Reform, change and challenges in Turkey's reinsurance market

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Market reforms and big-ticket investments in the construction and energy sectors, especially nuclear and renewable energy, have provided enormous market opportunities for Turkey's insurance sector. A maturing SME sector, the rise of trade credit products and health insurance have all opened new possibilities for the sector. Meantime, the reinsurance market has grown at about 20% in local currency terms in 2015 even as currency pressures have exerted a negative impact. Even so, the reinsurance portfolio continues to be stable with Fire and natural catastrophes constituting 40% of the overall market. By Pelin Paysal, partner and Ilgaz Önder, associate, Gün & Partners report on the main trends.

According to a report published by the Jardine Lloyd Thompson Group, **The Turkish Insurance Market Outlook 2016-2017**, there are currently 61 active insurance companies incorporated in Turkey consisting of 37 non-life insurers, 19 Life and Pension insurers, four life insurers and one reinsurer. Reinsurance cover is mostly provided to Turkish insurance companies by foreign reinsurers whereas Milli Reasürans AŞ (Milli Re) that is, the sole local reinsurer in the market has a market share of 27% in 2017.

Even though ceding companies in Turkey continue to mostly reserve their portfolio under a surplus share type of proportional treaty, there has been a gradual shift from proportional to non-proportional reinsurance. The split is currently as follows: Fire (51.5%), Marine (7.5%), Accident (11%), Engineering (28%) and Land Vehicles and Land Vehicles Liability (2%).

There is an expectation that the aggregate premium volume from proportional and non-proportional reinsurance agreements will increase by roughly 15% in 2017. However, it is also noted that premium growth was severely restricted over the years due to strong depreciation of the Turkish Lira. Moreover, the Turkish reinsurance market has also experienced a decline of 5.6% in USD terms due to the exchange volatility.

It has been reported that due to the absence of significant losses in 2016 and positive technical results of reinsurance treaties, renewals completed smoothly in 2017. However, it is to note that the renewals were compelling compared to previous years due to the losses triggered by terrorism episodes. According to the latest Milli Re Activity Report 2016, insured global catastrophe losses due to natural disasters in 2016 reached approximately USD 50 billion whereas they were roughly $37bn in 2015. These losses have been recorded as the highest insured losing figure since 2012.

The current regulatory framework

Insurance law is mainly regulated under Turkish Commercial Code no 6102 (TCC) where the Book VI: Insurance Law governs the content, interpretation and validity of insurance agreements. With the exception of the special provisions under the Agriculture Insurance Act no. 5363, the only and main provision which particularly concerns reinsurance agreements is included in the TCC. Insurance companies may re-insure the risk on whatever terms and conditions that are deemed fit and necessary (Art. 1403). Despite the wording of this particular provision, and the fact that there is no other provision that directly concerns reinsurance agreements in Turkish law, many academics take the view that the reinsurance agreements are ultimately subject to the mandatory pro-insured provisions governing insurance agreements.

The corporation and governance of reinsurance companies, on the other hand, is regulated under the Insurance Act no. 5684. Accordingly, the Secretariat of Treasury under the Prime Ministry has the responsibility to draft, implement, and monitor the implementation of insurance legislation; to conduct the work of harmonising such legislation with the European Union Acquis; to prepare general conditions, tariffs and instructions related to insurance; and to prepare, implement and monitor regulations on market entry and exit, and market activities of insurance, reinsurance and pension companies, insurance intermediaries, loss adjusters, actuaries and other related real and legal persons.

Regulatory developments due to come into effect

Newly-emerging risks, disasters and the economic climate significantly influence the underlying legislation and insurance tools. For instance, the Ministry introduced compulsory personal accident insurance for those working in the mining sector shortly after Turkey suffered one of the worst mine accidents (Soma disaster) in May 2014, which resulted in the death of 301 personnel. In the same vein, Building Completion Insurance Policy, Credit Insurance Policy and short-term trade credit for small and medium enterprises were introduced as products, to limit the effect of an economic slowdown, coupled with currency volatility.

Cyber risks are one of the newly emerging risks, which inevitably fall within the interests of insurance and reinsurance companies both in Turkey and globally. One of the biggest and most serious cyber-attacks in Turkey to date involved one of the most reputable banks in 2016. According to the bank's official statements, the attack occurred by logging into the system illegally and involved transferring the funds abroad. Reportedly, the loss incurred by the bank was then remedied as per the lower limit of the Banker's Blanket Bond without seeking any separate insurance coverage particularly concerning cyber risk.

With a fast-growing Turkish e-commerce market, new legislation and administrative measures are expected in the near future, which would cover cyber-attacks as a risk from an economic perspective as well as for national security. This would eventually impose additional legal responsibilities to companies and organisations and the increasing need for appropriate insurance.

Although the Turkish reinsurance market relies heavily on conventional products, insurers nowadays have different demands from the market. Facultative reinsurance addressing differentiated needs are reported to be gaining ground.

Certain requirements from insurers and those seeking insurance are fulfilled in practice by means of 'fronting', especially in cases where a prospective insured seeks for coverage which cannot be offered by local insurers due to their financial strength or magnitude of the risk in question. In these cases, the risk, albeit formally undertaken by a local insurer, is indeed transferred via a reinsurance contract to another (re)insurance company which are not licensed in Turkey. This structure is seen mostly in those sectors involving large risks such as banking, construction, energy and cash-in-transit.

Reinsurance contracts underwritten for 'fronting' purposes can present problems, usually more so than other reinsurance contracts, especially if the terms of such contracts are identical with the insurance policy between the local insurer and the insured. This is because reinsurance contracts are drafted by the reinsurers taking into account the law and practice of their own jurisdiction and are not properly harmonised, if ever, with Turkish law. Consequently, where there are disputes between the local insurer and the insured and even those between the local insurer and the reinsurer, the meaning attributed by Turkish Courts (which is often inconsistent with the precedents and/or incompatible with the practice) with respect to these terms and conditions plays a very crucial role for the outcome of the dispute.