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Insurance: Trends of Use in the Republic of North Macedonia

Abstract

Insurance supports a healthy and prosperous society, enabling businesses and individuals to protect themselves, property, and their finances against risk. As such, insurance today is not just important for the individual consumer, business client or businesses; it also has consequences for the entire economy, restoring businesses to health after natural disasters, acts of war, riots, strikes, fluctuations or financial crises, and state measures to dictate the import or export of goods. The aim of this paper is to examine the part played by insurance in the economy of the Republic of North Macedonia. This paper introduces and summarises an argument and outlines the nature of the exploration to follow. For this introductory purpose, referencing in the paper is kept deliberately light; aiming to find discussion points of relevant sources in the course of the argument as it unfolds. We argue that insurance operates not at the periphery, but also at the core of development, in both practical and conceptual terms. Research of the space that insurance occupies and the role that insurance has in general welfare is performed by using the legal platform that insurance has in place, including the Law on Obligations, the Law on Insurance Supervision, and the Law on Compulsory Traffic Insurance. Through the method of analysis, synthesis, and statistics, the author processes the official data of the Ministry of Finance presented by the National Bank, in order to provide a clear overview of the trends in the use of insurance in the Republic of North Macedonia. The results from the study show that in the time period analysed, the insurance sector is classified as the third most important segment in the financial system, and that life insurance prevails over other types of insurance.

Keywords: Insurance, Individual Consumer, Business, Economy, Development, Welfare

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Introduction

The risk of harmful consequences of various events that may occur, while being unpredictable as to when they will happen or whether they will happen at all, has forced people to think about creating mutual funds which will be used to compensate for the damage of those who have suffered from such events. As such, insurance represents the institute for protection from the risk of the occurrence of harmful events, even though those events are unpredictable, and it is uncertain whether they will happen or not, when they will happen, to whom they will cause harm, and what kind and in what amount of harm will be caused to their victims (Shabani, 2021).

Insurance is a transaction of risk allocation, where one party (the insurance company) undertakes to insure the other party (the insured) against possible losses. The arrangement is manifested through a contract, i.e., an insurance policy. The insurance contract obliges the insurance contractor (the insured), based on the principle of reciprocity and solidarity, to invest a certain amount of money in an insurance company, respectively, in an insurance company against risks (the insurer), while the company is obliged to pay the insured or any third party a contracted amount or to do something else upon a specified loss, damage, illness, or death occurring (Law on Obligations, 2001).

Insurance activity has seen an evolutionary development. While insurance can be traced back millennia, only in the middle of the last century has a shaping of the comprehensive and profound meaning of this complex economic institution been achieved (Zweifel, 2012). Individuals seek to protect themselves against irregular and largely unexpected ‘shocks’; those which have a high potential to affect their lives, health and property, by using one or more risk management tools, such as renewing or, in particular, buying insurance. Therefore, the importance of insurance increases in proportion to the increase in the value provided. Unlike in the past, the insurance activity of today serves not only to protect the interests of individuals who are insured, but, often, also the interests of third parties who do not participate in the creation of the mutual fund. There is a strong aspiration in modern law to ensure the protection of a certain circle of persons who are exposed to certain risks which arise as an inevitable consequence of general development (e.g., in public transport) and who, through no fault of their own, can suffer harm to their life, health, personality or property. Therefore, insurance is of great importance not only for the social community, but also from various aspects, primarily economic and social, in which case, increasing the use of insurance

is closely associated with increased well-being within society (Merkin, Steele, 2013). This importance has led to the growth of insurance activity from that of private work to a kind of public service. Through insurance, large capital is formed, which is part of the state savings reserved to deal with unforeseen circumstances. In addition to the function of repairing any damage caused, the common function of insurance is also prevention. An important activity of the insurer is also the undertaking of measures for prevention and the prevention of risk which threatens an insured person and property (Perović, 1995).

Approaches to insurance can be grouped into two 'poles' of analysis, which highlight different key features as typical of the insurance phenomenon. One approach has given rise to more sociological attitudes, rather than legal ones. This model highlights the collective nature of insurance. The other has been prevalent in insurance economics studies, but is also in line with the regulatory definitions of the insurance business. This defines insurance primarily in relation to the ratios in which the risk is transferred from one party to the other. The second approach, by emphasising the relationship created by insurance, actually deserves wider attention (Merkin, Steele, *op. cit.*).

Scope of Insurance

According to the Law on Insurance Supervision, insurance activity includes insurance (life and non-life insurance), reinsurance, insurance representation, and insurance-brokerage. As part of the work in question, insurance companies may also carry out the following work directly related to insurance brokerage (Law on Insurance Supervision, 2002):

- Mediation during insurance or reinsurance contracting;
- Operations with futures contracts, options and other specific instruments, if they are not used as insurance against the risks presented as a result of exchange rate movements and interest rates; the recording of risks;
- The recording and assessment of damage;
- Mediation during the sale and sale of waste from insured items that have suffered damage;
- Establishment of measures to prevent, reduce, and eliminate damage and risks which pose a risk to non-life insurance;
- Providing legal assistance in insurance and reinsurance;
- The provision of other intellectual and technical services related to insurance and reinsurance work.

The Legal Platform for Insurance Regulation in the Republic of North Macedonia

Insurance activity in the Republic of North Macedonia is regulated in legal terms, mainly based on the legal provisions of three laws: the Law on Obligations, the Law on Insurance Supervision, and the Law on Compulsory Traffic Insurance. From these and other laws that indirectly deal with insurance issues, a number of regulations, ordinances, guidelines, and instructions for the smooth implementation of the insurance institute in practice have been produced and are being implemented.

The Law on Obligations regulates the central insurance instrument – the insurance contract expressed through the document known as the insurance policy; the elements of the contract, the conclusion of the contract, the cases excluded from insurance, the rights and obligations of the contracting parties, the duration of insurance, as well as forms of insurance (property insurance and personal insurance) with all the features that characterise them (Law on Obligations, 2001).

The Law on Insurance Supervision regulates: the conditions under which life insurance, non-life insurance, and reinsurance activities can be performed, insurance representation activities, insurance brokerage operations, establishment, operation, supervision and termination of operation of insurance companies and reinsurance, insurance brokerage companies and insurance representation companies as well as the establishment and operation of the Insurance Supervision Agency (Law on Insurance Supervision, 2002).

Finally, the Law on Compulsory Traffic Insurance regulates the compulsory insurance of: passengers on public transport due to the consequences of an accident; owners, i.e., users of motor and trailer vehicles; passengers, luggage and items on air traffic as well as air carriers, i.e., aircraft operators; and owners, i.e., users of ships, i.e., motor-powered boats, from liability for damage caused to third parties in traffic, and other issues of importance for the mandatory traffic insurance (Law on Compulsory Traffic Insurance, 2005).

Although there is a set of legal norms that deal with insurance regulation, they not only do not exclude each other, much less provide for something that contradicts each other, rather the prevailing harmony is seen in the fact that the provisions of laws expressly instruct in the implementation of the provisions of the other law.

Trends in the Use of Insurance in the Republic of North Macedonia

In 2015, the growth of the insurance sector continued, expressed through the movements of gross written premium, which is significantly greater compared to the most of the countries in our environment. The increase of the assets of the insurance companies is mostly due to the increased sales activities and, partially, from capital growth. In conditions of increased net costs for the implementation of insurance, the amount of transferred risks from reinsurers, and the profitability of the insurance companies have all improved due to a slower increase in claims and increased premiums. The solvency of the sector is extremely high, which is one of the factors for its stability. The liquidity of the sector has also improved. The threat of spillover of the risks from the banking sector to the insurance sector through the use of insurance policies in banking products is still low. The most important factors for the uninterrupted function of the insurance sector are the stability of the banking system (due to invested deposits), and of the government (due to the investment in securities). The risk of change in interest rates in insurance companies registered a mild increase (Financial Stability Report in the Republic of Macedonia, 2016).

In millions of Denars

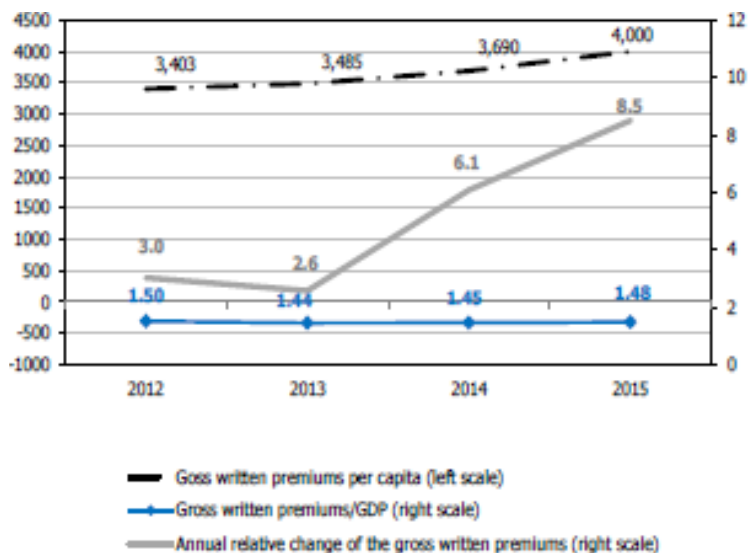


Chart 1: Insurance sector development indicators

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia's internal calculations, 2016.

Looking at 2015, the increase in the insurance sector is evident, with a significantly higher annual growth rate of the gross written premiums. The density degree (gross premiums written per capita) increased by 8.5% (up from 6.1% in 2014), and the degree of penetration (share of gross premiums written in GDP) registered minimal changes. Thus, the dominant contribution to the growth of the total gross written premium is that of non-life insurance with 67.2% (mostly the class of compulsory MTPL), while life insurance is today slowly penetrating the North Macedonian insurance market. The increase of the insurance sector in the Republic of North Macedonia, measured according to the movements of the gross written premiums, is constantly high compared to most countries in our environment, as well as compared to the countries of Central and Eastern Europe (the average rate in 2015 is 1.5%) (Financial Stability Report in the Republic of Macedonia, 2016).

As percentages:

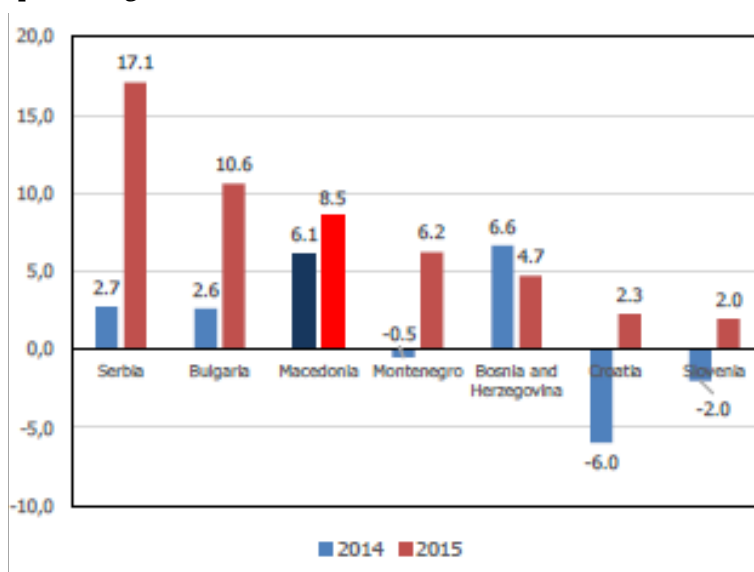


Chart 2: Annual relative change in the total gross premium written in the countries of the region

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia's internal calculations, 2016.

The insurance market is moderately concentrated in terms of shares of the insurance companies in assets and gross written premiums. Non-life insurance companies contribute to the moderate concentration, i.e., dispersion. Due to the small number of companies (four) which perform

life insurance activities, there is a high concentration in life insurance, whereby almost 84% of the gross written premium is concentrated in two companies (Financial Stability Report in the Republic of Macedonia, 2016).

The total activity of the insurance sector in 2016 increased due to the growth of gross written premiums, thus maintaining third position in the overall financial system. The insurance sector continues to have high coverage of the technical reserves and maintains profitable operation, albeit reduced in volume compared to the previous year and has strengthened a high solvency position. The threat of creating and spreading risks to the financial system of the Republic of North Macedonia is small, primarily due to the weak links of the insurance sector with other segments of the system, but also due to the absence of complex financial instruments and services in this sector and domestic financial markets in general. The low level of development in this sector enables further growth through the constant enrichment of the products' supply, for which the economy's recovery and increase of households' disposable income shall have an adequate impact.

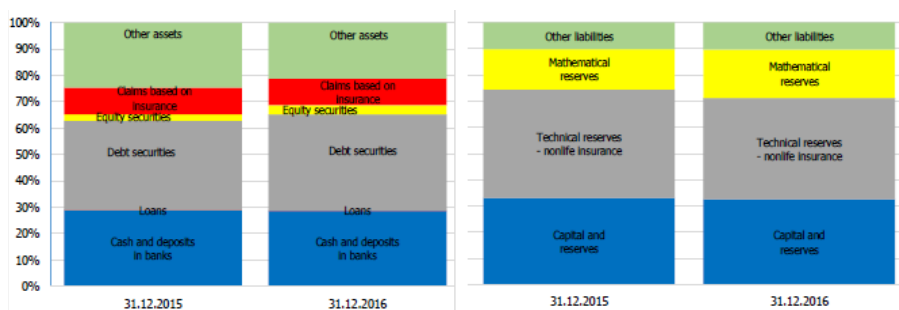


Chart 3: Structure of insurance companies' assets (left) and liabilities (right)

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia's internal calculations, 2017).

Setting an efficient premium rate is the key aspect of insurance, i.e., a premium which, on one hand, will attract and persuade a potential client to invest in this financial instrument, and on the other hand will guarantee the possibility of fulfilling the obligations of the insurance companies and their profitable operations. Insurance companies should be able to pay claims at any time, even if the cost is higher than expected. In this regard, the most significant risks of the insurance companies are the risks

at the premium level and the risk of insufficiently allocated technical reserves. The risk level of the premium level, i.e., the risk that premiums being paid by insurance companies might not cover future costs, measured through the claim coefficient (the ratio between net claims in the year and net written premium) decreased by 1.2 percentage points in 2016. Technical reserves coverage also increased. Namely, at the end of 2016, the assets of insurance companies which covered technical reserves are 106.2% of the total technical reserves (in 2015, 105.4%) (Financial Stability Report in the Republic of Macedonia, 2017).

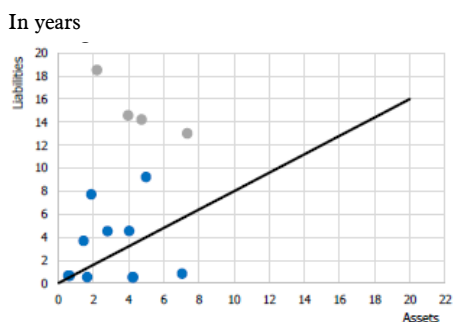


Chart 4: Gap between assets and liabilities' positions, according to their residual maturity, by insurance company

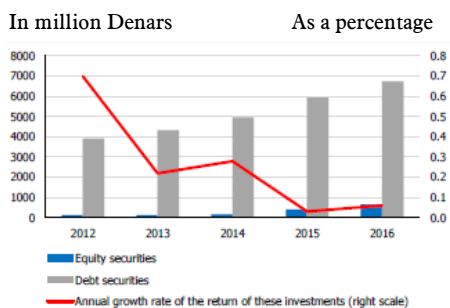


Chart 5: Insurance companies' investments in debt and equity securities

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia's internal calculations, 2017.

It is important to note that in 2016, insurance companies registered a positive financial result, which decreased by 7.47% year on year. That is due to the high amount of liquidated claims which increased by 13.3% in 2016. Despite the higher increase of gross paid claims in life insurance (62.2% or, in Denar, 80 million more compared to 2015), gross paid claims in non-life insurance which increased by 11.2% or 342 million Denar, have a greater influence on the growth of liquidated claims and on the decreased positive financial result. The main incomes of the insurance sector come from gross written premiums which, in life insurance, increased by 17.3%, whereas in non-life insurance, the increase was 3.5% (Financial Stability Report in the Republic of Macedonia, 2017).

In 2017, the sector's assets registered an intensified growth which reached 8.4% (5.2% in 2016). Around one-third of the growth of insurance sector assets is due to the capital positions of a newly-formed life insurance company (which started operations in 2017), while half of the

growth is due to larger activities in the life insurance domain. Non-life insurance continues to prevail in the insurance market of the Republic of North Macedonia, which, by the end of 2017, accounted for 69.9% of the total assets of the insurance sector. However, life insurance registers a continuous growth, whereby its share in the assets of the overall insurance sector in the last five years has increased by 11 percentage points (from 19.1% in 2013 to 30.1% in 2017). Life insurance expansion is perceived through a number of newly-concluded contracts (an increase of 25.1%). This growth, however, is not accordingly accompanied with the growth of the contract values, for which macroeconomic factors, primarily the volume and growth of household disposable income, play a key role (Financial Stability Report in the Republic of Macedonia, 2018).

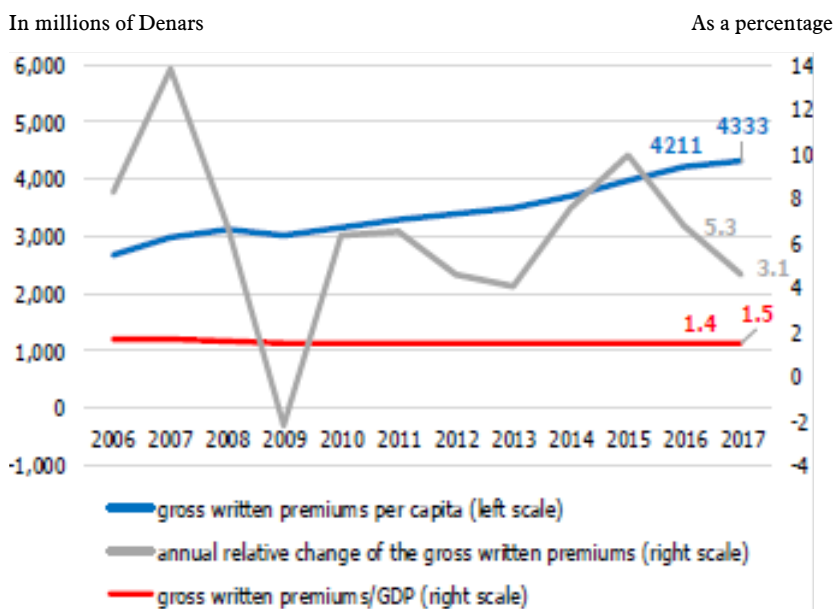


Chart 6: Insurance market development indicators

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia’s internal calculations, 2018.

During that year, the insurance market development indicator improved. This was perceived through the improvement of the insurance penetration and insurance density of its products on the market.

Furthermore, in 2017, the reinsurance volume did not change in life insurance, while there was a slight decline in non-life insurance. On the

other hand, the share of net paid claims of insurance companies in gross claims also increased to 83.3% which arises from non-life insurance.

In millions of Denars

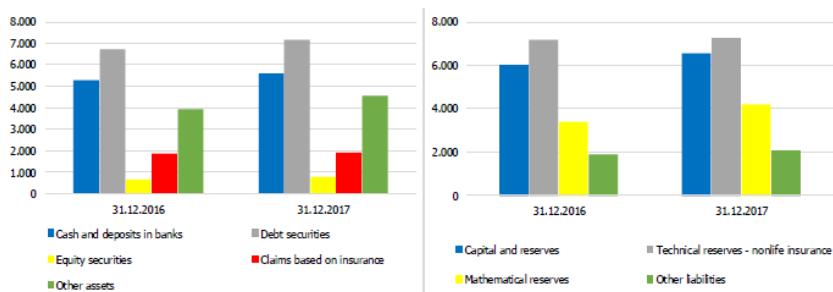


Chart 7: Structure of insurance companies' assets (left) and liabilities (right)

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia's internal calculations, 2018.

By size of assets, the insurance sector is the third largest segment in the financial system of the Republic of North Macedonia. The Macedonian insurance sector is still small, with its total assets accounting for just 3.3% of GDP (3.2% in 2017). The large number of policies concluded in 2018 is, however, an indication that the public is becoming more aware of the need of securing its financial future in various ways. Despite accelerated growth in life insurance, non-life insurance is still prevalent, within which, the motor-based, third-party-liability insurance still being the most dominant class of insurance. This means that, despite the progress made in insurance, there is still room to stimulate larger use of the benefits from the non-mandatory classes of insurance. Life insurance registers high growth rates, although its share is still insufficient. There are several factors for this, primarily the size and growth of household disposable income, financial literacy, and a very important factor is that this segment is still relatively “young”. Introduced tax reliefs can somewhat contribute to a larger uptake of life insurance. In addition to this is the fact that households' financial assets have grown over the years, which is one of the bases for growth in the insurance market (Financial Stability Report in the Republic of Macedonia, 2019).

Non-life insurance is prevalent on the insurance market according to the number of insurance companies, the amount of total assets, the amount of gross premiums written (GPW), and the number of concluded contracts. In 2018, the amount of GPW for non-life insurance registered

a much faster growth (9.4%) compared to its growth in 2017 (1.6%) and contributed to the total GPW growth for the whole sector with 76.1%, (against a contribution of 42.9% in 2017). However, despite its acceleration in 2018, GPW growth is lower than in the life insurance segment (15.5%). The level of development of the non-life insurance market has been improving slowly, albeit well below the EU level.

Table 1: Features of the insurance sector

Category	2014		2015		2016		2017		2018	
	Amount/Number	structure in %	Amount/Number	structure in %	Amount/Number	structure in %	Amount/Number	structure in %	Amount/Number	structure in %
Number of insurance companies	16	100	15	100	15	100	16	100	16	100
Non-life insurance	11	68,8	11	73,3	11	73,3	11	68,8	11	68,8
Life insurance	5	31,3	4	26,7	4	26,7	5	31,3	5	31,3
Total assets, in millions of denars	16.416	100	17.562	100	18.480	100	20.030	100	21.639	100
Non-life insurance	12.152	80,1	13.641	77,7	13.674	74,0	13.993	69,9	14.545	67,2
Life insurance	3.264	19,9	3.921	22,3	4.806	26,0	6.037	30,1	7.093	32,8
Gross written premium, in millions of denars	7.631	100	8.280	100	8.722	100	8.992	100	9.927	100
Non-life insurance	6.742	88,4	7.179	86,7	7.430	85,2	7.546	83,9	8.258	83,2
Life insurance	888	11,6	1.101	13,3	1.292	14,8	1.446	16,1	1.670	16,8
Number of contracts concluded (policies)	1.135.156	100	1.199.860	100	1.292.749	100	1.385.676	100	1.476.374	100
Non-life insurance	1.126.338	99,2	1.191.177	99,3	1.279.016	98,9	1.368.493	98,8	1.454.110	98,5
Life insurance	8.818	0,8	8.683	0,7	17.733	1,1	17.183	1,2	22.264	1,5

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia’s internal calculations, 2019.

As a percentage

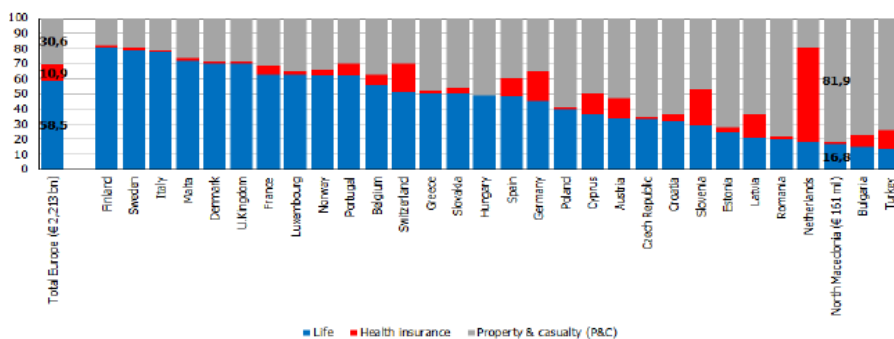


Chart 8: Structure of GPW value by insurance class, by country

Source: European Insurance, Key facts, October 2018. The data refer to 2017, except for the Republic of North Macedonia which refer to 2018, 2019.

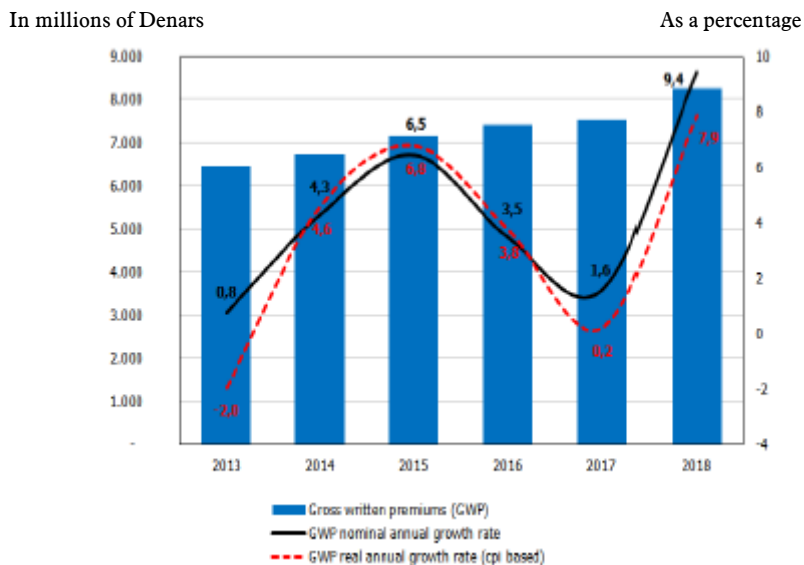


Chart 9: Movement of the total gross premiums written (GPW) from non-life insurance

Source: Insurance Supervision Agency and National Bank of Republic of North Macedonia’s internal calculations, 2019.

The increased number of concluded non-life insurance policies and technical reserves growth conditioned asset growth of the non-life insurance companies by Denar 552 million or 3.9% compared to the preceding year (Financial Stability Report in the Republic of Macedonia, 2019).

During 2019, the insurance sector continued to grow and to increase its importance within the domestic financial sector. The total assets of the insurance sector increased by 10.5% on an annual basis, which is its highest growth rate in the previous five years. The life insurance segment continues to register higher growth rates of assets, although at a slower pace in the last two years, unlike non-life insurance, which has an accelerated upward trend. However, for the first time in 2019, the two segments of the insurance sector have a similar contribution to the asset growth of the insurance sector. The total gross written premium (GWP) of the insurance sector in 2019 on an annual basis increased by 6.6%, for which non-life insurance had a greater contribution, with further growth of life insurance premiums. Non-life insurance continues to prevail in the structure of the domestic insurance market with a share of 65.4% in total assets and 82.7% in total GPW of the insurance sector. This situation is the opposite of developed countries, where life insurance is more important, measured by GWP and total assets (Financial Stability Report in the Republic of Macedonia, 2020).

In millions of denars

As a percentage

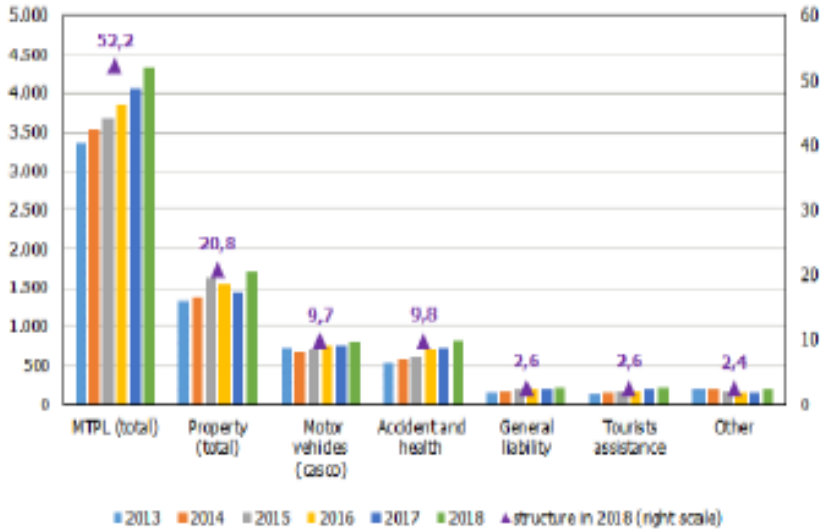


Chart 10: Gross policies written (GPW) by non-life insurance class

Source: National Bank based on data from the Insurance Supervision Agency, 2019.

As a percentage

As a percentage and in percentage points

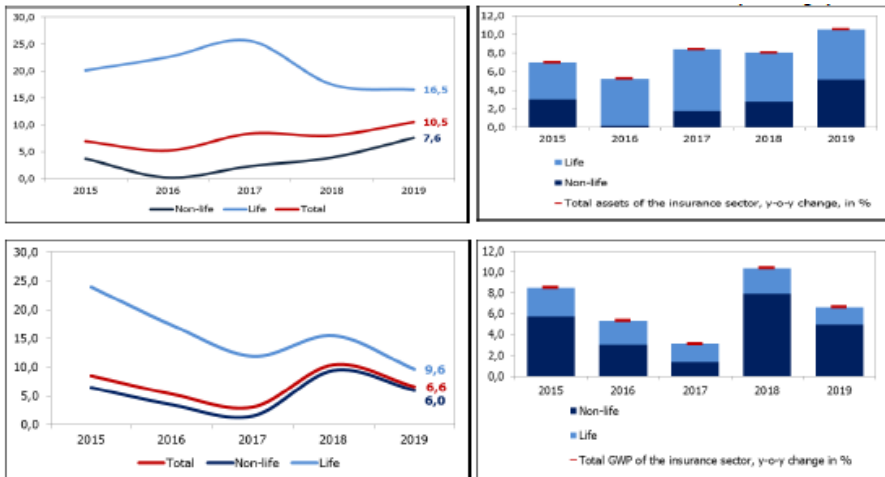


Chart 11: Annual rates of change and contribution to the annual growth of assets (top) and GWP (bottom) of the insurance sector

Source: National Bank based on data from the Insurance Supervision Agency, 2020.

At the end of 2019, the assets of the insurance sector make up 3.4% in GDP, as opposed to 78.8% which is the share of the assets of the banking sector. With a degree of insurance penetration of 1.5% of GDP and a degree of insurance density of Denar 5,099 (or Euro 82.9) per capita in 2019, the Macedonian insurance sector is among the smallest and least developed of markets, compared to the more advanced European economies, as well as the countries in the region. International comparisons show a link between the size of the insurance sector and the degree of development of the economy, with more developed economies tending to have larger insurance markets and vice versa (Financial Stability Report in the Republic of Macedonia, 2020).

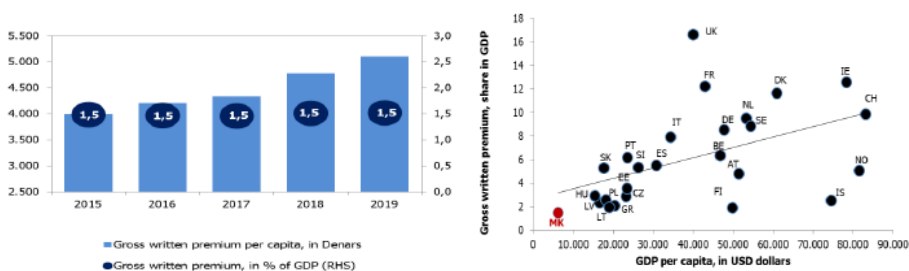


Chart 12: Indicators for the development of the insurance market in the Republic of North Macedonia (left) and in comparison with the EU countries (right). Note: The data in the chart on the right, for all countries, including RNM, refer to 2018

Source: National Bank, based on data from the Insurance Supervision Agency and the OECD, 2020.

During 2020, despite the challenges posed by the COVID-19 Pandemic, the domestic insurance sector maintained a sound liquidity and solvency position and achieved a positive financial result. It thus showed good preparedness for dealing with shocks, which was contributed to by the good condition of the sector before the pandemic, but also highlighted the measures adopted by the Insurance Supervision Agency (ISA), as a competent supervisor and regulator, in response to the crisis. The pandemic affected the operation of the sector mainly through reduced demand for insurance policies, which applied to both segments of insurance.

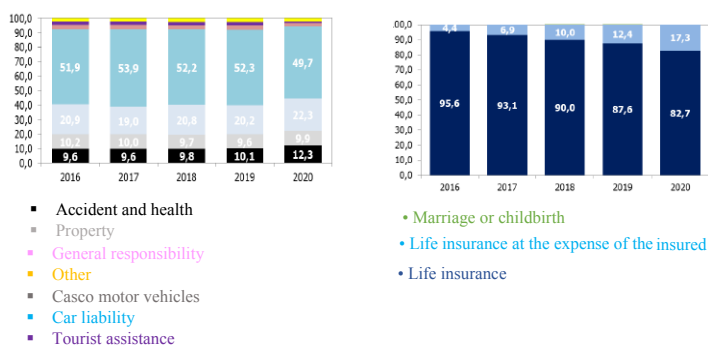


Chart 13: Gross policy premiums according to life insurance classes (left) and life (right)

Source: National Bank based on data from the Insurance Supervision Agency, 2021.

The reduced activity in 2020 is accompanied by an improvement in profitability in both insurance segments. The improvement was especially pronounced in the non-life insurance sector, which was contributed to by the consolidation of two insurance companies which, in 2019, showed significant operating losses. Thus, the total segment of non-life insurance in 2020 achieved positive rates of return on assets and capital of 1.7% and 4.7%, respectively, compared to the negative rates of return in the previous year. The life insurance segment continued to operate at a profit and improved the rates of return on assets and capital which, in 2020, were 1.9% and 10.1% respectively (Financial Stability Report in the Republic of Macedonia, 2021).

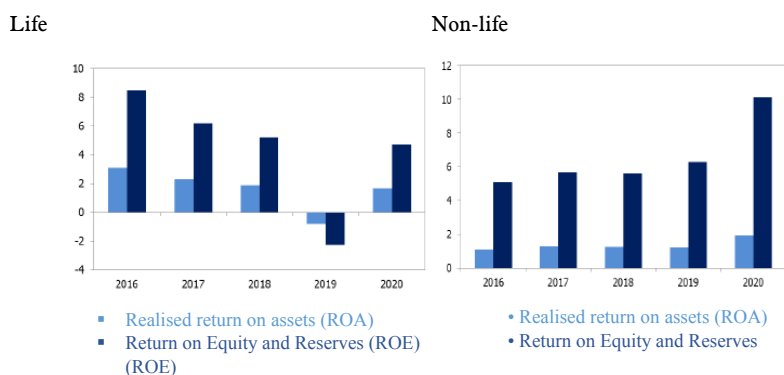


Chart 14: Profitability indicators of the domestic insurance sector (in percent)

Source: National Bank based on data from the Insurance Supervision Agency, 2021.

However, low operating efficiency, as a long-term characteristic of the insurance sector, remains a limiting factor for the growth of the sector's profitability. Such conditions arise from the high costs of implementing insurance, with high costs for commission charged by indirect sales channels. These expenses, in 2020, in non-life insurance continued to grow and reached 27.4% of the total realised GVA through the insurance intermediaries (insurance brokerage companies, insurance representation companies, and banks). Thus, they contributed to maintaining a very high cost ratio of non-life insurance which, in 2020, was 51.4%. In life insurance, the cost of commission in 2020 decreased, which contributed to the improvement of the cost ratio from 32.7% to 29%. However, their share in the total administrative costs and the costs of implementing the insurance is still high and in 2020 it was 45.6%. Such conditions impose the need for more economical cost management and cost-effectiveness improvement, especially in the current context, when the risks to the sector's profitability are emphasised. Namely, at the end of 2020, the regulatory relief brought by the ISA in response to the crisis, which had supported the profitability in the previous period, ceased to apply. An additional risk factor is the uncertain dynamics of economic recovery, which may continue to affect the scope of activities of the sector. In addition, the crisis can cause structural changes, such as permanent changes in the habits and needs of customers, which can increase the need for investment and the adjustment of business models in the direction of greater digitalisation and development of new products and services in insurance (Financial Stability Report in the Republic of Macedonia, 2021).

Conclusions

The North Macedonian insurance sector is still small, but with a likelihood of serious improvement. This sector is characterised by full coverage of technical reserves (technical reserves and mathematical reserve in life insurance), i.e., future liabilities that arise from insurance policies and possible losses regarding risks related to performing insurance activities, with permissible fund categories. Furthermore, the insurance sector's solvency – as an indicator for the stability of the sector - remains high, which is based on the high capitalisation of the sector.

The period selected for research has its own peculiarities in the Republic of North Macedonia. Firstly, the change of political power after 2016 did not leave the direction of economic development unaffected, and that includes the approach of the security sector. Secondly, the global Covid-19 Pandemic, as everywhere in the world, affected our country. Frequent changes in insurance legislation are a consequence of various changes

occurring in the insurance sector, along with the need imposed by the requirement for harmonisation with EU directives and regulations. The pandemic situation seems to have highlighted the benefits of having financial protection against adverse risks and has raised the awareness of households and the corporate sector about the need for insurance, which is reflected in the growth of optional insurance classes.

The insurance sector is the third largest segment according to the size of assets in the financial system of the Republic of North Macedonia. Non-life insurance continues to prevail within its scope, whose slower growth in 2017 contributed to the deceleration of the growth of the insurance sector overall. The last five years have been characterised by a high growth of life insurance with an investment component, which contributed to increasing its share in the total Gross Value Added (GVA) of life insurance from 4.4% in 2016 to 17.3% in 2020. The reason for such movements may be the search for return by the insured, which in turn increases the exposure of the insured to market risk and the possibility of losses due to investment risk. The representation of these products in the financial assets of the population is currently low. Moreover, in the last five years, the insurance sector has registered a growth at a higher average rate compared to the banking sector. Asset growth in the last three years exceeds the historical average for the previous ten-year period, which is a positive indicator for the development of the insurance sector. However, compared to the banking sector, the size of the insurance sector remains small, which limits the importance of the sector as a source of risks to financial stability. Finally, the solvency of the insurance sector as an indicator of the stability of the sector is still high, based on the high capitalisation of the sector, which exceeds the regulatory minimum several times over.

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