

## THE INSURANCE MARKET OF THE REPUBLIC OF MOLDOVA IN TERMS OF INVESTMENT POTENTIAL

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### Abstract

The financial market of the Republic of Moldova has been characterized by a high degree of uncertainty during the last years. The political instability had its consequences causing disturbances, especially on the bank market. At the same time, the global financial crisis has had a direct impact on the national financial market as well, reducing thus the investment potential in the bank and non-bank financial sector, especially of the foreign investors. Notwithstanding the insurance market of the Republic of Moldova has registered a growth during this period. The paper presents an analysis of the insurance market in terms of its investment potential and tries to explain the behavior of the insurance products' consumers in the conditions of the actual financial and economic crisis.

**Keywords:** financial market, life and non-life insurance, financial crisis, bank sector, investment potential

**JEL Classification:** D53, E22, G016, G22, G23

The last years show major fluctuations in the global economy resulting in situations of uncertainty on economic segments of all countries of the world. Since 2008 the global economy has been marked by major problems in the financial market of the United States which occurred in mid-2007. These problems have spread rapidly around the

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world and since September 2008 have been transformed into an international financial crisis. Only since 2010 the world economy entered a recovery phase, but at a very slow pace. Each country has traveled its path for a return to normal economic operation. Some countries have suffered more serious consequences than others, but the recovery was full of risks for each.

2012 was again a fairly difficult year. Economies continued to feel the consequences of the most severe financial and economic crisis following World War II represented by: high unemployment, high inflation rates, fiscal consolidation, etc. Regressive trends in the global economy in recent years have found themselves reflected in the national economies. Moldova is no exception, which has suffered from the financial crisis, especially on the public budget and the financial market.

In the economic system of the Republic of Moldova the most powerful is banking segment. Although it cannot be compared with the performance of banking systems of European countries and the U.S., however, for our country is the most advanced sector of the financial market. Certain characteristics of the banking sector in Moldova, the crisis has not led to a taint system and resisted those negative effects marked by the developed banking systems. However, the particularity of the Moldovan banking system is that it is the main and almost the only source of funding. Unlike developed countries where the main source of funding is the stock market.

More and more financial experts emphasize the importance and necessity of regulating banking and insurance<sup>1</sup>. The significance of the insurance industry in the national economy is often neglected. In Moldova, the industry is left in the shadows compared to the banking industry, but insurance contribution to economic growth and social welfare is recorded by many states. Insurance and financial stability contribute to increased risk taking financial and otherwise. These flows can generate reliable and substantial life insurance. Insurance companies can create a competitive banking system in the process of financial intermediation. They are organized so as to gain money from

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<sup>1</sup> *Adriana Rodica NASTASE „Asigurările și criza financiară”, Buletin AGIR nr.3/2011, July-September, pages 134-140*

insurance premiums paid by customers which means that the money collected must find where to be invested. Therefore, insurance companies can become sources of capital for banks on a very long term for the capital market or other instruments.

The insurance sector in Moldova outlines an investment potential that can be exploited so that the effect would be felt by the population, the public budget and the economy in general.

In countries with a tradition in the insurance field, there are used quantitative and qualitative indicators for the development level assessment of the insurance industry analysis. Some of these have been applied in this study to reflect the "potential" accumulated in the insurance sector in Moldova.

"Penetration" in the economy is a synthetic indicator which shows the contribution of the insurance sector in GDP creation and is calculated as the ratio between the amount of direct gross premiums and GDP. "Density" is expressed as the ratio of total direct gross premiums receivable by them and the total population of that country, thus expressing the average premium per capita. [2]

**Table 1 The size of the insurance market of Moldova in quantitative parameters**

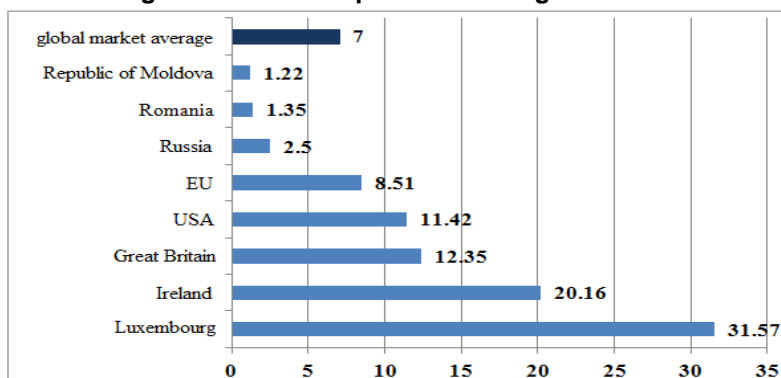
	2007	2008	2009	2010	2011	2012
<i>Gross written premiums, mil. lei</i>	724.2	837.2	816.5	914.7	1006.3	1088.1
<i>GDP, mil lei</i>	53429.5	62921.5	60429.8	71885.4	82 174	87 847
<i>Rate / growth rate of GDP, %</i>	-	117.7	96.0	118.9	114.3	99.2
<i>Population, mil. resident</i>	3581	3573	3267	3,563	3559	3560
<i>Penetration, %</i>	1.36	1.33	1.35	1.27	1.22	1.24
<i>Density, lei</i>	202.2	234.3	249.9	256.7	282.7	305.7

*Source: developed by the authors based on data NCFM for 2007 - 2012*

From the table we see that in Moldova the insurance share in GDP is quite insignificant. This indicator shows a slight decrease in the last years but more importantly, the overall insurance contribution to GDP is insignificant in Moldova.

This is worrying given the major role of the insurance industry in the sustainable development of a modern economy. For comparison we mention that, according to OECD statistics for 2011, the penetration of insurance in GDP in other countries is much higher. The first place in this top is held by Luxembourg, a very small state which is not precluded from having the highest insurance penetration in GDP, namely 31.57%, followed by Ireland with 20.16% and the UK with more than 12%. In the U.S., where the insurance industry is one of the strongest in the world, the indicator is 11.42%.

**Figure 1 Insurance penetration degree in GDP**



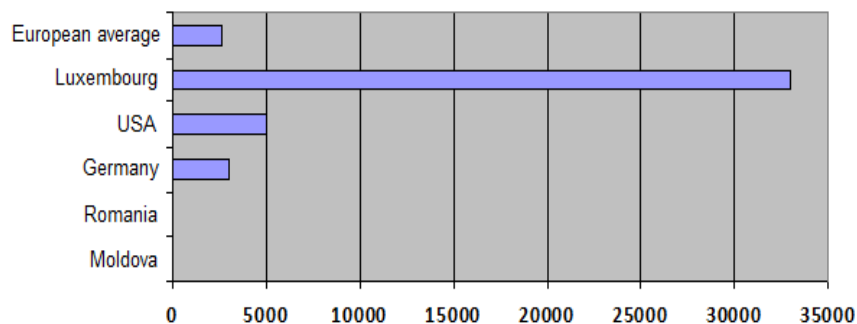
Source: Authors' calculations based on OECD data, 2011

Obviously Moldova remains far behind with a penetration of only 1.24%.

Insurance density is an indicator that reflects the costs incurred for insurance products per capita and shows how the risks of citizens are managed effectively.

In a common interpretation we can say that every citizen in the Republic of Moldova is entitled to about 250 lei, or 20 USD in gross premiums paid for the insurance, while in Luxembourg this figure reaches the value of 33 thousand USD, in the U.S. - 5000 USD, 3000 USD in Germany, and in Romania - 60 USD / capita. The overall average for Europe in premiums per capita, according to the CEA (see figure below) is 1879 euro in 2010 (or 2615 USD).

**Figure 2 Gross written premiums per capita**



Source: developed by the authors based on data from OECD Yearbook 2011 and CEA

Is an obvious discrepancy between gross written premiums relating to each citizen in our country compared to the countries that have a developed insurance industry. Just compared to the European average this indicator in Moldova is 124 times smaller.

The positive development of the insurance market in Moldova over the last years becomes even more apparent through the constantly increasing volume of premiums collected. In 2012 was also reached the historical record in this regard by exceeding a billion lei since raising premiums. Thus, the national insurance market was not significantly affected by the crises that have occurred worldwide and has brought major discrepancies for the main indicators of activity.

**Table 2 Insurance sector developments**

	2007	2008	2009	2010	2011	2012
Gross written premiums, mil. lei	724.2	837.2	816.5	914.7	1006.3	1088.1
Benefits & claims paid, mil. lei	235.3	273.8	361.2	322.7	348.4	430.5
Net assets, mil. lei	364.9	656.4	812.7	1081.7	1192.4	1241.8
Capital, mil. lei	207.7	323.1	388.5	420.1	515.2	556.7

Source: developed by authors based on data NCFM

The evolution of the insurance sector in Moldova has major fluctuations during the difficult years from a financial standpoint. A slight decrease in gross written premiums acquired during 2009. However, the insurance sector in Moldova recorded dynamic growth rates over the last years. In the context of implementation of reforms in the insurance sector the income from received premiums insurance / reinsurance increased.

However, there are opinions that the difficult economic situation influenced the Moldovan insurance market, given that it is actively connected to other areas such as construction, leasing or transporting. However, at the end of 2010 we had an optimistic result, concluding the insurance market with an increase of 12 percent, and over the past two years growth was evident.

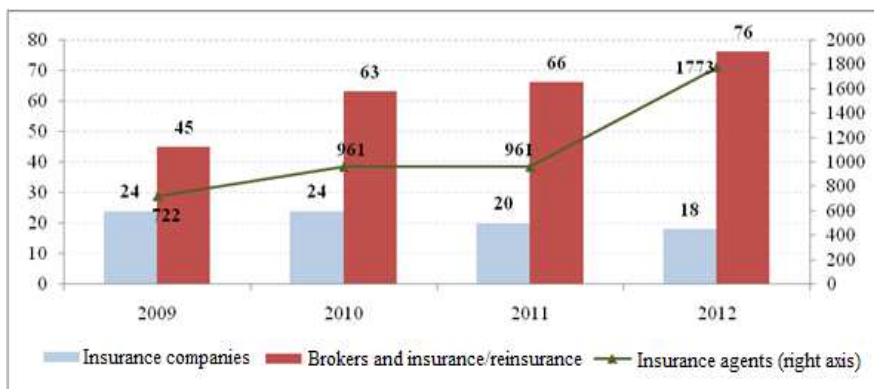
Steady growth of net assets shows that the insurance sector in Moldova is quite profitable, because according to the balance sheets of insurance companies it was recorded an increase in net assets due to higher net income of the reporting period and to the increased long-term assets. This shows the profitability and safety of long-term insurance business based in the country.

Another indicator that can quantitatively assess the state of the insurance market is the number of participants of the insurance market. In Moldova this indicator shows significant fluctuations due to changes in the regulatory framework, in particular the requirements on minimum capital and reserve requirements.

Thus, if market-wide aggregates were not affected by the recession, at the level of insurance companies, were large fluctuations.

Over the years the number of insurance companies operating in the insurance market decreased significantly (Figure 3). According to data provided by the NCFM, in Moldova there are 20 currently working insurance companies and 66 insurance and reinsurance brokers.

**Figure 3 Evolution of professional participants on the insurance market**



Source: NCFM, annual reports for 2009 -2011

From Figure 3 it appears that by adopting new business conditions established by the Law on Insurance<sup>2</sup>, the number of insurance companies is held constant. Following the imposition of new game rules the number of companies began to decrease, largely due to non-provision of a capital increase.

However, the new law allowed the establishment of new insurance and therefore the insurance portfolio diversification. This has led to the necessity of intermediaries in the insurance market. Thus, in 2009 the first insurance/reinsurance brokers appeared whose number has increased dramatically over the last years, reaching 76, the number of insurance agents has also increased from 722 recorded in 2009 to 1773 in 2012.

The aggregated structure of the insurance portfolio of companies in Moldova shows predominance of mandatory insurance. Population appeal to insurance companies only where it is required by law, and this would mean that there is potential for major development in the field of voluntary insurance, especially life ones.

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<sup>2</sup> Law of Insurance No. 407-XVI from 21.12.2006. Oficial Monitor No.47-49/213 from 06.04.2007

**Table 2 Insurance portfolio of insurance companies from the Republic of Moldova during 2010-2012**

Class of Insurance	Indemnification and insurance claims on insurance classes					
	2010		2011		2012	
	mln lei	quota, %	mln lei	quota, %	mln lei	quota, %
<b>I. General Insurance, inclusively</b>	860.90	94.12	940.80	93.49	1 020.70	93.70
- Casco	176.48	19.29	192.62	19.14	192.63	17.68
- MTPL	452.00	49.41	512.51	50.93	555.37	50.99
- Goods and health insurance	232.42	25.41	235.67	23.42	272.70	25.04
<b>II. Life Insurance</b>	53.82	5.88	65.52	6.51	68.57	6.30
<b>Total</b>	<b>914.72</b>	<b>100</b>	<b>1006.32</b>	<b>100</b>	<b>1089.27</b>	<b>100</b>

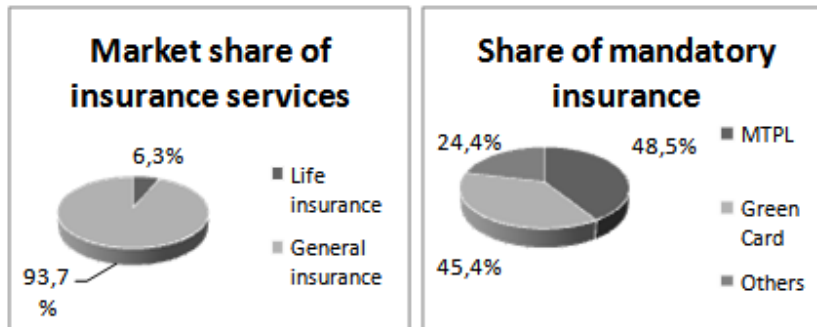
Source: developed by the authors and based on the NCFM Report 2012

It is obvious that the most popular insurance is mandatory insurance especially MTPL (Motor Third Party Liability) with a share of about 51% of total premiums. However, this type of insurance has the largest share in most Moldovan companies. The smallest share is held by security people that are voluntary and include life insurance, health or accident insurance.

From the aggregated structure of insurance portfolio for 2012 it is clear that 93.7% of insurance policies are included under general insurance. This enormous rate is due to MTPL insurance that is mandatory under the law and fall under the category of general insurance.



Figure 4 Aggregated structure for insurance portfolio in 2012



Source: developed by the authors based on data and NCFM

European statistics and insurance services divide the world into two categories: life insurance and non-life insurance. Thus the CEA statistics indicates that in the developed European states the insurance business is based mostly on life insurance. As mentioned above, the average gross written premiums per capita in Europe is 1879 euro, of which 1147 euro (or 61%) is life insurance. In Moldova, only 6.3% of the total portfolio insurance lies with life insurance.

The same limited request is also characteristic to health insurance in our country. This type of policy has a share not exceeding 5% of the market of insurance services and therefore there is a need to develop this segment. The need comes from discontent against mandatory health insurance that does not provide opportunities for financial coverage for all types of medical services.

The life insurance field for Moldova is at an early stage not only because of the lack of a culture of providing the population that does not know how to manage their risks. Another reason would be that trust in the state as insurer of last resort still remained in the public consciousness. Also nor the retirement system is reformed so that the state diversifies the risks in providing pension or social security for some population groups. It monopolized the right to manage completely the collected money without giving away some of its bonds, though often there were failures. Another reason is that life insurance requires large

investments and entails major risks, thus companies do not engage easily in this sector, which is a strategic one. Following the model of developed countries we can realize that life insurance will become increasingly popular in our country, so this will be a very attractive sector for investment.

The insurance industry is a complex area but extremely necessary for a modern economy and this sector is well prepared for the financial challenges because they do not contain systemic risk. At the same time they offer different coverage possibilities for several financial risks, commercial and social, but also accumulate a significant investment potential.

Analyzing the key indicators of the insurance market in Moldova, we find that it indicates steady growth rates for the past 10 years. The legislative changes have helped to strengthen the sector and to establish tough work criteria for participants which filtered unreliable companies. There have also been established clear rules, thus increasing the confidence of foreign investors. Another extremely important change to promote our image is political stability. After the tedious parliamentary elections from 2009 and the political crisis due to the failure to elect the President, which resulted in a successful finale, the country has come to establish a certain European vector. Thus, the investors across Europe have obtained the confidence that they can invest in Moldova. All these factors contribute to the development of the insurance market's investment potential.

On the other hand, there are sectors underdeveloped in the portfolio of local insurance companies which means that there is an untapped potential in this segment. Considering that only two of the 20 companies in the country provide services for life insurance, it would be a very interesting area for investment because it provides long-term stability and therefore is a safe investment.

A few years ago, on the Moldavian banking market there were given highly favorable terms for deposits. Banks needed liquidity that increased their loan portfolios, therefore raising capital by paying interest rates on deposits in nearly 20% for MDL and 6-8% for foreign currency. Back then bank deposits were the most advantageous way to invest money and to secure an income in the future. In recent years the

situation has changed on the banking market. The interest rates have dropped significantly, being only of 9-10% for MDL and of 4-6% for foreign currency. This shows that the interest of people to invest in bank deposits and thus decreases the investment alternative becomes insurance, especially voluntary ones. Thus lately insurance premiums of life insurance increase which is in itself an indicator of the stability of long-term insurance companies, given that the minimum term for life insurance is for 10 years. Therefore investors who will invest in insurance, especially life, will be provided through annual premiums paid by policyholders during long periods of time. Obviously there are risks of occurrence of the insured, there is a need to create reserves, to increase statutory capital, but it is much smaller than the benefits.

So, on the insurance market in Moldova there are major investment opportunities due to the following factors: favorable conditions for a new or insurance intermediary insurance company; acceptable competitive environment, the positive dynamics of foreign investment on national insurance market, legislative framework adjusted to European standards; development of infrastructure, the use of an automated information system in the MTPL and the Green Card; the improvement of strategies in terms of transparency, management of risk and structure of provided facilities; restoring the trust of civil society in the insurance system.

The development of the insurance industry has a great future in the Republic of Moldova and the interest of society towards this segment is becoming increasingly evident. But to reach the maturity of the insurance market, we need many reforms, significant investments and persistent competition in this area.

Profound and accelerated changes in the insurance market, due to the promoted reforms, lead to the financial strengthening of the insurance institutions and to providing services in accordance with the highest standards of quality and accessibility for the population.

Recently it was managed to adjust the legislative framework to the Community acquis and international practices, was developed infrastructure operation and were offered insurance products as the needs of society. The changes in the economic and financial environment have led to a new approach aimed at transparency,

consumer protection, financial education, and also to the high professional standards in the insurance business. New regulations in the insurance field confirm the qualitative evolution and growth in the insurance market positions and, of course, encourage innovation and technology development in this field.

The factors that conditions the current situation of the population are low income, low insurance culture in society, people learning to rely on state support in difficult situations, and insufficient legal framework that would foster the development of quality insurance.

The experience of economic and financial crisis has shown that the economic models used for risk reduction have not worked effectively. Insurers need to manage risks and maintain an adequate level of resources to cope with various risks and to quantify future financial position in a broad sense. For these reasons, our main task is to create an area resistant to any future crisis.

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