the applicant company does not take account of the supervisor's objections, the supervisor may refuse the license, or grant it subject to certain conditions.

Conclusion

As a conclusion, it should be mentioned that in this review we focused on some key aspects of changes made in the law on Insurance. In general, this field of Georgian legislation needs fundamental revision and all the issues mentioned in this review should be regulated together with other not less important issues. For the purpose of further development, continuing major work is expedient in terms of the sophistication of legislation in line with EU standards, as well as recommendations elaborated by international organisations working in this field.

[7] Article 51.3 of Directive 2002/83/EC.