

## ***Emerging Markets; the insurance industry In the face of globalization.***

***Report by: SWISS RE***

### **Introduction**

Since the beginning of the nineties, international primary insurers have been intensively expanding their activities in emerging markets. The market share of insurers who are either partly or fully foreign owned, has tripled in Latin America and central and eastern Europe to 47% and 41% respectively. The average in Asia is 12%. The figure depends largely on the relevant legal framework - market entry restrictions and structure of local providers - and range from less than 2% in china and Russia to more than 70% in Hungry and Chile.

The high growth potential in the emerging markets is one of the major factors attracting foreign insurers, in the nineties the growth rate in these countries was as high as in the industrialized countries.

Overall, the emerging markets account for 9% of global premium volume. Most of global insurers studied generate between 3% and 5% of their premium income from these markets.

### **Focus and structure of the study**

While premium growth rates in mature insurance markets have fallen to very modest levels - especially in non-life business - the emerging markets of Central and Eastern Europe, Asia, Latin America and South Africa are expanding rapidly, often reporting double-digit growth. High growth in these countries is attracting global insurers, who, given the deregulation process during the nineties, are now able to take over local companies or set up their own national subsidiaries.

Global insurers are defined as the largest primary insurers worldwide which are striving to establish a global presence for their business and already have significant operations in emerging markets. (Significant) means having primary insurance activities in at least two of the regions examined in this study, and in six different countries in total. Applying these criteria, the list of global insurers comprises:

### **Driving Forces of Globalization**

The insurance industry has also succumbed to the general trend towards globalized markets and risks. This general trend is evident in the fact that in recent years there has clearly been more rapid growth in global trade, direct investments and portfolio investments than in the production of goods and services.

In the following, more detailed consideration is given to the driving forces behind the globalization of the insurance industry.

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<b>Push Factors</b> <b>Foreign insurers motives</b>		<b>Pull Factors</b> <b>Emerging markets factors</b>
<b>Following existing customers</b> <ul style="list-style-type: none"><li>- increasing global trade</li><li>- growing direct investments</li></ul>	<b>Removal of barriers to market entry</b>	<b>Demand for cover</b> <ul style="list-style-type: none"><li>- Strong economic growth</li><li>- Increasing trade</li></ul>
<b>Potential growth</b> <ul style="list-style-type: none"><li>- saturation in industrial countries</li><li>- strong growth in emerging markets</li></ul>		<b>Capital requirements</b> <ul style="list-style-type: none"><li>- major risks</li><li>- solvency regulations</li></ul>
<b>Gains in Efficiency</b> <ul style="list-style-type: none"><li>- diversification</li><li>- economies of scale/ know how</li></ul>		<b>Know-How requirements</b> <ul style="list-style-type: none"><li>- new products</li><li>- new risks</li><li>- tougher competition</li></ul>

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## The push and pull factors behind increasing globalization

Well-oiled insurance and financial markets will become more important as trade becomes more international. Globally active industrial and service companies expect worldwide support from their insurers. Commercial insurance is thus as a rule the first branch in which foreign insurers become active in a new market. The last decade witnessed a sharp increase in direct investments. These investments are an indication of cross-border mergers, takeovers and new companies being founded by industrial and service companies in emerging markets.

In recent years there has been a strong increase in the demand for insurance in the emerging markets. The average annual growth rate in the emerging markets has, since 1990, been twice as high as in industrialized countries in both life and non-life insurance. At the same time the global insurers home markets are marked by certain saturation in non-life business. Combined with the large increase in underwriting capacity in recent years this led to a marked price war and competition for market share. The strong growth markets of Asia, Latin America and Central and Eastern Europe thus offer global insurers a welcome opportunity to conquer new markets to ensure future potential profits with the aim of enhancing the corporate value.

A further reason for foreign insurers to expand into emerging markets can be found in heightened competition and the ensuing on costs. The process of globalization offers new opportunities for risk diversification and reducing costs.

One advantage of global non-life insurers - particularly in commercial business is their huge financial strength. International insurers are able to take on risks, which exceed the financial capacities of local insurers. As the former have lower capital costs owing to their diversification they are able to raise the efficiency of risk transfer and offer lower prices or greater capacities. In addition, the global insurers often have superior know-how relating to products, rating and risk management. This is an advantage in life and health business, namely in Latin America and Central and Eastern Europe, due to the demand for new life, health and workers compensation products on the back of privatized social security systems. Foreign insurers are able to fall back on the experience gained in other countries. They are also able to profit from their reputation as sound, financially strong companies, which is a particularly significant factor in life insurance, given its long-term nature.

However, the alignment of products, services and distribution channels to the needs of the local markets is not without costs. It is questionable whether economies of scale can be achieved with expansion in emerging markets, since the complexity of the organization increases with international expansion and, as a consequence, the demands made on management. Regulatory and cultural differences cause further costs, which can have a detrimental effect on the use of economies of scale)

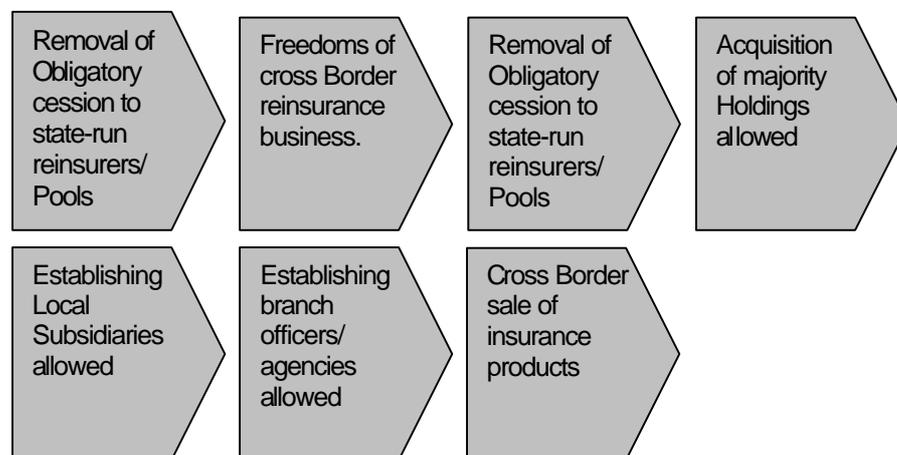
The emerging markets continuing integration into the global economy and sound economic growth have

fueled the demand for insurance cover. A shift in regulatory controls towards solvency control and the opening up of new business areas have raised the capital and know-how requirements. In Latin America and Asia, a number of local insurers have therefore begun to search out suitable foreign partners in recent years. Many local insurers were, and still are, family businesses or form part of a comprehensive financial services/industrial company. Economic reforms and privatization have given rise to improved business opportunities in other sectors as well, which has prompted some companies to concentrate on certain areas and sell off their insurance holdings.

## Regulatory framework

### *The stages of Liberalization*

The globalization of the insurance markets was only made possible by the liberalization and deregulation of what had hitherto been a strongly protected insurance industry. In the early nineties, radical reforms were introduced in Latin America and Central and Eastern Europe. In Asian countries the liberalization process has clearly gained momentum following the Asian crisis. The process has been favored and speeded up by multilateral agreements, such as the WTO, EU and NAFTA.



## The role of the GATS/WTO

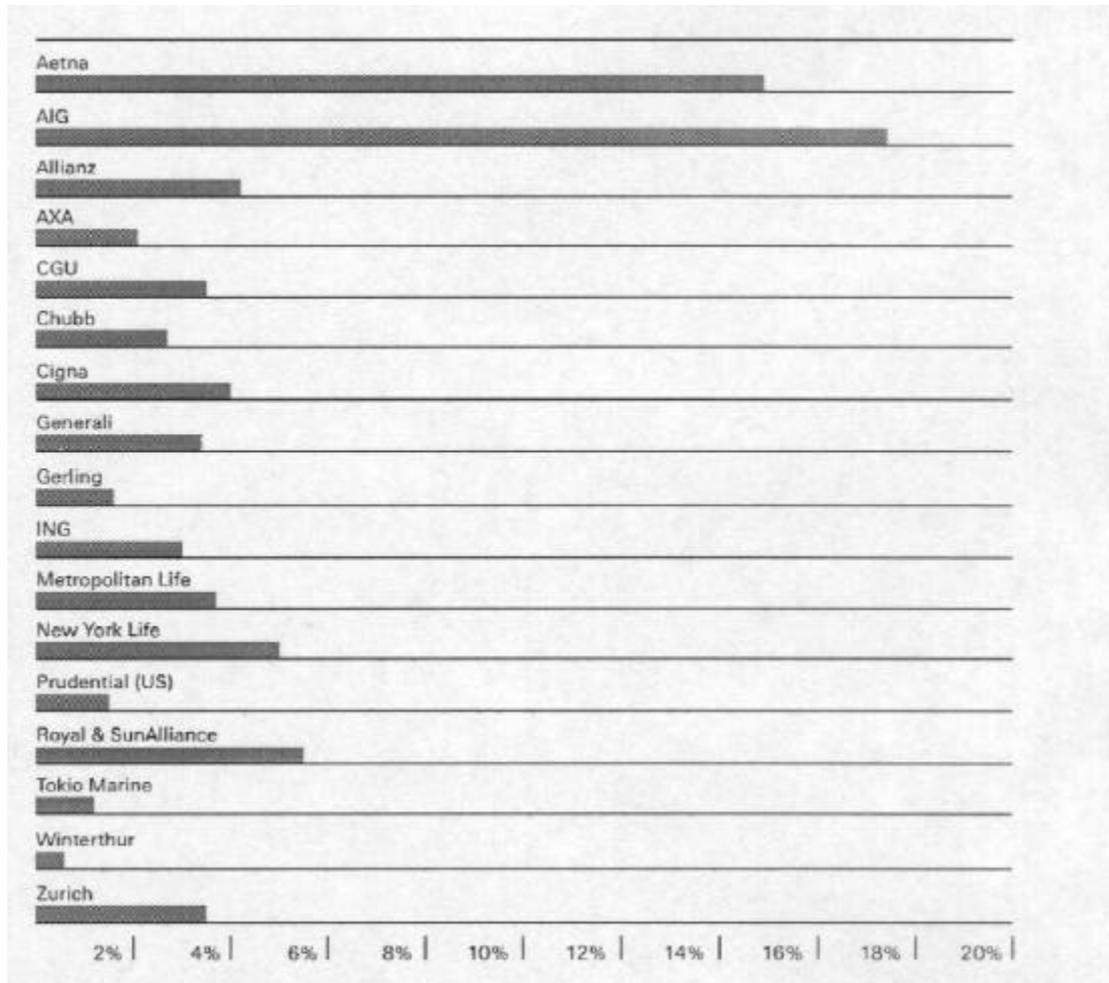
Of particular significance in the liberalization process are the multilateral negotiations as part of the General Agreement on Trade in Services (GATS), a component of the World Trade Organization (WTO). A major breakthrough was achieved at the end of 1997 with the agreement on the liberalization of financial services, after the Uruguay Round in 1995 had failed to yield any agreement on specific commitments. In this agreement, which came into force on 1 March 1999, a total of 70 countries offered improved conditions of access to their markets. Thirty-two countries maintained the promises undertaken in 1995 so that altogether 102 countries undertook a commitment to liberalization as part of the GATS.

## Overview of the Most important Global Primary insurers in Emerging Markets

The importance of emerging markets varies significantly from one global insurer to another. After a long period in which mainly European companies and AIG were globally active, US insurers have, over recent years, increasingly extended their operations into the emerging markets. While some companies specifically target emerging markets in order to benefit from the high growth rates available, others see emerging markets more as a complement to their global activities. Two firms in particular, Aetna and AIG, already generate a substantial portion of their premiums in emerging markets. The majority of companies examined in this study generate between three and five percent of their premium volume in emerging markets.

## The Importance of Emerging Markets for Global primary insurers

(Share of direct premiums generated in the 22 emerging markets considered in the study of the companies total direct premium.)



Below is a summary of key information on the emerging market activities of the global insurers included in this study.

**AIG:** with a presence in more than 130 countries, AIG rates as the most global of all insurance companies. As soon as a country allows foreign insurers to qualify for a license, AIG forms a new subsidiary or looks for a local joint venture partner.

**Allianz:** Allianz aims to be a leading player both in mature and emerging markets, and in recent years has concluded new acquisition and joint ventures in Asia especially in pursuant of this goal. Allianz was the first foreign insurer to enter the central and eastern European markets in the second half of the eighties and remains the biggest global insurer in the region. Its acquisition of AGF in Nov 1997 Doubled its market presence in Asia and Latin America.

**AXA:** the French group expanded to become one of the biggest insurance group in the world through a series of major acquisition in the nineties, the focus of its activities to date have been the bigger mature insurance markets. So far AXA has not been one of the leading foreign insurance provider in emerging markets, but its now plans to expand its market position in Asia and Latin America through additional offices and acquisitions.

**CGU:** CGU is the result of the merger of Commercial Union and General Accident In 1998. Through the recent merger with Norwick Union, its position in the UK has further strengthened. The new company is focusing in expanding its life activities as well as building up a strong position in Poland Life Market,

# Insure Egypt

the group has been active chiefly in Asia. CGU is particularly interested in expanding its life business in Asia in the future.

**Royal & SunAlliance:** Royal & SunAlliance was the result of a merger between Royal Insurance Holding and the Sun Alliance Group in 1996. The group already has a strong presence in Latin America and Asia and plans to step up its expansion drive in Asia especially. The main focus will initially be on commercial lines, with personal lines to follow.

AIG and Allianz have the biggest presence in the countries studied, both in life and non-life business. Other global insurers focus on specific regions and specialize in life or non-life business, or even in individual sub-segments. For example: the presence of Cigna and Aetna in emerging markets reflects their global strategy of concentrating on health insurance, while Chubb, Gerling and Tokio Marine focus on commercial business. Other insurers, such as ING, specialize in certain lines of insurance such as life business in some regions, even though they offer the full range of insurance products in other markets.

Looking at the activities of global insurers in the recent past, it is clear that a large part of their attention is being concentrated in Asia. European global insurers in particular are trying to establish and expand their positions in this region. Some of them, such as AIG, Royal & SunAlliance and CGU, have long been established in the region.

In Latin America most global insurers already have an established presence. In the markets studied there are virtually no restrictions on shareholdings and the formation of new subsidiaries. As a result, the global insurers have their most pronounced market presence in this region. Several global insurers have taken the opportunities for substantially expanding positions in individual markets by acquiring local insurance companies. In March 2000, for example, ING acquired a stake in Commercial America, the largest Mexican insurer; New York Life acquired Seguros Monterrey, ranked number three in the Mexican life market at the end of 1999; while Allianz purchased Colseguros, number two in Colombia. Generali secured top place in the Argentinean market by acquiring a stake in the market leader Caja de Seguros y Ahorro.

Various foreign companies set up subsidiaries in Central and Eastern Europe following the liberalization and opening up of the markets in the early nineties. Other opportunities to acquire market share have arisen from the privatization of the former state monopolies. So far it has mainly been AIG and those global insurers from the neighboring Western European countries which have gained a foothold. Metropolitan Life and Prudential are two other insurers from the US that have acquired a license for the Polish life insurance market.

In South Africa during the nineties, several foreign insurers acquired holdings in local primary insurers or set up their own subsidiaries, almost exclusively in non-life business. Whilst the global insurers maintain a significant position in this segment despite several withdrawals from the market, in the life business, where volumes very attractive, it is exclusively domestic insurers who are active,

## **Benefits and challenges of liberalization in emerging markets**

The opening up of the insurance markets in developing countries to foreign competition has long been a contentious issue. Numerous arguments, including the unfavorable balance-of-payment effect and the need to protect infant industries, have been advanced to justify measures to confine foreign inroads. It is often the case of striking a fine balance between the stability of the insurance market on the one hand and ensuring efficiency and consumer values on the other hand. While most Latin American and Central and Eastern European countries embarked on their liberalization processes in the early nineties, nothing like the recent financial crisis in Asia has been more instrumental in bringing to the authorities attention the issue of liberalization. Most policymakers have concluded that liberalizing long-term capital inflows (eg foreign direct investments) is more conducive to sustainable economic growth than solely freeing short-term capital movements.

The benefits of liberalization are multi-faceted. Foreign insurance companies can enhance the efficiency of the local insurance market by providing superior customer services, introducing new products and transferring technological and managerial know-how. Liberalization increases competition and encourages a more pronounced specialization according to comparative advantages. While for example

most insurers in Latin America were composite companies insuring all kinds of risks. an increasing number of specialized companies have emerged in recent years.

From a macroeconomics point of view, opening up the insurance market could help to mobilize national savings and narrow the investment gap of developing economies. In emerging markets, domestic savings have not been fully mobilized despite huge funding needs arising from infrastructure projects, for example. Insurance companies as important long-term institutional investors, therefore functioning as financial intermediaries, contribute to bringing together savers and borrowers. The benefit would be most sizeable with the participation of foreign insurers possessing superior financial skills (eg asset-liability management). Enhancing domestic financial intermediation would further render emerging economies less dependent on short-term and highly volatile foreign capital inflows.

Due to their greater financial strength and risk diversification capabilities, foreign insurers are often characterized by superior claims paying ability, which would also help to enhance the financial condition of individuals, households and corporations in emerging markets. Although form and rate controls have been employed by developing market supervisors to maintain financial stability, this has proven to be less than cost efficient as well as suffocating the development of a competitive environment. The recent switch towards solvency-based supervision in emerging markets is expected to result in a shake-out of companies. It is particularly against such a backdrop that foreign insurers could provide the financial security needed for a smooth transition towards a more consolidated marketplace.

Last but not the least, the participation of foreign insurers could improve the capital allocation efficiency of emerging economies. Underwriting and investment decisions made by foreign insurers based on their international experience and best-practice considerations could send useful signals for efficient resource allocations. The availability of these signals, particularly in markets where credit allocations are not completely based on economic considerations, is important in improving capital productivity.

## **Concerns about foreign inroads**

There are still concerns over the potential pitfalls of greater foreign participation.

There are worries that selective marketing by foreign insurers could result in the neglect of some customer groups. Foreign insurers, which are generally more focused on high-value clients, could fail to provide insurance covers to certain customer sectors, particularly to lower-income groups.

Another often-quoted argument in favor of limiting foreign inroads is that the local market is already well served by indigenous companies and that further entrants could threaten the financial stability of existing companies. This, however, is best addressed by prudential supervision of the solvency of insurance companies and adequate liquidation rules to facilitate the proper exit of insurance companies.

Another potential pitfall of liberalization relates to the possible outflow of foreign exchange. There are concerns that increased penetration of foreign insurers would eventually result in rising fund outflows over the longer term in the form of profit repatriation. This, however, has to be balanced by other considerations. The immediate impact on the capital account will be favorable, as foreign insurers have to capitalize their new operations as well as invest in offices and equipment. Furthermore, the long-term outflow arising from profit repatriation could be more than offset by other inflows. Foreign direct investment would benefit from the increased sophistication of the domestic insurance market. The improved competitiveness of domestic exports, in view of the trade facilitating effect of insurance, could also result in more capital inflows. Taking into consideration these factors, it is fair to conclude that the net impact on the capital account is likely to be positive.

Overall, the benefits emerging markets stand to reap from opening up their insurance markets to foreign participation should more than offset any negative considerations. Provided that liberalization is being pursued against the backdrop of a solid set of prudent supervision, consumer protection and competition regulations as well as disclosure of information of the companies, the opening up of insurance markets should bring long-term benefits to developing economies.