



Exploiting the growth potential of emerging insurance markets

Swiss Re

Economic growth of emerging markets has time and again outpaced that of industrialized nations. Alongside the rising importance of emerging market economies, their evolving insurance sector is also drawing more attention, not least because of its robust growth of late: life and non-life insurance premiums in emerging markets have grown annually by 10.4% and 7.3% respectively in real terms over the past 10 years, against industrialized nations' average of 3.4% and 2.6%. Growing apprehension of market saturation in industrialized economies and further liberalization and deregulation in emerging markets continue to keep the latter in the spotlight.

Emerging insurance markets vary in size and structure. Despite this multiplicity, a number of common trends and characteristics can be observed among these markets.

- Strong economic growth will continue to drive development. Increasing affluence will give room for new products. New distribution channels will help to tap growth potential.
- Supervisory authorities will further realign local regulations to international best practice, particularly in terms of solvency, corporate governance and transparency. This will foster confidence in insurance. At the same time, insurers will find stronger incentives to maintain sound underwriting standards.
- Emerging insurance markets are moving towards a more liberal regime with fewer entry barriers, reduced micro-management of business practices by regulators and growing competition. The process is arguably more advanced in Latin America and Eastern Europe than in Asia and the Middle East.
- These developments will also entail further transformations in the insurance corporate landscape, characterized by the gradual privatization of state companies, consolidation in some fragmented markets and higher penetration of foreign players in previously reclusive markets.

The most important emerging insurance markets in the regions, ordered by their total insurance premiums in 2003, are listed below. They collectively account for at least 85% of the premium volume of their respective region.

Regional aggregates will always include the following markets.

- Asia: South Korea, China, Taiwan, India, Hong Kong, Singapore, Malaysia, Thailand, Indonesia and Vietnam.
- Latin America: Brazil, Mexico, Chile, Argentina, Venezuela and Colombia.
- Eastern Europe: Russia, Poland, Czech Republic, Hungary, Ukraine, Slovenia and Slovakia.¹
- Africa: South Africa, Morocco and Egypt.
- Middle East: Turkey, Iran, United Arab Emirates, Saudi Arabia, Lebanon, Kuwait.

Heightened interest in emerging markets

This is particularly the case for the insurance industry: the saturation of industrialized markets contrasts sharply with the high growth potential in emerging markets. International insurance companies also look to emerging markets for better risk diversification while at the same time fulfilling the need to follow their global clients beyond national borders. The trend towards investing in emerging insurance markets has a long history and has arguably, due to regulatory considerations, been more advanced in Latin America and Eastern Europe. In Asia, a multitude of activities erupted in the aftermath of the 1997 financial turmoil but enthusiasm among foreign insurers has been muted since the global stock market collapse in 2000. Nevertheless, as the global insurance market begins to recover and emerging markets move further to lower entry barriers, there has been a general revival of interest in these markets.

Importance of emerging markets

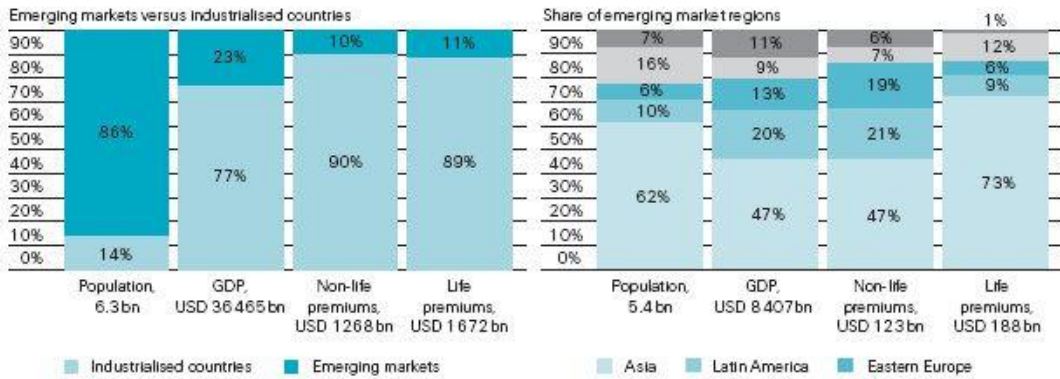
Emerging markets are home to 86% of the world's population, including some of the most populous nations like China (1.3 billion), India (1.1 billion) and Indonesia (0.2 billion). Collectively, emerging markets account for 23% of global economic output,² with some of them being among the biggest economies worldwide, for example China (7th), South Korea (10th) and Mexico (11th).

Emerging markets collectively accounted for 10% of global non-life and 11% of life insurance premiums in 2003.³ These percentages are clearly lower than the emerging markets' share in output (GDP), not to mention population, which implies huge catch-up potential (see Figure 2). Asia is by far the most important



region in the emerging world, accounting for 62% of population, 47% of GDP and non-life premiums and an impressive 73% of life insurance premiums.

The emerging markets still need to catch up in insurance



Source: Swiss Re Economic Research & Consulting

Insurance business is concentrated in a few markets

The insurance business in emerging markets is concentrated in certain areas. The top ten countries account for 87% of life and 66% of non-life premiums.

Life insurance	Premium volume (in USD million)	Share of emerging markets	Non-life insurance	Premium volume (in USD million)	Share of emerging markets
South Korea	41 998	22.4%	South Korea	17 760	14.4%
China	32 442	17.3%	China	14 468	11.8%
Taiwan	23 739	12.6%	Russia	9 257	7.5%
South Africa	20 728	11.0%	Taiwan	8 662	7.0%
India	13 590	7.2%	Brazil	8 259	6.7%
Hong Kong	10 117	5.4%	Mexico	6 690	5.4%
Brazil	6 306	3.4%	South Africa	4 670	3.8%
Singapore	5 561	3.0%	Poland	3 946	3.2%
Russia	4 887	2.6%	India	3 712	3.0%
Mexico	4 230	2.3%	Singapore	3 337	2.7%
Top 10	163 598	87.1%	Top 10	80 762	65.7%

Source: Swiss Re Economic Research & Consulting

Non-life penetration – big impact of structural factors

As in the life insurance sector, non-life insurance penetration on average increases with average per capita income. Other factors influencing demand for insurance are compulsory insurance schemes and a region's exposure to natural catastrophes. Structural factors, however, may also prohibit a market from ever reaching the "expected" level of penetration for a certain level of income.

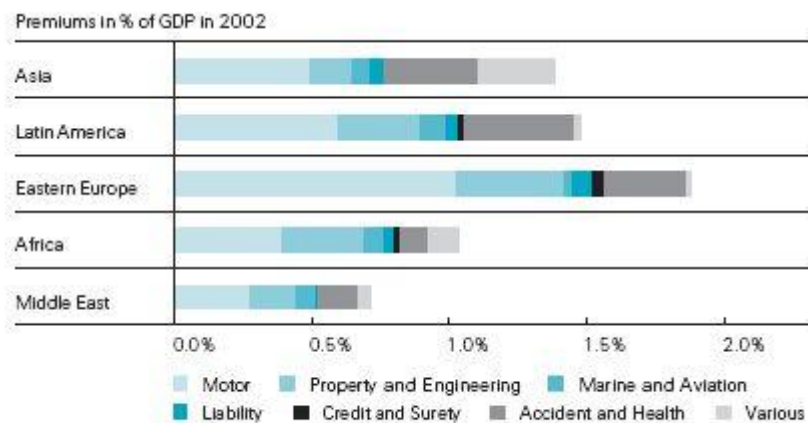
<p>General factors</p> <ul style="list-style-type: none"> ■ Economic growth ■ Wealth: distribution of income ■ Religion: culture ■ Education ■ Property rights: legal certainty ■ Products offered ■ Distribution channels ■ Risk awareness ■ Insurance regulation ■ Trust in insurance 	
<p>Non-life insurance</p> <ul style="list-style-type: none"> ■ Compulsory insurance ■ Natural catastrophe exposure ■ Public role in health and workers' compensation insurance ■ Claims awards 	<p>Life insurance</p> <ul style="list-style-type: none"> ■ Economic stability (inflation, currency) ■ Savings rate ■ Demography ■ Tax benefits ■ Pension system

Source: Swiss Re Economic Research & Consulting



Non-life insurance dominated by motor and property insurance

Motor insurance is the dominant non-life business line in most emerging markets. Due to the fact that motor third party liability insurance is compulsory in most countries, insurers get into contact with clients and can thus sell them motor own damage insurance as well. In addition, leasing contracts for cars often require the purchase of motor own damage insurance. Property and accident and health insurance are in most cases the next biggest in terms of premium volume. The importance of accident and health insurance depends heavily on the government's role in this line of business. Where workers' compensation is covered by the private insurance industry – as is the case in several Latin American and Asian markets – or where public health insurance is insufficient, these lines are more important. Transport insurance is insignificant in Eastern Europe, but accounts for 6–10% of non-life premiums in the other regions. Liability is still of minor importance in most markets. In Eastern Europe, however, its importance has increased strongly in recent years. Changes in liability regulations as these countries approached the EU have stimulated growth in liability insurance business. In Asia, liability business has also increased, albeit from a low base, due to demand for product liability covers for exports to the US as well as more widespread liability regulations.



Privatisation

State involvement in the form of state-owned insurers has decidedly lost importance over the last ten years in Latin America as well as in Eastern Europe. The government still plays a major role in parts of Africa, the Middle East and Asia. In South Africa, state involvement is minimal, but in Morocco and Egypt, for example, the state still plays a key role. In Morocco this is manifested through the state-owned reinsurer SCR, and in Egypt through the public sector reinsurer Egypt Re as well as state ownership in direct insurers which control 75% of non-life and 69% of life insurance premiums. While the privatisation of public sector insurers has been on the table in Egypt, the process is currently on hold.

Liberalisation

Entry barriers to most emerging insurance markets have been reduced over the last decade, leading to more international insurers entering into these markets. In turn, merger and acquisition activities have accelerated and competition intensified.



Market share of (≥50%) foreign-owned insurers			Market share of (≥50%) foreign-owned insurers		
	Life	Non-life		Life	Non-life
Asia			Eastern Europe		
South Korea	10%	1%	Russia	na	na
China*	2%	1%	Poland	52%	41%
Taiwan	33%	12%	Czech Republic	81%	89%
India	0%	0%	Hungary	85%	89%
Hong Kong	87%	74%	Slovenia*	17%	2%
Singapore*	58%	53%	Slovakia	97%	96%
Malaysia*	81%	25%			
Thailand*	41%	7%	Africa		
Indonesia*	48%	25%	South Africa*	0%	14%
Philippines*	61%	29%	Morocco	52%	28%
Vietnam	56%	6%	Egypt	11%	10%
Latin America			Middle East		
Brazil	32%	43%	Turkey	12%	27%
Mexico	75%	58%	Iran	0%	0%
Chile	62%	63%	United Arab Emirates	na	na
Argentina	53%	35%	Saudi Arabia	na	na
Venezuela	39%	50%	Lebanon*	≥64%	≥35%
Colombia	38%	46%	Kuwait*	14%	14%

Notes: The foreign market share is calculated from the total premium volume of companies with a foreign majority stake. Latest available figures are used, which typically refer to 2003 (+2002 data; *2001 data); in India and Iran, foreign insurers are not allowed to hold majority stakes.

Source: Swiss Re Economic Research & Consulting

Deregulation

In big parts of Eastern Europe and Latin America, Africa and the Middle East, tariffs have disappeared over the last decade. Exceptions are mainly for tariffs on compulsory motor third party liability (MTPL) covers.

In Asia, South Korea, Singapore and Indonesia have successfully moved away from tariffs but in some other non-life insurance markets, detarification is still a major subject. Taiwan is in the process of giving up price control. Other markets, including India, have voiced their intention to follow suit, but some 75% of India's non-life premiums are still generated under tariffs. China took a big step when it abolished motor tariffs on 1 January 2003. Detarification is expected to result in more volatile underwriting results while post-deregulation price developments will depend on the rate adequacy of prior tariffs. Motor own damage tariffs, for example, are below a sustainable market level in India. Price deregulation will thus likely lead to higher rates going forward.

Solvency regulation changes all over the world

A clear trend to align standards of insurance supervision to international best practice can be observed across the world. Regulators in the emerging markets are increasingly gravitating towards insurance supervision as promoted by the International Association of Insurance Supervisors (IAIS) and other supranational bodies. Product and pricing controls are being lifted and solvency control reinforced. An example is the adoption of risk-based capital (RBC) frameworks.

The enforcement of a more stringent solvency standard will help to underpin the need for sound technical underwriting, foster confidence in insurance and possibly accelerate market consolidation. In many markets there are still numerous undercapitalized insurance companies – some of them will need to search for partners, merge, or cease business.

Growth in emerging markets outpaced that of industrialized countries

Over the past five years, growth in emerging markets' insurance premiums has clearly outpaced that of industrialized nations.



	Total premium volume 2003, in USD million	Real premium growth 1998–2003				
		Total	Life	Non-life	Motor	Property
South Korea	59 758	0.5%	-1.2%	5.3%	5.9%	1.7%
PR China*	46 911	23.1%	31.6%	11.5%	14.2%	3.0%
Taiwan	32 402	14.3%	15.2%	12.1%	3.5%	9.5%
South Africa	25 398	4.2%	4.1%	4.8%	5.6%	16.8%
India	17 302	15.3%	17.5%	8.9%	na	6.2%
Brazil	14 565	6.5%	16.6%	1.4%	-1.4%	2.4%
Russia	14 145	23.3%	27.3%	21.5%	na	32.2%
Hong Kong	12 494	17.1%	20.0%	8.3%	6.5%	1.4%
Mexico	10 920	6.5%	3.2%	8.9%	7.7%	11.1%
Singapore	8 898	14.0%	14.1%	13.7%	8.3%	6.8%
Poland	6 258	4.4%	9.3%	2.1%	-1.0%	3.7%
Asia	194 473	10.5%	11.3%	8.8%	8.2%	4.6%
Latin America	41 784	5.4%	7.6%	4.3%	1.0%	8.1%
Eastern Europe	34 460	13.0%	17.4%	11.4%	2.5%	18.3%
Africa	30 919	4.3%	4.2%	5.0%	5.6%	16.8%
Middle East	5 870	8.3%	8.0%	8.6%	7.2%	8.2%

* For motor and property insurance 1998–2002

Note: Growth rates are shown in local currency terms adjusted for inflation. Growth by region is derived by weighting individual market growth by premiums from the preceding year in USD.

Source: Swiss Re Economic Research & Consulting

Strong economic growth will continue to underpin insurance demand

Emerging insurance markets will continue to grow at a fast pace. Healthy economic growth and increased stability will favor insurance market development.

While the economies of industrialized countries are projected to increase by an annual average of less than 3% over the next ten years, the economic growth of emerging markets will average nearly 5% pa in real local currency terms. Asia is expected to show above average growth of 6%, whereas growth in the other regions will reach about 4% per annum.

In addition to the healthy economic growth and higher stability, insurance will benefit from increasing household wealth and the globalization of emerging markets. Experience suggests that in countries with per-capita income between USD 2 000 and USD 10 000, insurance premiums increase on average by one to two times faster than the overall economy. For the 2004–2014 period it can be expected that premiums in emerging markets will increase by 7.5% in real terms per year.

Growth rates will, however, vary across regions and countries. Growth will not only depend on economic development, but also on insurance rate developments and changes in the other insurance-specific factors: new products offered, the use of new distribution channels, the availability of tax benefits, the introduction and enforcement of compulsory lines, as well as privatization of social security business (workers' compensation, pension insurance). Asia will likely outperform, particularly when looking at absolute growth.

Challenges ahead – what does it take to realise growth potential?

In order to realise the growth potential of emerging markets, certain prerequisites have to be met.

Government and supervisory authority's role in releasing the growth potential In order to grow, insurance business needs a predictable environment: this includes economic stability, legal certainty, stability of institutions and the enforcement of property rights. Clients need confidence in obtaining real value

benefits in the event of a claim; insurers need a legal framework they can trust in as a basis for their business plan.

Insurance supervision needs to be effective to enhance insurers' reputations. Only if the market environment is attractive will there be competition which entails the provision of a large variety of products and high service levels. Privatisation, liberalisation and deregulation of the insurance markets, if implemented appropriately, are important steps in that direction. In addition, a further relaxation of investment rules may help insurers to respond to market developments and thus make insurance more attractive.

Besides these general market conditions, insurance-specific efforts by the authorities could help to realise this potential, including the admittance of private pension, health or workers' compensation insurance, as well as the introduction and enforcement of compulsory lines of business. The demand for compulsory insurance is being fuelled by government's and society's increased willingness to protect consumers or other potential victims. Third-party liability insurance, for example, guarantees that necessary funds are available to compensate accident victims; compulsory earthquake insurance helps to avoid adverse selection. Further government initiatives may comprise the provision of information with



regard to insurance (eg standardised forms, sent annually to insured clients, stating social security benefits and possible protection gaps) as well as tax incentives to employers for promoting group risk coverage or to individuals to promote private retirement arrangements.

The insurance industry's role in enforcing growth

The biggest effort, however, has to come from the insurance industry. If insurance business is to grow strongly, new clients have to be reached and/or new insurance products sold. Insurers have to listen to their clients' needs, to design products accordingly and explain them to their clients. Innovative distribution

channels, like bancassurance, distribution through department stores, or the sale of insurance in combination with the purchase of a car, help to reach a wide sector of the population. Cost efficiency will be crucial, especially with regard to low price products. For life insurance, in contrast, product transparency

is a major challenge: insurers will need to design simple products and increase their information efforts.

Insurers also need to act in a professional manner in order to increase the industry's reputation.

Potential clients have to trust in the insurer's risk management capabilities and be convinced that a warrantable claim will be paid out in a reasonable time frame.