RESEARCH SUMMARY

Insurance Development in Emerging Markets: The role of public policy and regulation

Insurance Development Forum

THE GENEVA ASSOCIATION

INSURANCE FOR A BETTER WORLD

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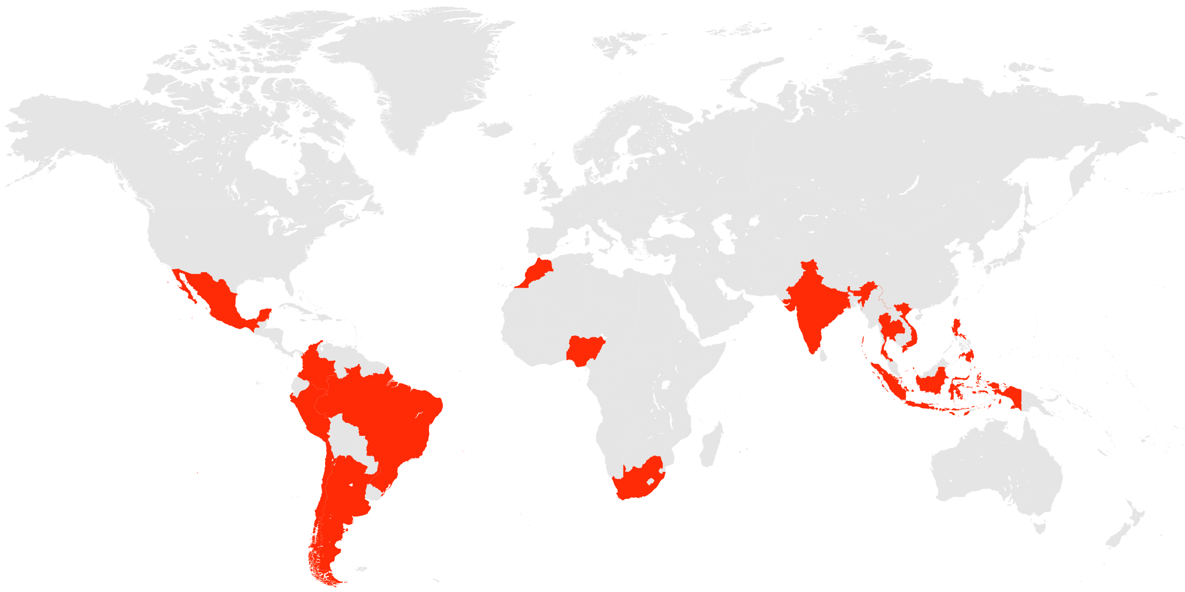
Over the past few decades, the economies of many emerging markets have grown rapidly, lifting millions out of poverty and creating a growing middle class. Insurance is critical to economic development as it enables economic activity by protecting lives, livelihoods and assets against insurable risks. Insurance also acts as a shock absorber of adverse events, provides critical risk mitigation services and helps attract private capital to economies. With climate-change-related events, COVID-19 and other catastrophes increasing societal vulnerability, it is of great concern that insurance penetration in emerging markets remains low.[1,2]

Figure 1: Countries in scope



- Argentina (population of 46 million)
- Brazil (population of 215 million)
- Chile (population of 19 million)
- Colombia (population of 52 million)
- India (population of 1.4 billion)
- Indonesia (population of 279 million)
- Mexico (population of 130 million)
- Morocco (population of 37 million)
- Nigeria (population of 215 million)
- Peru (population of 34 million)
- Philippines (population of 113 million)
- South Africa (population of 61 million)
- Thailand (population of 67 million)
- Vietnam (population of 99 million)

2.8 billion people covered

Combined gross written premiums (GWP) of USD 332 billion (2020)

Source: The Geneva Association

1 OECD 2021.

2 The Geneva Association 2018. Author: Kai-Uwe Schanz.

This summary of a report by The Geneva Association and Insurance Development Forum (IDF) explores how regulation as well as broader government policies can facilitate or curtail the development of robust, responsive insurance markets that help close critical protection gaps. It also provides recommendations on what steps governments can take to provide a legal, regulatory and policy environment that will attract insurance resources and capabilities to emerging insurance markets.

Core elements of effective regulation and supervision in emerging markets

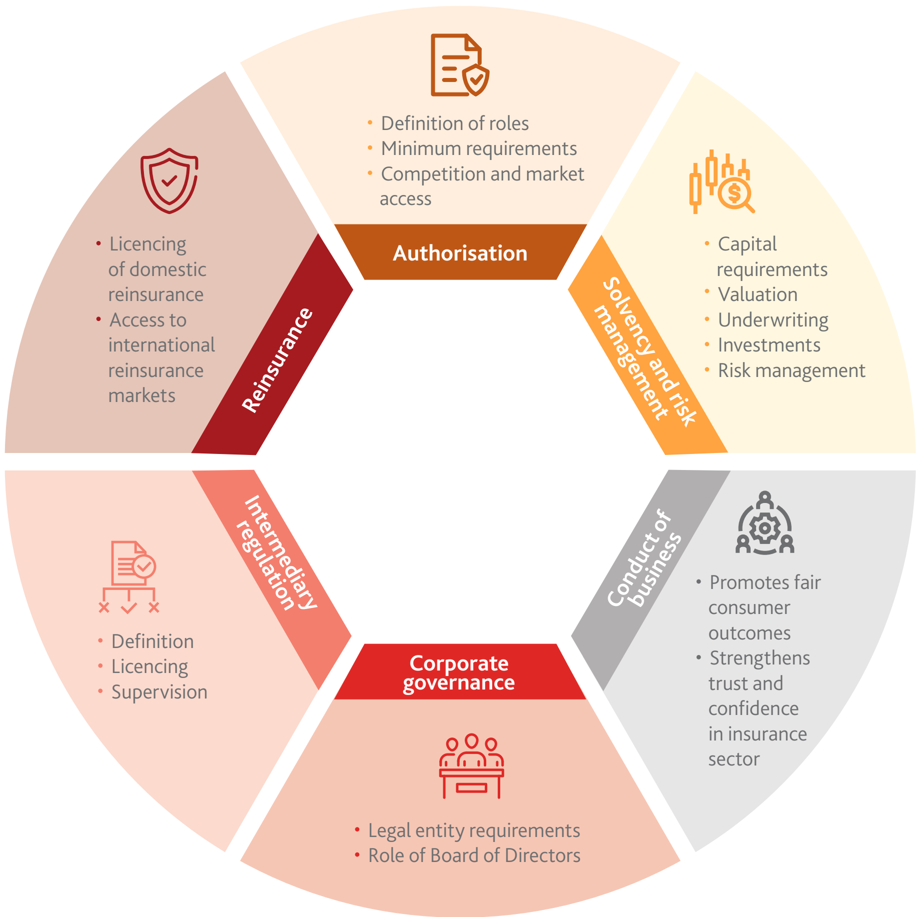
There is a general consensus that the primary duty of insurance regulators is to protect the interests of policyholders. The execution of this role has two different dimensions: first, the prudential aspects where regulators focus on the risk carrier's ability to pay individual claims, even very large losses, as they come due.[3] The second is the conduct dimension, which addresses the performance of re/insurers in carrying out their duties to customers and other stakeholders.[4] A third possibility, which is currently a topic of debate within regulatory circles, revolves around promoting the role of insurance in enhancing financial inclusion, whether through public, private or hybrid mechanisms.[5,6]

Emerging markets require a distinct approach to insurance regulation and supervision. In more mature environments, insurance regulation has become increasingly risk based, with capital requirements reflecting the complexity of underlying risks. In less developed countries, this premise must be balanced against the need for simplicity, not least given the skills and resources available at both regulators and supervised insurers.[7] As a result, it is important that regulatory frameworks are proportionate to the maturity of the market. In concrete terms, regulatory 'techniques and practices should not go beyond what is necessary in order to achieve their purpose'[8] and opt to balance prudential and market development objectives.[9]

Against this backdrop and based on an analysis of the legal, regulatory and broader government policy environments in 14 markets, the report finds that a set of common main factors influence the development of insurance market development across these markets. They include whether there is sufficient political prioritisation of insurance, the level of financial (including insurance) literacy, the effectiveness and efficiency of insurance regulation and supervision, risk awareness and a lack of trust among customers. Our proposed 'hexagon' of key legal, regulatory and supervisory elements in emerging insurance markets (see Figure 2) provides a generic taxonomy of regulatory and supervisory practices, allowing us to analyse insurance market development in emerging countries.

3 Marano and Siri 2017; OECD 2020a.
4 Norton Rose Fulbright 2014; OECD 2020a.
5 Biener et al. 2014.
6 CISL 2015.
7 United Nations Conference on Trade and Development (UNCTAD) 2007.
8 IAIS 2019.
9 OECD 2020.

Figure 2: Hexagon of insurance legislation and regulation in emerging markets



Source: The Geneva Association; IDF[10]

Financial literacy and risk awareness

As shown in numerous studies, a key barrier to insurance demand in most emerging markets is the low level of financial literacy. This translates into a lack of understanding and formal tools to manage risk and vulnerability. Experience from several countries show that successful financial literacy programmes focus on getting people to understand their exposure to loss and its implications as well as their ability to take steps to avoid or mitigate the impact of loss. For a lasting effect, such programmes need to be part of the core curriculum in childhood education. Financial literacy, along with a sound legal and regulatory environment, is critical to establishing trust in the insurance market.

Solvency regulation

Regulators, particularly those in emerging markets, have the difficult task of balancing policyholder protection and financial stability mandates with market development. Contrary to what research suggests, some regulators perceive the market development mandate to come at the expense of solvency and market conduct goals. Often regulators have the added challenges of insufficient financial and human resources and support at the political (e.g. ministerial) level, mainly due to a lack of prioritisation of insurance by policymakers and their limited appreciation of insurers' contribution to resilient societies

The expert and executive interviews conducted for this report suggest that in nearly all markets, the regulatory authorities are working on modernising regulatory regimes, for example by implementing risk-based capital (RBC) regimes and liberalising rate and form control regulations. However, mainly due to political headwinds, many of these core market development initiatives have been delayed. The insurance regulatory authorities that are successful in promoting market development spend a significant amount of time and effort in both educating decision makers in government about insurance and jointly working through the political processes to drive needed legislative changes forward.

Considering these factors and a study of development initiatives in a few countries, the report identifies concrete steps policymakers, insurance regulators and insurers could take to narrow protection gaps:

- Developing closer collaboration between governments, regulators, and the insurance industry to enhance the understanding of the role of insurance to societies and the importance of good insurance regulation
- Removing overly restrictive market access barriers to insurers and reinsurers to derive the benefits of competition, innovation and global risk diversification

10 IDF 2021. http://www.insdevforum.org/wp-content/uploads/2021/07/IDF-Insuring-Resilience-report-on-Critical-Legal-Regulatory-and-Policy-Architecture.pdf

- Making financial literacy a key policy priority
- Including and supporting insurance market development as part of the mandate for insurance regulators, in addition to the policyholder protection and financial stability mandates
- Calibrating product regulation and other regulatory rules to foster innovation

Furthermore, for insurance markets to thrive, several conditions need to be met, including:

Supply side:

- Access to markets
- Availability of capital and risk appetite
- Underwriting expertise
- Efficient and market-appropriate distribution channels

Demand side:

- Affordability
- Products that meet consumer needs
- Clarity regarding product benefits
- Financial (including insurance) literacy of stakeholders
- Establishing trust

Policy and regulatory environment:

- Conducive insurance regulatory frameworks and public policies
- Rule of law
- An appreciation and understanding of the contribution of insurance to society, at a political level

These factors not only enhance economic stability and financial soundness, but also promote competition, innovation and responsiveness in the insurance sector, to ultimately make societies more resilient.

An important step in building political support is to ensure policymakers appreciate the essential role of insurance in promoting economic and societal prosperity and devote sufficient attention and resources to insurance regulation and supervision as well as financial education. In addition, in many developing countries the public-finance system does not consider insurance issues and dynamics. This is often true regarding the efforts of the development finance community, which can have a significant impact on government priorities and investments. Both the insurance industry and regulatory community must work together to bring insurance to the top of the policy agenda. Quantifying the contributions of insurance to prosperity and resilience will be vital to the dialogue with policymakers and can lead to the creation of public-private partnerships, which are critical to addressing protection gaps.

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