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## THE ROLE OF STATE INSTITUTIONS IN THE FORMATION AND REGULATION OF INSURANCE MARKET

*The formation of a national model of the insurance market in Kazakhstan is still pending. The current regulatory system is facing the problems related to the functioning of both the regulator (the National Bank), and market subjects. By analyzing the institutional framework the promising ways to improve the system of state regulation of the insurance market is defined.*

*Keywords: government regulation; insurance market; supervision.*

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## РОЛЬ ДЕРЖАВНИХ ІНСТИТУТІВ У ФОРМУВАННІ ТА РЕГУЛЮВАННІ СТРАХОВОГО РИНКУ

*У статті показано, що формування національної моделі страхового ринку в Республіці Казахстан досі не завершено. Чинна система його регулювання стикається з проблемами, пов'язаними як із функціонуванням самого регулятора (Національного банку), так і учасників ринку. На основі аналізу інституційної структури визначено перспективні напрями вдосконалення системи державного регулювання ринку страхових послуг.*

*Ключові слова: державне регулювання; страховий ринок; нагляд.*

*Табл. 1. Рис. 1. Літ. 17.*

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## РОЛЬ ГОСУДАРСТВЕННЫХ ИНСТИТУТОВ В ФОРМИРОВАНИИ И РЕГУЛИРОВАНИИ СТРАХОВОГО РЫНКА

*В статье показано, что формирование национальной модели страхового рынка в Республике Казахстан еще не завершено. Действующая система его регулирования сталкивается с проблемами, связанными как с функционированием самого регулятора (Национального банка), так и участников рынка. На основе анализа институциональной структуры определены перспективные направления совершенствования системы государственного регулирования рынка страховых услуг.*

*Ключевые слова: государственное регулирование; страховой рынок; надзор.*

### Introduction

The shift to market economy, large-scale reforms in the post-Soviet area enhanced a significant increase of risks for all economic factors: government, business, households. Under such conditions a specific part is assigned to the mechanisms of the insurance coverage of enterprises, organizations and citizens. Despite more than two decades of the insurance market development, its potential is still not fully realized.

One of the reasons for it being backward in the CIS countries in general and the Republic of Kazakhstan (hereinafter – RK) in particular to the world's level of insurance coverage is the unsolved problem of creating a balanced interaction between the participants of the insurance market and state, combining elements of both direct and indirect public administration (market self-regulation).

### Recent research and publications analysis

Among scientific publications of contemporary scholars on the development of the insurance market one should mark the works of such scholars as A. Adambekova

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(2012), K. Vobly (1995), I. Zhuk (2010), Y. Spletuhov (2007), K. Turbina (2000), R. Yuldashev (2002) etc. Studies of economic processes with the use of institutional methodological approach are examined in the works of V. Polterovich (1999), A. Oleynik (2002), A. Shastitko (2010) and others. It should be noted that little attention is paid to the theoretical study of the interaction of institutions in the process of regulation of the insurance market, and the research related to the characteristics of the insurance market development in RK is still missing.

#### **Problem statement**

This paper aims at identifying the methodology and best practices to provide further development of the system of the insurance market regulation through effective cooperation between state and non-state institutions (on the example of the insurance market of RK). The study addressed the following objectives: the analysis of institutional trends at the insurance market is carried out; the role of state in the regulatory system is clarified; the current problems of the development of the insurance market and measures to improve the efficiency of its operation are identified.

#### **The research findings**

In almost all developed economies insurance market is one of the basic elements of the financial services sector. Contemporary insurance mechanisms counteract effectively the risks inherent in the global economy, thereby ensuring following the financial interests of economic entities and social protection of society as a whole. In addition, the financial resources of insurance are important macroeconomic factors: they advocate a stable source of long-term investments in the economy, thereby significantly affecting the state of public and corporate finance.

The development of the insurance market in RK started in the early 1990s, and by the time of the adoption of the Law "On Insurance" in 1993 the number of insurance companies reached a few hundred, and only 40 of them, united in the Union of Kazakhstan Insurers, were able to fulfill the requirements imposed by the Law. According to the Decree of the President of the Republic of Kazakhstan "On the organizational and legal measures for the formation and development of the insurance market" (19.04.1994) the first body of state insurance regulation named the Department of Insurance Supervisors was created, included in the Ministry of Finance (On insurance..., 1992; On organizational and legal..., 1994).

The next stage in the development of the insurance market is connected with the implementation of the Decree "On measures to further optimizing the government" (30.06.1998) since the functions of the supervisory authority were transferred to the National Bank of the Republic of Kazakhstan (On further measures..., 1998). Due to the tightening of capital requirements, the total number of insurance companies at the market decreased from 150 to 72. Thus, the formation of the insurance market in RK took place in 3 stages: 1) the 1992–1995 period was associated with a sharp increase in the number of insurers; 2) in 1996–2004 there was a general trend of downsizing and consolidation of insurance companies; and 3) the period from 2004 to present is characterized mainly by qualitative changes at the market: the spread of the insurance approach to the social security system, the increase in the number of forms of voluntary, as well as the development of compulsory insurance (Baimagambetova, 2010).

An important factor in institutional changes in the financial sector was the creation in 2004 of the Agency on Regulation and Supervision of Financial Market and Financial Organizations performing the following tasks laid down by the law: 1) providing stability of the financial market and financial organizations; 2) protecting the interests of consumers of financial services; 3) creating equal conditions, standards and incentives of financial institutions; 4) monitoring and supervision of financial markets etc.

By the Presidential Decree #25 (12.04.2011) the functions and powers of the Agency were transferred to the National Bank, and by the decree #61 (18.04.2011) the Committee for Control and Supervision of Financial Market and Financial Organizations of the National Bank was formed performing almost all basic functions of control and supervision over insurance business, pension funds, investment funds, securities market entities and credit bureaus, as well as protecting the rights of consumers of financial services (On further improvement..., 2011; On several issues..., 2011; Committee for Control...).

As of early 2013, Kazakhstan had 35 insurance companies. The institutional structure of the market became more complex, there are such participants as insurance brokers, underwriters, actuaries and insurance companies with foreign investments (Table 1).

The institutional dynamics of the insurance market in the context of the economic crisis of 2008–2009 and the post-crisis years indicates no significant structural changes, the growth of the reinsurance segment (increase in the number of insurance brokers at 17%), and stable increase in companies strength (through participation in the Fund to Guarantee Insurance Payments). Despite significant losses due to the financial crisis, the formation of the contemporary insurance market in Kazakhstan is continuing.

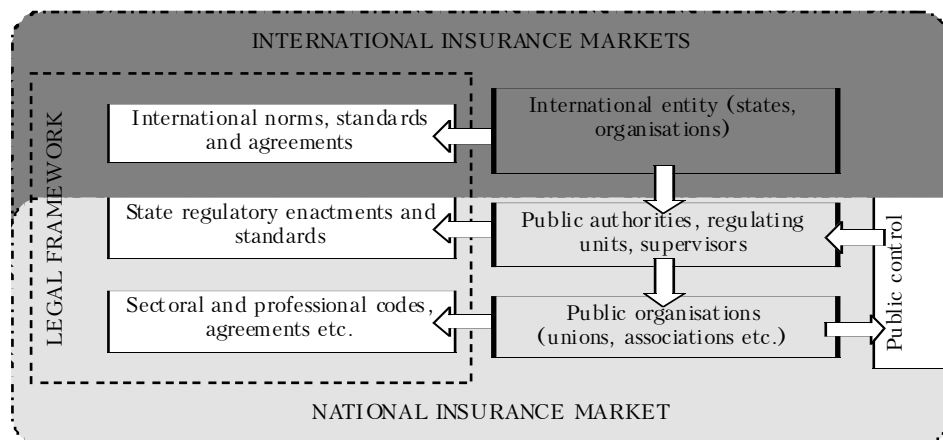
**Table 1. Changes in the institutional structure of the insurance market of Kazakhstan in 2010–2012**

Subjects at the insurance market	Number as of:		
	01.01.2011	01.01.2012	01.01.2013
Insurance companies, including:	40	38	35
– Life Insurance	7	7	7
– member organizations of the Fund to Guarantee Insurance Payments	27	33	31
– organizations with foreign capital	10	8	8
Insurance brokers	13	14	13
Actuaries	70	85	82

Source: Committee for Control...

Identification of the problems in the development of RK insurance market related to the peculiarities of its institutional structure is the first step in the development of measures to improve the methodology and the methods of regulation. From the standpoint of institutional economics the insurance market can be represented as a complex, interdependent, dynamically developing system of relations between the following institutions: first, the subjects of the insurance market, secondly, non-governmental organizations that represent their interests, and thirdly, by regulatory agencies.

As a part of the economic theory the institution (institute) is an aggregate of formal and informal rules and regulations mandatory for compliance enforced by responsible organizations (public and private), representing institutions. The institutional structure of the insurance market is the organizational, legal and economic standards being the basis to develop, realize and consume insurance services (institutional environment). Practical activities to implement the same rules and regulations are carried out by specialized organizations undertaking insurance activities, state bodies, bodies of international management (organizational structure) (Figure 1).



Source: Developed by the author.

Figure 1. **Interaction of the institution environment and organisational structure of the insurance market**

Thus, in the framework of the institutional approach insurance market should be considered by arranging structural elements. The development of institutional environment cannot occur by itself without the intervention of an organizational component. Making decisions on changes to the existing "rules of the game" or creating new ones can be initiated both from outside (international agencies, organizations) and inside (public authorities, organizations of insurers, the public), but is approved only by authorities. The need to delegate some responsibilities of market regulation to the state is conditioned by the fact that it is the government that ensures the formation, support and development of new institutions, and can solve the problem of "market failures" (the pursuit of profit maximization, risk tolerance, lack of planning horizon, the evasion of social responsibility etc.).

The state cannot and should not become the owner of "monopoly" as "the failures of regulation" existing objectively in the economy (inertia in the system of management, information asymmetry, the risks of corruption etc.) mean that self-regulating institutions and organizations at the market are necessary elements. However, the development of institutional economic environment is associated with the rise of undesirable externalities – "institutional traps", that is inefficient but stable rules (Polterovich, 1999).

Analysis of the institutional environment of the insurance market in Kazakhstan pointed that the current regulatory system shows the signs of institutional traps. In

particular, the transition from a decentralized model of financial market regulation to the integrated one (the so-called "mega-regulator concept," when every market segment, namely banking, investment and insurance sectors is controlled by the National Bank of Kazakhstan) is ambiguous.

The need to create a mega-regulator provides a significant degree of integration of the financial market, for example, when banking institutions provide insurance services, including pensions, in addition to purely banking ones. This is where a change of some regulating units by one is fully justified. Today in Kazakhstan the association of banks, investment and insurance companies is rather situational, than systemic.

A. Adambekova calls the following factors driving the transition to an integrated system of financial regulation: mutual penetration of various directions of financial business; increasing the role of non-bank institutions and increasing their cooperation with the banking sector; changes in the qualitative and quantitative characteristics of risks; consolidation of business by mergers and acquisitions; development on this basis of a megabank and megafinance structures (Adambekova, 2012).

Creation of a single financial regulator in Kazakhstan forms a complex of problems related to the conflict of interests of market participants (e.g., insurance and investment companies), the asymmetry of resources (financial and information) of market participants and supervisory body, which makes the model of interaction between government and business unstable in general, prone on the one hand, to expand the scope and powers of regulation, and on the other hand, to reduce the effectiveness of control.

The introduction of the new model requires a deeper understanding of international experience in the field of methodology and methods of regulation of the insurance market, moreover, it is necessary in terms of entry to international insurance markets, taking into account Kazakhstan's joining the WTO. The analysis points to the need for the development of the following elements of the national system of state regulation of the insurance market: 1) the risk management system (based on the EU Solvency II Directive); 2) efficient insurance legislation; 3) the balance between integrated and prudential supervision; 4) strong institutions of self-regulation; 5) information openness and transparency of the insurance market (Global Insurance Outlook, 2012).

Informational factor is one of the most important constraints of institutional development of the insurance market as it is closely linked to the level of guarantees for insurance services consumers. In addition, not only insurers are interested in access to information on the activities of the insurance market, but also shareholders, foreign investors and lenders. The development and adoption of national standards on information disclosure, including the key performance indicators of all participants, the supervisory authority and the market in general are also required. Another direction to increase openness is to get rankings in the international rating companies such as Standard & Poor's, Moody's or AM Best.

### **Conclusions**

With the globalization of financial markets, significant changes are taking place at the insurance markets of developing countries. For such changes to provide a synergistic effect in the national economy in order to prevent potential negative conse-

quences it's necessary to increase the efficiency of the system of state regulation of the insurance market. Its structure includes: 1) the legal framework harmonized with the global regulatory system; 2) an independent public controller; 3) self-organized market infrastructure; 4) external (public) control.

Despite the fact that the system of regulation of the insurance market in the Republic of Kazakhstan showed a positive trend, the process is far from being completed, and it provides the greatest opportunity for further improvement of relations between the state and market in the future, with a view to improve the quality and reliability of the insurance industry, and ultimately to increase the society welfare.

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