Making waves

The Turkish market has long been viewed as an attractive area for growth. Pelin Baysal and Ilgaz Önder of Turkish law firm Gun+Partners examine the reinsurance sector.

Turkey has been among the fastest growing insurance markets of its size in Europe. Along with the rapid growth in the Turkish Insurance sector, there have been major changes to the insurance legislation in the last few years. New legislation has improved the regulatory framework and has brought the industry more into line with international practice. Although the top three insurers are Turkey-based, the market as a whole has a high level of foreign investment due to the fact that Turkey is a prospective market and tempting foreign investment from the gulf countries and Malaysia as well as Europe.

The relevant legislation including but not limited to the 2007 Insurance Code (numbered 5684) and the Regulation on the Constitution and Working Principles of Insurance and Reinsurance Companies provides that with a few exceptions, those resident in Turkey can insure their interest only with insurance companies located in Turkey. In order to provide full service in Turkey, reinsurance companies as well as insurance companies should be under the supervision of the government being incorporated in Turkey in the form of a joint stock company or cooperative and meet certain capital requirements.

The Turkish insurance industry needs for reinsurance is mainly met by the international market. In the presence of this regulation and due to the absence of any specific provision addressing the reinsurance market, insurance companies in Turkey reinsure the undertaken risk under a pool of foreign reinsurance companies on a cross-border basis by which the underwriting takes place outside of Turkey. Statistics reveals that 76% of the reinsurance market is dominated by foreign reinsurance companies whereas the remaining coverage is provided by one active reinsurance company established in Turkey.

INTERNATIONAL PRACTICE

In consideration of the this unsaturated Turkish market and continued legislative studies by the government in order to align the relevant legislation with that of Europe, Lloyd's have been very enthusiastic about expanding its presence in Turkey and providing local insurance and reinsurance services to Turkey-based clients. Accordingly, it was planned that Lloyd's would establish a locally based operation headquartered at the Istanbul Finance Centre. For this purpose, however, Lloyd's feels the need for Turkish legislation to be more compliant with and hospitable for international practice. In this respect, Lloyd's have been negotiating with the Turkish government in order to create a more benevolent market. These lobbying activities were at last materialized as an attempt of amendment in the Insurance Law but seemingly failed after long discussions at the parliament.

The amendment proposal which was submitted to the parliament in March of 2015 aimed to provide a system where insurance companies which are not incorporated in Turkey would also be able to provide service in Turkey by being a member of a syndicate led by a managing insurance company incorporated in Turkey as used by Lloyd's model. According to the proposed amendment, "managing company" is defined as joint-stock company authorized by the Treasury to establish and manage a syndicate which provides all kinds of insurance and reinsurance services in Turkey including executing insurance / reinsurance agreements on behalf of insurance / reinsurance companies established in or out of Turkey. While the syndicate conducts its activities in Turkey, a managing company bears the administrative, legal and criminal liability towards the state on behalf of

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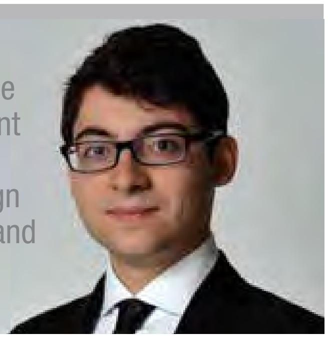

the members of the syndicate.

In order to avert the opposition at the parliament, the proposers explained the reasoning of this amendment as follows:

- The Turkish insurance market could not achieve the desired level of competitiveness and progress until now. This is evident especially when recognizing the fact that the premiums are very high due to the capital structure of local insurance companies. For the same reason, there is a very wide range of business and projects posing very high level of risk but cannot be insured by the local companies. The foreign insurance companies are enthusiastic to fill this gab; however, they could not enter into market because of lack of regulation.
- This amendment introducing the syndicate to be led by a managing company aims to fill this gap. By this mechanism, the risk which is too high to be covered by a single insurance company would be distributed among a number of insurance companies. Thanks to this mechanism Turkey can host Lloyd's who have been active in the international market for 300 years and the competitiveness of the market can be empowered. Thus, it is expected that Lloyd's which would enter to the market after the enactment of this underpinning amendment aims to insure huge projects and pipelines in Turkey.

In spite of this reasoning, concerns which were raised by the respective commission at the parliament overwhelmed and the amendment could not pass from the parliament. The law amending the Insurance Law was enacted on 27.03.2015 without incorporating any of the above mentioned market structures.

Accordingly, it is stated that such a development would inevitably cause a monopoly in the market especially considering the fact that this proposal is requested by a specific company, Lloyd's instead of the proposed structure subject to the amendment, a structure which the Treasury is also involved as a partner would be more proper for the sake of companies which prefer to be established in Turkey being subject to the supervision of the state. When examining the minutes of the discussion session in the parliament, it is not hard to sense that the main concern behind this opposition is the fact that the market has already been dominated by foreign investment around 76% and therefore new structures should be developed to increase share of local insurance and reinsurance companies in the Turkish Insurance Market.

FIERCE COMPETITION

Following the legislative proposal that has been shelved, the insurance companies in Turkey continue to increase premium rates and focus on risk selection in order to improve their profitability which is one of the most important problems of the sector. Yet, fierce competition among the insurance companies still causes low premium generation and this generation is accumulated by the biggest 10 insurance companies out of 48. Hence, insurance companies are expected to focus on balanced portfolio allocation in such a competitive market and seek reinsurance from abroad in order to distribute high volume of undertaken risks.

The Turkish reinsurance market, on the other hand, follows a different trend that reinsurance companies behave less selectively for their portfolio and reduce the premiums because of shortfall in demand and level of risk occurrence which is below average. Yet, due to the positive atmosphere in the reinsurance sector it is expected that foreign reinsurance companies will enhance their practice in Turkey by new investments, mergers and acquisitions. re

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