

# THE MAIN CHARACTERISTICS OF SUPPLY AND DEMAND ON THE ROMANIAN INSURANCE MARKET<sup>387</sup>

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*Nowadays, the insurance market in Romania can be characterized thus: a developing market both from a quantitative and a qualitative point of view, with demand concentrated in areas of above-average economic activity, having a varied supply and increasing competition. On the Romanian market there is a discrepancy between potential and effective demand. Potential demand is high, due to the large number of persons, the large number of properties, due to unsatisfied needs of both natural persons and legal entities. However, effective demand is quite low. The impact of the global financial crisis on the insurance industry in Romania was so far 'relatively limited' and has mainly affected consumer trust.*

## **1. Insurance supply**

Services supply is represented by the production of services on the market. Similarly, we can define insurance supply as being the production of insurance/ reinsurance meant to be traded on the market. The insurance supply is presented by a number of insurers and reinsurers, specialized societies authorized to function in this domain. Insurers are financial intermediaries that use private capital to finance consumer and business risks of financial loss, for a profit to the providers of that capital.

Insurers and reinsurers must have the ability to meet payment obligations towards their customers. This ability is evaluated with the help of a series of financial – economic indicators. There are agencies specialized in evaluating insurance companies – the rating agencies. The largest and best known rating agencies are Standard and Poor's, Moody's, AM Best.

In Romania, the only parties which can be engaged in the insurance activity are public companies, mutual societies, branches of foreign insurers, constituted as Romanian legal entities, authorized by the Insurance Supervision Committee and branches and subsidiaries of insurers, foreign legal entities, authorized by the Insurance Supervision Committee. Insurance companies must observe a series of legal requirements regarding the size of the minimum share capital, the size of the obligations they can assume, the premium reserves, the reserves for indemnities they must hold, the modality of recording their activity etc. In 2008, there were 43 insurance companies authorized to function on the Romanian market by the Insurance Supervision Committee.

From the point of view of existing products, the supply on the insurance market is extremely diversified. Insurance services are in a continuous and complex process of diversification, emphasized by the permanent multiplication of insurance products.

A defining feature of insurance supply derives from the fact that insurance can be considered part of the category of services based on personnel. Consequently, the quality of the supply depends on the training and skills of the personnel (both the staff coming in direct contact with the clients and the staff in charge of the management of funds), on the managerial capacity of the managers of insurance companies.

The link between the insurers and the insured on the insurance market is either direct or through intermediaries. Insurers can distribute their products directly by opening branches in various regions or cities. The intermediaries can be insurance agents or insurance brokers.

On the insurance market, there are also specialized societies which offer services associated with the insurance / reinsurance activity, risk inspectors, risk managers, insurance experts etc.

The supply on the Romanian market - from the point of view of existing products - is varied, and there are numerous types of insurance which can be divided function of several criteria, such as: function of the nature and

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type of risk insured, there are: non – life insurance (general) and life insurance; function of the domain they refer to, insurance can be divided into: property insurance, insurance for individuals and third party liability insurance; function of the legal form of taking out insurance, there are: optional insurance and mandatory insurance. In Romania, there is nowadays only one type of mandatory insurance, namely third party motor liability insurance.

The various types of insurance destined for natural persons offer protection against a large number of risks. For instance, through life insurance, financial protection is offered for the family and the persons in the care of the insured, in the case of the death of the insured; other forms of insurance include investments, retirement funds, savings funds (for example for the future of the children: studies, dowry etc.). Through health insurance, care is provided for the period of the illness, through travel insurance, accidents or illnesses that can occur during travel are insured, through property insurance, the protection of the house and goods is provided, through third party liability insurance, the insurer undertakes the obligation to pay indemnities for the damage caused by the insured to a third party, through financial insurance, the insured is protected against financial risks etc. The insurance supply for legal entities is mainly formed of the following types of insurance: group life insurance, health insurance, loss and injury insurance for the employees, retirement insurance for the employees, third party liability insurance, property insurance, freight insurance, financial insurance (credit insurance, insurance against lost of profit etc.).

The supply on this market continues to diversify, as an important number of new products adapted to the specific needs of the Romanian market have appeared. The societies bringing most novelties on the market are those with foreign capital.

## **2. Insurance demand**

Demand is the result of the needs existent on the market manifested both by natural persons and legal entities, which are willing and able to take out insurance, when confronted with various (insurable) risks.

Potential demand on the Romanian insurance market is high, due to the large number of persons and properties and due to the existence of unsatisfied needs of both natural persons and legal entities. However, the real demand is quite low. This discrepancy can be explained, on the one hand, by a series of economic reasons: the low level of income of the population, the lack of financial support and, on the other hand, an important role is played by the lack of education in the field on the part of potential clients. The relatively low interest in taking out insurance is due to a large extent to misunderstanding the role and necessity of insurance. This lack of information is the result of a long period in which the population was used to free coverage of damages by the state. Therefore, the role of insurance companies is extremely important, as they have to create a new mentality. The insurance companies must not only supply a series of products, but they must also have an informative and educational role.

The insurance demand on the Romanian market does not have a uniform character, neither regarding the types of insurance in demand, nor concerning geographical distribution; it is focused on geographical areas with a high economic potential and on the above-average income population. Thus, most gross premiums were underwritten in 2007 in the Bucharest – Ilfov area, 46.26% respectively, followed, at a considerable distance by the North – Western region (which includes Bihor, Bistrița Năsăud, Cluj, Maramureș, Sălaj, Satu Mare counties) with a share of 9.2% of the total. In the first semester of 2008, the distribution of gross written premiums by development regions has not recorded significant changes, being, according to the Insurance Supervision Committee data, the following: Bucharest – Ilfov area: 46.51%, North – Western region: 9.6%, Central region: 8.83%, Southern region 8.57%, South - Eastern region 8.04%, North – Eastern region 6.89%, Western region 6.37%, South - Western region 5.2%.

The size and structure of demand on the insurance market depends to a large extent on the level of economic development of the country, as well as on the order of priority given by each person to insurance protection, compared to the need for food, housing, clothing, health care, culture, entertainment etc.

The evolution of demand recorded an ascending trend, as between 2002 and 2007 the volume of gross written premiums in the insurance contracts has increased from 548 million Euros to approximately 2 billion Euros. Even if the interest in taking out insurance is still quite low, we can notice from the evolution of the volume of gross written premiums that the insurance market in Romania is expanding – see Table 1.

**Table 1. Development of the volume of gross written premiums in insurance contracts (both from direct insurance and from reinsurance incomes) in the 2002-2007 period**

Years	Volume of gross written premiums (RON)	Volume of gross written premiums (mil. Euro)	Nominal growth compared to the previous year	Real growth	Inflation rate
2002	1,914,534,300	548.00	-	-	17.8%
2003	2,673,816,291	650.29	39.60%	22.40%	14.1%
2004	3,476,543,926	876.52	30.02%	18.96%	9.3%
2005	4,417,165,819	1,201.26	27.07%	17.01%	8.6%
2006	5,729,284,541	1,694.20	29.70%	23.68%	4.8%
2007	7,175,789,699	2,033.83*	25.25%	17.53%	6.57%

Source: CSA (Insurance Supervisory Commission) – Reports 2002, 2003, 2004, 2005, 2006, 2007

\*Computed function of the leu/Euro exchange rate from the 31st December 2007: 3.582

Nowadays, the demand on the insurance market is affected by the crisis in Romania, but the effects are not so damaging, as it is based to an overwhelming degree on the mandatory motor third party liability insurance – RCA, professional liabilities, CASCO insurance for cars taken under leasing agreements, etc. (which are compulsory). In 2008, the demand for general insurance represented 80% of the insurance market, and auto insurance represented 75% of general insurance. Even if the automobile market has recorded a significant decrease, the effects on the insurance market are not immediate, as automobiles already existent are insured. On a medium and long term the effects can though appear on the insurance market as well, if the situation does not improve. These types of insurance are 20 to 30% more expensive in 2009 compared to 2008, on average, and specialists forecast a decrease in the number of optional policies issued.

The general insurance sector is much more developed in Romania than the life insurance sector, as mandatory insurance has a large share in the total volume of premiums collected. The most wanted type of insurance policy is and will continue to be the mandatory motor third party liability insurance – RCA. In the general insurance sector, the rate of growth of demand was lower than in the life insurance domain because after the 90s, the rate of growth of the demand in the life insurance sector was extremely significant due to the fact that the starting point was very low.

The global financial crisis has affected most the demand for the unit-linked and life insurance.

### 3. Statistical forecasts on the evolution of the Romanian insurance market

The fact that the Romanian insurance market is an expanding one is proved by the favorable evolution of some indicators, such as: the degree of insurance penetration in the economy and the insurance density. **The insurance penetration in the economy** has recorded a slow growth. If in 1996, the degree of insurance penetration in the economy was of 0.51%, in 2002 the indicator exceeds the 1% level. In 2007, the insurance penetration in the economy was *calculated as being the gross written premiums from direct insurance-to-GDP ratio* and it was of 1.77%. Although recording an increase compared to the previous years, the insurance penetration in the economy stays at a low level compared to values recorded in Central and Eastern European states (between 3 and 5%) or to the average recorded in developed countries in the European Union, of over 8%.

**Table 2. The evolution of the insurance penetration in Romania in 2002-2007**

Years	Gross written premiums (RON)	GDP (billion RON)	The degree of penetration (%)
2002	1,914,534,300	151.2	1.27%
2003	2,673,816,291	189.1	1.41%
2004	3,476,543,926	238.7	1.46%
2005	4,417,165,819	287.2	1.54%
2006	5,729,284,541	342.4	1.67%
2007	7,175,789,699	404.7	1.77%

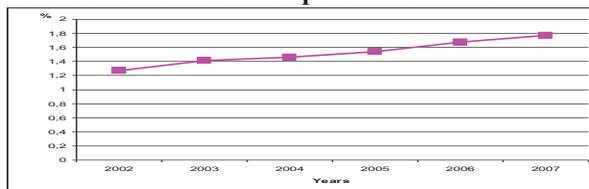
Sources: CSA– Annual reports 2002, 2003, 2004, 2005, 2006, 2007

Function of GDP, the gap compared to developed countries of EU of **insurance penetration** in Romania is significant. To estimate the period necessary to reach the level of countries with a developed insurance market, we have used the average growth and the trend methods.

According to *the average growth method*, the annual average growth of insurance penetration was of 0.1% in the 2002-2007 period. Using this method for forecasting, in 2008 the insurance penetration is of 1.87%, in 2009 of 1.97%, in 2010 of 2.07%, and it would follow that in approximately 62 years, we could reach, if the current trend continues, a 8% level of insurance penetration.

In the case of the *trend method*, to choose the function for adjusting we will first represent in a graphic the evolution of the absolute level of specialization function of employment (Figure 1).

**Figure 1. The evolution of insurance penetration in Romania in 2002-2007**



According to the graphic representation, we shall use the linear trend method, the evolution of the **insurance penetration** recording an approximately constant growth in the period analyzed. Function of the equation:  $y_i = 0.093 x_i + 1.57$  the forecast of the insurance penetration indicates the following values: 2008: 1.85%, 2009: 1.94% and 2010: 2.03%. When forecasting by using this method we have reached the same conclusion as in the case of the previous method.

The evolution of the life and general insurance market was an ascending one. From table 3 we can notice that the most important contribution to the total volume of gross written premiums from insurance came on the whole period analyzed from general insurance.

**Table 3. Development of gross written premiums from the total insurance activity, as well as on insurance categories 2003-2007**

Years	Total insurance mil. Euro	Life insurance %	General insurance %
2003	650.29	23.19	76.81
2004	876.52	21.98	78.54
2005	1,201.26	23.50	76.50
2006	1,694.20	19.87	80.13
2007	2,033.83	20.19	79.81

Source: CSA – Report 2007

In order to study the evolution of the structure of the Romanian insurance market we have used statistical methods such as the Markov chain and by this method for 2009 the forecasted structure of the insurance market is: Life insurance 18.92%, Non-life insurance 81.08%.

In **conclusion**, we can say that even if the Romanian insurance market has recorded an ascending trend in recent years, the level of real demand is quite low in spite of the diversified supply, and the impact of the crisis on the insurance industry in Romania was so far ‘relatively limited’ and has mainly affected consumer trust, as the negative reaction was firstly an emotional one, influenced by the current context.

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