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

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The Geneva Association

The Geneva Association was created in 1973 and is the only global association of insurance companies; our members are insurance and reinsurance Chief Executive Officers (CEOs). Based on rigorous research conducted in collaboration with our members, academic institutions and multilateral organisations, our mission is to identify and investigate key trends that are likely to shape or impact the insurance industry in the future, highlighting what is at stake for the industry; develop recommendations for the industry and for policymakers; provide a platform to our members and other stakeholders to discuss these trends and recommendations; and reach out to global opinion leaders and influential organisations to highlight the positive contributions of insurance to better understanding risks and to building resilient and prosperous economies and societies, and thus a more sustainable world.

Insurance Development Forum

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First announced at the UN Conference of the Parties (COP21) Paris Climate Summit in 2015, and officially launched by leaders of the United Nations, World Bank Group and insurance industry in 2016, the IDF looks to leverage the technologies, expertise and financial mechanisms native to the insurance industry to enable the world's most disaster vulnerable governments, economies and populations to enhance risk understanding and build resilience.

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Contents

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Foreword

The role of insurance in supporting economic growth and resilience has received increasing attention over the past five years. Its value in providing disaster risk financing and disaster risk mitigation services has come to the forefront in discussions regarding climate change and the urgent need to address climate-related risks. But even beyond climate risk, insurance plays a critical role in addressing life and health risks, as well as humanitarian aid more generally. It is one of the cornerstones of economic and societal development and it provides a critical safety net, particularly for the most vulnerable.

As important as insurance is, there are significant risk exposures and losses that are not covered by insurance but could be. Protection gaps exist in every country – emerging, developing and developed. But they are greater in emerging and developing economies, where the consequences of uninsured risks can be even more severe and long-lasting, because of the lack of personal or state resources to meet these losses. Sadly, we see these consequences play out almost every day across the world.

There are many reasons why protection gaps exist and in many instances are growing. These include the need for the insurance sector to focus even more carefully on the needs of consumers and think more imaginatively about the risk-financing and risk-mitigation products and services it can provide. But the power of governments to help close these protection gaps is also essential. Climate change and the recent experiences of the COVID-19 pandemic have driven a surge in risk awareness. With this has come a corresponding need for and appreciation of better protection systems. Insurance has a critical role to play here in boosting the development of new solutions and systems to help match rising expectations.

Accordingly, the Insurance Development Forum and The Geneva Association have collaborated to produce this report, which addresses the role a country's laws, regulations and broader government policies can have in facilitating or hindering the development of a robust and secure insurance market; that is, an insurance market that can support individuals, companies and the government itself in harnessing the skills and capabilities of the insurance sector to reduce losses and provide financing for the losses that do occur.

There is much that can be done to close existing and emerging protections gaps. Urgent action is needed, for the consequences of not acting will have devastating consequences for many. We hope this report will stimulate discussion and importantly, spur necessary action.

Jad Ariss
Managing Director
The Geneva Association

Ekhosuehi Iyahen
Secretary General
Insurance Development Forum

1. Executive summary

Over the past few decades, the economies of many emerging markets have grown rapidly, lifting millions out of poverty and creating a rising 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. An increase in climate-change-related events, COVID-19 and other catastrophes have heightened people's sense of vulnerability. For that reason, it is of great concern that insurance penetration in emerging markets remains low.[1,2] As a result, many of the individuals, households and businesses in the 14 markets covered in this study remain exposed to the risk of falling back into poverty and financial ruin.[3]

> Many individuals, households and businesses in emerging markets remain unprotected and exposed to the risk of falling back into poverty and financial ruin in the event of misfortune.

This report considers what it would take to develop insurance markets in emerging economies. It analyses 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.

Based on an analysis of the legal, regulatory and broader government policy environments in 14 markets, this report finds that a common set of 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.

In light of these factors and a study of development initiatives in a few countries, there also appear to be concrete steps that a jurisdiction can take to help close protection gaps. This report presents a number of recommendations for policymakers, regulators and insurers, including:

- 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

1 OECD 2022.
2 The Geneva Association 2018. Author: Kai-Uwe Schanz.
3 Markets include Argentina, Brazil, Chile, Colombia, India, Indonesia, Mexico, Morocco, Nigeria, Peru, Philippines, South Africa, Thailand and Vietnam.

- Removing overly restrictive market access barriers to insurers and reinsurers to derive the benefits of competition, innovation and global risk diversification
- 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

The literature review covered in the first part of the report reveals that 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.

> A key barrier to insurance demand in most emerging markets is the low level of financial or, more specifically, insurance literacy.

As shown in numerous studies, a key barrier to insurance demand in most emerging markets is the low level of financial or, more specifically, insurance literacy. This translates into a lack of understanding and formal tools to manage risk and vulnerability. According to the experts we interviewed, 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 not only be developed as a joint effort between insurers, regulators and the government, but also form 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.

All 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. Regulators often 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 understanding of how insurance contributes to making societies more resilient.

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 both educating decision-makers in government about insurance and jointly working through the political processes to drive the needed legislative changes forward.

To build political support, it is important for policymakers to appreciate the essential role of insurance in economic and societal prosperity, and devote sufficient attention and resources to insurance regulation and supervision as well as financial education.

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.

2. Introduction

Since the beginning of this century, emerging markets have made an ever-increasing contribution to global insurance premium growth.[4] Although insurance markets in emerging economies grew faster than in mature economies over the past ten years,[5] the momentum has primarily been driven by expanding middle-class populations and strong economic growth. At the same time, insurance penetration (premiums as a share of GDP) in emerging markets has only reached about 35% of the level recorded in mature insurance markets.[6] According to Swiss Re's Sigma database, the weighted average insurance penetration across the 14 markets[7] discussed in this report has increased from 1.9% in 2005 to 3.3% in 2020.[8] Compared to the average insurance penetration across OECD markets, which grew from 8.6% in 2005 to 9.4% in 2020, the gap has narrowed slightly but is still significant. These figures illustrate that while devastating protection gaps – the delta between insured and economic losses after catastrophic events – exist globally, they are most severe in emerging markets.[9]

To understand and address the drivers of underinsurance in emerging markets, it is important to look at how public policy and regulatory incentives and barriers can impede the development of insurance and its contribution to sustainable economic development.

To understand and address the drivers of underinsurance in emerging markets, it is important to look at how public policy and regulatory incentives and barriers can facilitate and/or impede the development of insurance and its contribution to sustainable economic development. The 1997 survey paper by Harold D. Skipper[10] is one of the first examining the potential contribution of insurance to economic growth in emerging markets, both as a provider of risk transfer and indemnification and as an institutional investor, more specifically through: (i) promoting financial stability, (ii) facilitating trade and commerce, (iii) mobilising domestic savings, (iv) allowing different risks to be managed more efficiently by encouraging the accumulation of new capital, (v) fostering a more efficient allocation of domestic capital, and (vi) helping to reduce or mitigate losses.

Building on this work, the World Bank 2006 offers a systematic assessment of the impact of insurance market activity (proxied by insurance premiums) on

4 Insurance Information Institute 2020.
5 Swiss Re 2021.
6 Swiss Re 2021.
7 Markets include Argentina, Brazil, Chile, Colombia, India, Indonesia, Mexico, Morocco, Nigeria, Peru, Philippines, South Africa, Thailand and Vietnam.
8 Swiss Re Sigma Database 2022. South Africa is excluded from this calculation given its exceptionally high and institutionally driven life insurance penetration of almost 14%.
9 The Geneva Association 2018.
10 Skipper 1997.

economic growth.[11] They found robust evidence of a causal relationship between insurance market activity and economic growth, both for life and non-life insurance.

This thinking has increasingly permeated the regulatory space, for example in the 2020-2024 Strategic Plan of the International Association of Insurance Supervisors (IAIS), with its heightened focus on financial inclusion and protection gaps.[12]

2.1 Building on previous research

Starting in 2014, The Geneva Association has systematically explored the root causes of and potential remedies to different shapes of protection gaps, defined as the gap between insured and economic losses. The following paragraphs summarise the current state policy as well as regulatory barriers and incentives in the context of such protection gaps, helping to identify areas that warrant further examination.

Policy and regulatory shortcomings

The Geneva Association 2018 report sheds light on various legal, regulatory and institutional obstacles that can contribute to the emergence and persistence of protection gaps.[13] In many emerging markets, the legal environment – as reflected in proper contract and dispute resolution laws – is weak and rules cannot often be enforced. Apart from an effective legal framework based on the rule of law, a sound regulatory framework is essential to enabling a stable insurance market and protecting policyholders.

In low- and lower-middle-income countries in particular, insurance regulatory frameworks are often less developed than those in mature economies.[14] Importantly, regulatory regimes need to be aligned with the insurance market's level of development. As our study shows, there is more to adequate regulatory frameworks than the implementation of risk-based solvency. Adequate regulatory frameworks also address market conduct, proportionate approval and licencing requirements, robust implementation and enforcement, and transparent regulatory and supervisory processes. Regulatory modernisation initiatives are ideally undertaken in consultation with the industry and tailored to market-specific circumstances to foster market development and innovation.[15]

Rudimentary or insufficiently enforced frameworks are clearly not conducive to risk-based pricing, adequate risk retention, product innovation, fair treatment of customers, or the overall resilience and stability of insurance markets. Under such circumstances, corporate defaults and mis-selling scandals, which undermine consumer confidence in the insurance sector, are more likely. This is a particularly severe threat in nascent markets.[16]

Public policy and regulatory incentives and remedies

> Government policies can have a profound impact on an individual's access to appropriate and affordable insurance.

Government policies can have a profound impact on an individual's access to appropriate and affordable insurance. This is sometimes done by introducing compulsory schemes, which create sufficiently large risk communities and risk pools. This of course cannot be done by insurance regulators alone, but requires collaboration across government entities at different levels. In addition, mandatory schemes can mitigate adverse selection by standardising premium rates across risk types, enabling the cross-subsidisation of higher-risk policyholders with the premiums from lower-risk policyholders. Such schemes can be accompanied by premium subsidies for low-income households.[17] For good customer outcomes, mandatory insurance schemes need to be accompanied by an adequate market conduct regulatory framework.

Public-private partnerships (PPPs) can be another powerful remedy in emerging markets. They can leverage existing public-sector infrastructure to enable wider distribution of insurance products, roll out products more quickly and realise benefits from pooling and diversification. Government-subsidised insurance programmes can also promote insurance penetration. In India, the Pradhan Mantri Fasal Bima Yojana (PMFBY) PPP scheme, which was mandatory until 2020, made crop insurance one of the biggest segments in the country's non-life insurance market.[18]

11 Arena 2006.
12 IAIS 2019.
13 The Geneva Association 2018.
14 Based on the World Bank's most recent country classification, low-income countries exhibit a GDP per capita of roughly less than USD 1,000, lower-middle income countries of between USD 1,000 and USD 4,000, and upper-middle income countries of between USD 4,000 and USD 12,000. The wealthier high-income countries are not covered by this publication.
15 The Geneva Association 2014.
16 Ibid.
17 Kousky and Kunreuther 2014; Kunreuther 2015.
18 The Geneva Association 2018.

Public-private partnerships (PPPs) in emerging markets can be a powerful remedy by leveraging existing public-sector infrastructure to enable wider distribution of insurance products, as well as roll out products more quickly and realising benefits from pooling and diversification.

It is also important for the regulatory environment to be responsive to consumer and industry needs, including effective, efficient, timely and transparent licensing and product approval decisions; reasonable accommodation of innovative distribution models; acceptance of new risk capital structures, such as insurance linked securities; and the use of parametric products where appropriate.

As a complement to improving risk transfer, protection gaps in emerging markets also need to be addressed through the prevention and reduction of losses. Government-sponsored building codes, for example, are essential to establishing and enforcing risk reduction measures.[19]

Finally, in order to maximise the potential of insurance, governments should refrain from establishing discriminatory access barriers to international insurers. While support for developing local insurance markets should be considered, policyholders and indeed local insurers benefit from a liberal market regime that allows access to international players' knowledge, expertise and capital.[20] This is also true for the reinsurance industry, which helps to spread the financial impact of a disaster among many carriers outside the national economy.[21] As the business model of insurance is based on risk pooling and diversification, '…national borders should not limit the pool'.[22]

2.2 Research objectives and methodology

Against this backdrop, this report pursues the following objectives:

- Establish a balanced overview of regulatory and supervisory practices in emerging markets based on the link between insurance regulation and insurance market development
- Identify and assess relevant public policies and frameworks that are spurring or hindering insurance market development
- Sensitise lawmakers and regulators to the benefits of promoting insurance market development and its contribution to economic and societal resilience
- Formulate actionable, research-based recommendations for policymakers, regulators and insurers.

The underlying methodology goes beyond an in-depth review of relevant academic and non-academic references. It also incorporates findings from structured interviews with key stakeholders (including local regulators and supervisors), local insurance undertakings, global insurance firms active or in the process of entering emerging markets, and multilateral organisations, such as the Organisation for Economic Co-operation and Development (OECD), Asian Development Bank (ADB), Access to Insurance Initiative (A2ii) and Insurance Development Forum (IDF).[23]

19 The Geneva Association 2014. Authors: Kai-Uwe Schanz and Shaun Wang.
20 Skipper 1997.
21 GRF 2021a.
22 Baltensperger and Bodmer 2012.
23 See section 5.1 for further details.

3. The rationale for regulatory intervention in insurance markets

The basic rationale for insurance regulation as indicated in the previous section is the remediation of market failures and protection of policyholders and consumers. Market failures that call for regulatory intervention include, among others, the asymmetric distribution of information between insurance customers and insurers as well as the impact of insolvency.[24] Against this backdrop, the following section examines the basic economic principles that should govern the regulation of insurance and employs these principles in assessing various regulatory tools.

3.1 Market failures in insurance

Insurers in emerging markets may engage in aggressive market practices that could harm customers – especially households and individuals with low levels of financial literacy and difficulty judging the financial risk of insurers and terms of insurance contracts. Another potential manifestation of this behaviour is the possibility that insurers engage in anti-competitive practices to restrict competition. This behaviour could result in barriers to entry and excessively high prices, both of which stifle insurance market development.[25]

Governments could remedy this type of market failure through appropriate and proportionate market conduct regulation, antitrust measures or price regulation to ensure that the prices charged reflect competitive market conditions. If, however, high insurance prices are due to elevated levels of risk with regulators trying to enforce lower prices, this might do more harm than good by discouraging insurance supply and innovation.[26]

Asymmetric information problems in the form of adverse selection and moral hazard also tend to be more pronounced than in more mature insurance markets.

Asymmetric information problems in the form of adverse selection and moral hazard also tend to be more pronounced than in more mature insurance markets. There, insurers can use effective underwriting, pricing, and deductibles and exclusions to keep adverse selection and moral hazard to acceptable levels. But in less mature markets, loss data and estimates are not as easily available. As fewer people are

24 Porrini 2017.
25 Klein 2013.
26 Ibid.

familiar with the basic underlying concepts of insurance, they may not fully understand what is being explained to them by agents. Insufficient insurance knowledge coupled with poor market practices can translate into distrust, with toxic implications for market development.[27]

3.2 Regulatory approaches to market failures

3.2.1 Solvency regulation

Insurers generally have greater levels of information regarding the riskiness of their portfolio than their customers. It would be (prohibitively) costly for policyholders to redress this imbalance, especially in low-income and low financial literacy environments. Solvency regulation helps signal the financial health of an insurance company to the market, which is particularly relevant because most consumers do not have the requisite expertise to conduct a financial review of their insurance carrier.[28]

Solvency regulation is designed to protect the overall stability of insurance markets. Regulators are concerned about 'contagion' where a spike in insurer insolvencies could undermine policyholder confidence in financially healthy carriers, with incalculable consequences.[29] In emerging markets where trust in financial institutions is still nascent and fragile, insurer insolvencies represent major setbacks for market development.[30]

3.2.2 Price regulation

According to Klein,[31] there are two potential reasons for regulation of insurance prices. The traditional explanation is predicated on solvency concerns. Individual insurers may be tempted to engage in detrimental or even ruinous price competition, which forces other market participants keen to retain their share of the business into predatory pricing and a destructive 'race to the bottom'. In the USA this view underpinned uniform prices in property and casualty insurance developed by industry-rating organisations, until the 1960s.

Another reason could be the public's preference for regulatory policies to cap insurance prices in line with social norms or objectives. This helps to explain why insurance prices are regulated in some circumstances, such as when governments compel customers or firms to buy certain types of insurance. However, price regulation can create harmful market distortions; for example, in markets where they do not reflect the true risk exposure. In many mature insurance markets, however, such regimes have disappeared. In this case, both life and non-life insurance markets tend to be highly competitive in terms of their structure (e.g. a sufficiently large number of providers, low concentration levels and barriers to entry) and performance (e.g. profitability levels commensurate with underlying risk).[32]

In emerging markets, price and product regulation is more prevalent given the local insurance industry's lower maturity, in terms of not only capital strength, risk management and pricing expertise, but also availability of data and effectiveness of supervision. But in these countries, too, there is a clear trend towards price and product liberalisation, for example in China and Malaysia, on the back of increasingly sophisticated risk-based solvency regimes.[33]

3.2.3 Market conduct regulation

While price regulation has become less prominent, market conduct regulation is gaining in relevance. This kind of regulation covers insurer market practices, such as product design, marketing and claims adjustment, and addresses the negative consequences of asymmetric information. The economic case for such regulation is obvious, with the bargaining power between insurers and their customers unequally distributed. There are constraints on customer choice due to, for example, low levels of financial literacy, which can make some customers vulnerable to aggressive marketing and claims practices of insurers and their agents, even in competitive markets.[34]

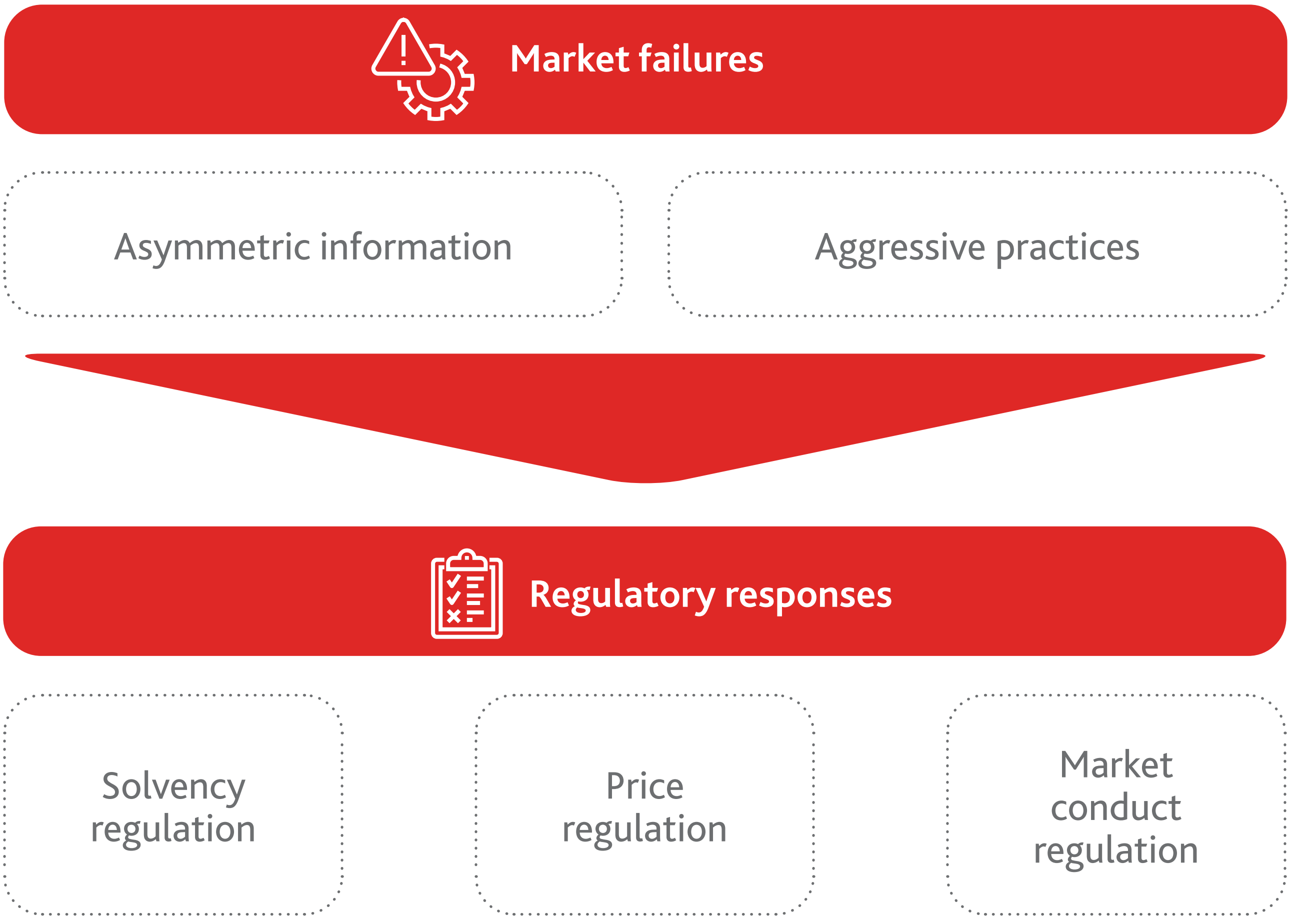
> There is abundant evidence that customers in emerging markets are often less equipped to understand insurance and other financial products, and can be misled by high-powered sales campaigns.

In emerging markets, there is also abundant evidence that customers are often less equipped to understand insurance and other financial products, and can be misled by high-powered sales campaigns. India is a case in point. At the beginning of the century, life insurers pursued

27 Biener et al. 2013.
28 Ibid.
29 ESRB 2018.
30 Porrini 2017.
31 Klein. 2012
32 Grace and Klein 2007.
33 Swiss Re 2017.
34 Klein 2012.

aggressive unit-linked growth strategies in the absence of customer-oriented conduct regulation. This led to severe incidents of mis-selling with significant losses to customers. In 2011, regulatory constraints were imposed on the sale of unit-linked insurance policies.[35]

Figure 1: Economic rationale for regulatory intervention in insurance markets



Source: The Geneva Association; IDF

35 Halan et al. 2014.

4. Core elements of effective regulation and supervision in emerging markets

As outlined in the previous section, an appropriate insurance regulatory system is critical to harnessing insurance for economic and societal development in emerging markets. A conducive regulatory environment would simultaneously ensure the financial strength of insurers and intermediaries, promote healthy levels of competition, encourage innovation in risk assessment and risk pricing, facilitate access to all forms of reliable capital, and provide necessary market conduct and product regulation.[36]

There is a particular need for adequate regulation in light of 'the inverted production cycle of insurance' where premiums are paid upfront.[37] This adds to the importance of consumer protection, especially in low-income markets. Although the time span between the collection of premiums and the settlement of claims is relatively short (i.e. 1–2 years) in most non-life insurance activities, it can extend to decades in certain life and non-life insurance segments.[38] This is why insurance markets will only be able to grow, flourish and fulfil their economic role in the economy, if policyholders believe and trust that insurers will actually be able and willing to make payouts when insured events occur.[39]

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.[40] The second is the conduct dimension, which addresses the performance of re/insurers in carrying out their duties to customers and other stakeholders.[41] A third possibility, which is currently a topic of debate within regulatory circles, revolves around the role of insurance in enhancing financial inclusion, whether through public, private or hybrid mechanisms.[42, 43, 44]

Emerging markets require a distinct approach to insurance regulation and supervision.[45] In more mature environments, insurance regulation has become

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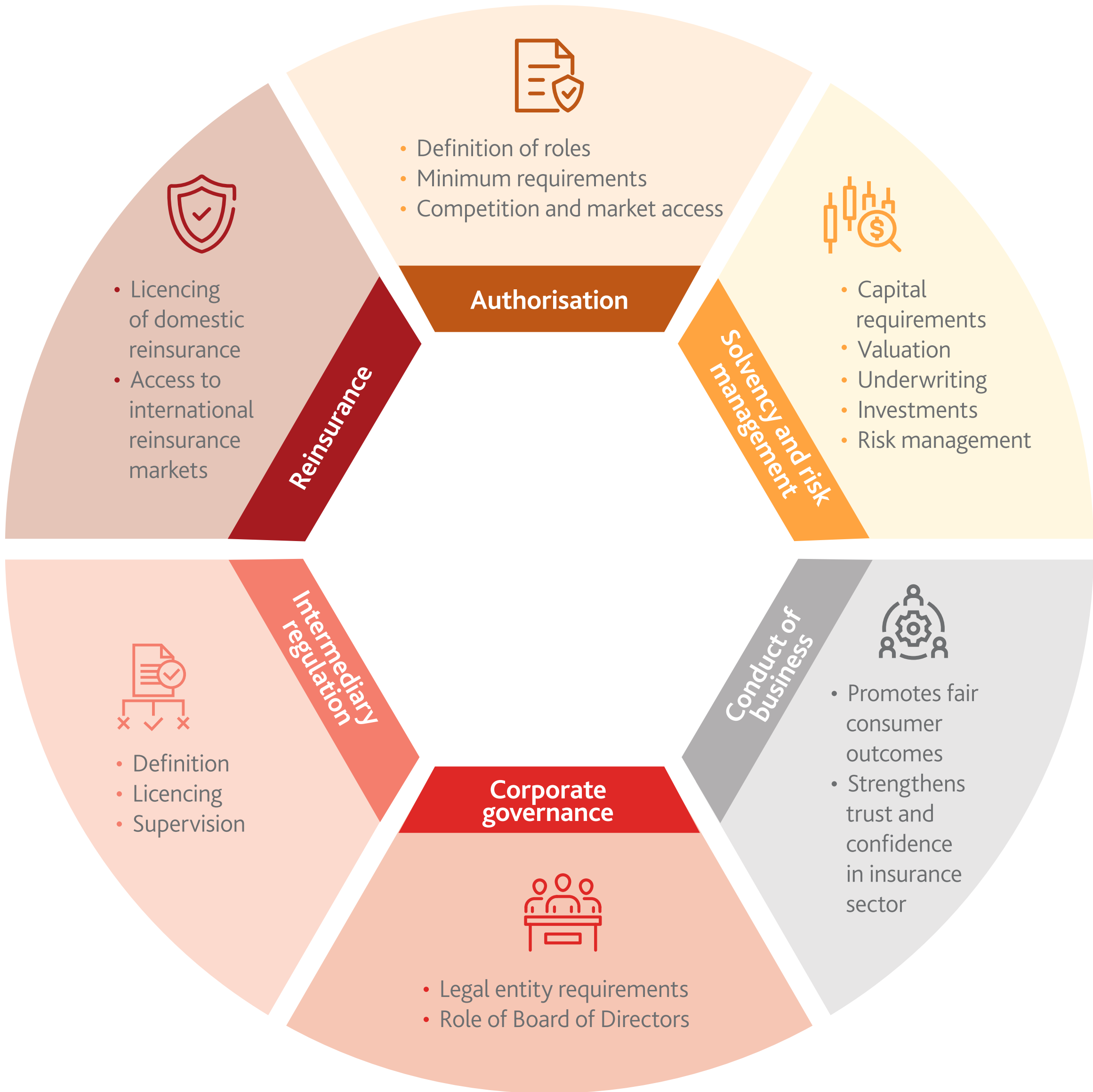
36 Skipper and Klein 2010.
37 IAIS 2011.
38 University of Cambridge 2015.
39 The Geneva Association 2019.
40 Marano and Siri 2017; OECD 2020a.
41 Norton Rose Fulbright 2014; OECD 2020a.
42 Biener et al. 2014.
43 CISL 2015.
44 See OECD 2018 page 43 for an overview of the different objectives and mandates of insurance regulation and supervision, based on a poll conducted in 50 countries.
45 Although not specifically addressed here, there are also microinsurance-specific regulatory frameworks (see section 5).

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.[46] 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'[47] and opt to balance prudential and market development objectives.[48]

Against this backdrop, we propose a 'hexagon' of key legal, regulatory and supervisory elements in emerging insurance markets, with a generic taxonomy of regulatory and supervisory practices. This framework allows us to analyse insurance market development in emerging countries in the following sections, including the executive interviews (see Figure 2).[49]

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



Source: The Geneva Association; IDF[49]

46 United Nations Conference on Trade and Development (UNCTAD) 2007.
47 IAIS 2019.
48 OECD 2020b.
49 IDF 2021. http://www.insdevforum.org/wp-content/uploads/2021/07/IDF-Insuring-Resilience-report-on-Critical-Legal-Regulatory-and-Policy-Architecture.pdf

Authorisation

A basic framework of authorising or licencing laws can be considered the backbone of an effective system of insurance regulation and supervision. Among other elements, it should include:

- The recognition of the role and authority of the supervisor or regulator, as well as its mandate, objectives, discretion, legal foundation and legal powers (this also includes, for example, the power to issue licences and apply conditions or limitations to licences, enforcement powers for failure to meet regulatory requirements, conditions and ongoing supervision)
- A wide range of business models, processes, potential market participants, including foreign providers of insurance linked securities (ILS) and other capital markets products and service providers
- Minimum requirements in areas such as licencing (e.g. entity identification), financial reporting, operations and pricing (e.g. actuarial soundness of rates)[50]

Solvency and risk management

Solvency rules are an important regulatory tool to protect policyholders and heighten trust in the insurance business. They are designed to ensure that insurers can live up to the promises they make to policyholders.

To account for uncertainty around the timing, frequency and severity of events, insurers are required to hold adequate levels of capital in addition to reserves for unassumed risks. The insurance regulator establishes the solvency rules in its jurisdiction, while the supervisors oversee insurers' adherence to the rules.

More specifically, solvency and risk management regimes in emerging markets should provide for:

- Appropriate minimum capital requirements
- Solvency control levels and supervisory intervention triggers, with rules on the identification and treatment of available capital resources to absorb losses
- Criteria for the assessment of capital charges
- Rules on how to value assets and liabilities for solvency purposes
- Guidance for control functions (e.g. actuarial, compliance, internal audit, risk management) and investment regulations[51]

Conduct regulation

Consumer trust is the prerequisite for insurance markets to develop and thrive.[52] With that in mind, market conduct regulation concerns the insurers' compliance with laws and regulations as well as their fair treatment of customers. From a trust-building perspective, the key objectives of conduct regulation include:[53]

- Protecting policyholders by ensuring fair consumer outcomes, such as the prompt payment of legitimate claims and timely handling of complaints
- Reinforcing honest and transparent sales practices, including the transparent provision of high-quality information to customers
- Ensuring that insurers act with due skill, care and diligence in their interaction with customers

Corporate governance

For insurers to operate effectively, there must be a system of rules, practices and processes in place. Corporate governance systems are designed to balance the interests of a company's many stakeholders, from shareholders, senior management executives, customers and suppliers to investors, government and communities.

The most important governance elements for insurance companies are as follows:

- Organisational structure and type of entity e.g. publicly traded, privately owned, or mutual, cooperative or community-based organisations (MCCOs)
- Internal oversight and management e.g. board composition and structure, suitability of board members, board powers and delegation to senior management, fiduciary duties
- Change of control process
- Company winding up or exiting[54]

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50 IDF 2021.
51 IDF 2017; World Bank 2004.
52 NAIC 2021.
53 IAIS 2019.
54 OECD 2017.

Intermediary regulation

The individuals and organisations with the most customer interaction are critical to the reputation and level of trust placed in the insurance carrier. Therefore, appropriate regulatory and supervisory frameworks for intermediaries are required. Ideally these will contain:

- A wide range of business models and service providers in intermediation
- Licencing requirements, including those applicable to intermediaries operating on a cross-border basis from outside the jurisdiction
- Minimum financial resource requirements
- Ongoing supervision of compliance
- Rules on fees and commissions[55]

Reinsurance regulations

As reinsurers typically do not deal directly with the policyholder, the consumer-protection-driven reasons for insurance regulation apply less to reinsurance companies. In addition, reinsurance as a business-to-business transaction does not typically require specific regulation of policy forms and contract wordings. However, the cross-border nature of most reinsurance transactions has driven the rise of specific regulations to protect the interests of domestic ceding companies. In this context, it is worth highlighting that reinsurance benefits economies and societies by providing risk diversification on a global scale. The global nature of many reinsurers allows them to offset large risks in one region against risks (different or the same) in other regions. In earthquake-prone regions such as Chile and New Zealand, the majority of insured earthquake losses are paid by foreign reinsurers, without which these risks would be uninsurable.[56] Research has shown that in countries where a relatively larger share of risk is transferred to international reinsurance markets, economies recovered more quickly in the aftermath of the event.[57]

Foundational requirements

In addition to specific insurance regulations as presented in the hexagon, general laws and regulations provide a robust and reliable legal framework that instils trust and provides support to commercial operations. This is particularly true for the formation and enforcement of contractual rights i.e. basic 'rule of law' requirements and more specifically includes:

- Contract execution
- Contract interpretation
- Dispute resolution mechanisms
- Arbitration laws
- Damages
- Enforcement and recognition of judgements
- Insolvency and bankruptcy rules[58]

The core elements of effective regulation and supervision listed in this chapter are important for a number of reasons. Above all, good insurance businesses thrive in a well-regulated, efficient and predictable legal environment. Insurers want a market that is – and seen by policyholders and investors as – reliable and secure. At the same time, there is a need for market access, including clear procedures governing licencing, cross-border reinsurance, product launches and other operating requirements. In addition, required regulatory approvals need to be pursued in a timely and transparent manner. Without these attributes, the legal and regulatory environment will discourage market entry, stifle innovation and reduce competition, all to the detriment of policyholders.

Earlier studies, such as those conducted by A2ii (and discussed further below), demonstrate that the critical legal and regulatory environment for emerging markets goes beyond insurance laws and regulation. A case study of insurance regulatory reforms in the Philippines (2010-2013) demonstrates that comprehensive reforms went beyond (micro) insurance regulation to include the enhancement of alternative dispute resolution options, which is a good example of a trust-enhancing mechanism.[59] One could supplement this list of critical laws with tax policies, securities law regulation, intellectual property (IP) laws and laws governing the use of information technology as well as data protection regulation.[60] The breadth of relevant laws also makes clear that insurance regulators cannot be responsible for all actions needed to create an enabling environment for insurance markets. Governments and legislators must be involved, too. This speaks to the importance of a (top of) government-led drive behind any reform seeking to enhance the role of insurance in economic growth and stability.

55 OECD 2020b.
56 GRF 2021a.
57 OECD 2018.
58 OECD 1999.
59 Access to insurance initiative (A2ii) 2016.
60 IDF 2021.

5. From theory to practice: Insights from 14 countries

The theoretical part of the report was enhanced by 31 interviews to apply the core elements of the taxonomy of insurance regulation to the practical realities in emerging markets. Interviews were conducted with experts and executives of nine insurance companies, seven national insurance associations and one broker, as well as 11 representatives of the regulatory community and one representative of a development bank.

The interviewees represent emerging economies across Latin America, Africa and Asia, with market selection based on population size and insurance penetration. The featured markets, representing USD 332 billion of direct life and non-life premiums, are as follows:

- **Latin America:** Argentina, Brazil, Chile, Colombia, Mexico and Peru
- **Africa:** Morocco, Nigeria and South Africa
- **Asia:** India, Indonesia, the Philippines, Thailand and Vietnam

Interview questions revolved around the following themes: general barriers to insurance market development, specificities of the regulatory framework, government policies and the legal framework.

Influences on market development can be classified into supply-side and demand-side factors. On the demand side, financial literacy, affordability and trust are among the most critical, whereas access to markets, capital and risk appetite, as well as underwriting expertise, drive insurance supply.

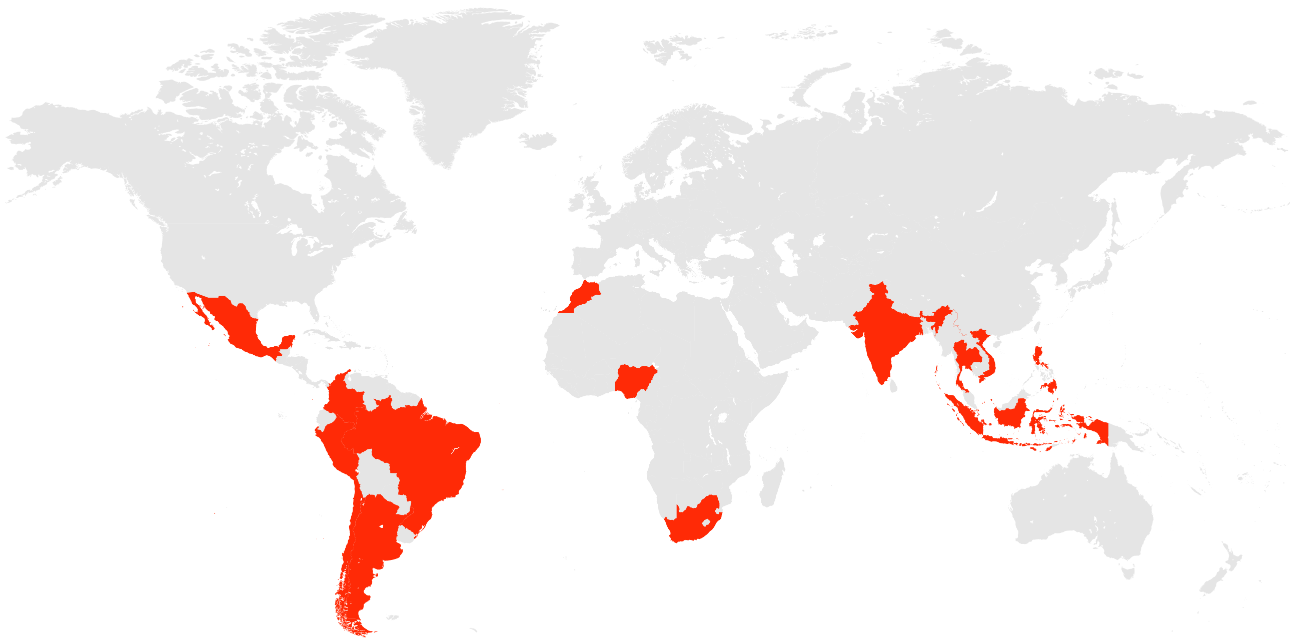
Public policies as well as insurance-specific regulation shape both supply and demand-side factors. Regulatory frameworks need to be aligned with the level of market maturity. In addition, sufficient resources and skills are required to conduct effective supervision. Our research found that these conditions are not always met, which in large part can be attributed to an insufficient understanding of insurance markets at a political level, as that is where resource allocation decisions are made.

On the demand side, affordability issues can be addressed through microinsurance as well as premium subsidies. For this reason, the practical section of this report takes a deep dive into public policies and initiatives to address these barriers.

Identified supply-side barriers relate to the legal, public policy and regulatory environment that shapes the behaviour of insurers. This can affect their ability to innovate both in terms of products they bring to the market as well as the types of distribution channels to reach customers. The regulatory framework also determines the speed of product and other relevant approvals as well as insurers' leeway as investors. Finally, market access is another supply-side factor and is particularly critical for reinsurers and the availability of sufficient risk-absorbing capacity in local markets.

> Misunderstanding contract clauses and exclusions may cause the insured to wrongly think that they have been swindled if not compensated due to an exclusion. This is very harmful to trust in insurance. – ***Salaheddine Aji, Deputy General Director, FMSAR, Morocco***

Figure 3: 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

5.1 The role of regulation in insurance market development

Our interviews also shed light on the role of regulatory capabilities and mandates, solvency frameworks, rate and form regulation, and microinsurance regulatory frameworks.

5.1.1 Capabilities, mandates and matching practical realities

The previous section identified many of the attributes of an enabling legal and regulatory environment for insurers. But laws and rules 'on the books' alone are not sufficient. When the implementation of regulatory frameworks is not sufficiently robust or sensible, it dilutes their good intentions. The importance of adequate implementation is underscored by a recent World Bank paper, which states: 'to secure the benefits of risk-based approaches to foster development, implementation processes are at least as important as risk-based formulas.[61] Implementation issues are often the result of inadequate resources, capacity and capabilities, not least caused by insufficient support at the political level.

The success of pursued enhancements largely depends on the extent to which implementation is carried out in a tailored, consultative and professional way. The pace of change needs to be matched by improved technical capabilities on the part of the regulator. If these conditions are not met, ambitious intentions could lead to unintended consequences, a misallocation of resources and ultimately have a negative effect on insurance penetration levels.[62]

Understaffing and insufficient training may also cause practical deficiencies in the implementation of regulatory reforms. The result in many jurisdictions is weak enforcement of core regulations and laws, which mainly exist on paper. As discussed earlier, many markets have adopted risk-based capital (RBC) frameworks, but when regulator capacity is severely constrained, regulatory approaches tend to remain stringent and rules based rather than principles based.

Of note, regulatory authorities depend on political support when it comes to modernising the insurance regulatory framework. We found that a lack of political appreciation for the work of insurance regulators is not uncommon and may negatively affect implementation and enforcement of regulation.

Another challenge occurs when the insurance regulatory authority is part of a combined financial services regulator. Banking often receives greater attention and resources than insurance. In addition, banking experts who are less knowledgeable about insurance business models tend to make the critical decisions within these organisations.

> Risk-based solvency regimes are fine, but many regulators and insurers in those markets lack proper understanding of what it means. Often they say they want Solvency II, without understanding what responsibilities they must fulfil as well as the costs.
> ***–Arup Chatterjee, Principal Financial Sector Specialist, Asian Development Bank***

Our interviews also explored the extent to which regulators have a mandate to develop insurance markets. An often-used yardstick for gauging insurance market development is insurance penetration, defined as premiums as a share of GDP. This measure, however, does not indicate how many people are insured and to what degree. Other more helpful measures could be the percentage of households and businesses with insurance and the level of 'protection gaps' (insured losses as a share of total losses).[63] Yet in emerging economies, data on these indicators are often unavailable. As a result, it is hard to measure the effectiveness of insurance market development initiatives, which was a recurring theme in our interviews, especially in the context of microinsurance regulation.

> Because data in emerging economies are often unavailable, it is hard to measure the effectiveness of insurance market development initiatives.

In addition to their core mandates of policyholder protection and financial stability, a number of insurance regulatory authorities also have an insurance market development remit.[64] However, such a mandate is often seen in the narrow sense of developing products for the low-income population. In turn, other important aspects are neglected, such as responding to the evolving risk-protection needs of rapidly growing middle classes and the development of a well-functioning insurance market, with more organic capacity to meet the needs of a wider range of customer segments.

61 World Bank 2020c.
62 MAPFRE Economics 2018.
63 Swiss Re 2017.
64 OECD 2020a.

As its name suggests, the Insurance Regulatory and Development Authority of India (IRDAI) is an example of an authority that has made insurance market development a core part of its mandate, statutory objectives and the underlying insurance act. It has promoted orderly market growth on the back of its success in helping to build insurance awareness and work with other government agencies.

> What makes a regulator a good one? A regulator that participates and engages in market development, on top of their other usual roles. What is lacking in many countries is the right political attention to the insurance industry and the lack of capacity and resources of the regulatory authorities. ***–Corneille Karekezi, Group Managing Director & CEO, Africa Re***

One identified obstacle to embracing the market development mandate is the perception among some regulatory and supervisory authorities that the pursuit of this objective could come at the expense of achieving two core objectives: consumer protection and financial stability. A 2007 IAIS Issues Paper on the topic of microinsurance, however, suggests that a market development mandate actually helps to achieve the other regulatory objectives.[65] Other research confirms that mandates related to development and financial inclusion are compatible with the financial stability objective,[66] provided there are synergies between the policies and tools used to achieve both objectives.[67]

5.1.2 Solvency regulation

Risk-based solvency regimes are progressively being implemented across the globe, including in emerging economies. Capital frameworks may spur or restrict insurance supply. Under risk-based frameworks, capital charges depend on the underlying risk profile of the insurer, typically leading to lower capital charges for insurers with lower risk profiles and strong risk management capabilities. Previous research conducted across Latin American markets indicates that insurance penetration improves following the implementation of a risk-commensurate capital framework.[68]

One third of the regulators surveyed for this report confirmed that their jurisdiction has a risk-based solvency framework in place, with another third transitioning to a risk-based system. Although the weighted-average insurance penetration across the emerging markets included in this study (and across life and non-life business lines) has gone up from 1.9% in 2005 to 3.3%in 2020[69], we could not isolate the impact of risk-based capital (RBC) implementation on insurance penetration rates. Much of the improvement in penetration can likely be attributed to an increase in GDP per capita, which is widely considered the single most important determinant of insurance demand.[70]

In practice, implementation of RBC regimes often progresses slowly, despite regulatory intentions. This is frequently caused by insufficient support or understanding at the political level as well as the limited availability of resources and expertise within the regulator.

Risk-based frameworks are met with resistance in a number of jurisdictions. In Nigeria, the regulator tried to implement RBC in 2018, causing insurers to fear significantly higher capital requirements. The regulatory authority was then taken to court, which ruled that the new regime was not compliant with the Insurance Act. Because the old static solvency regime remains in place, insurers are required to hold a fixed amount of capital, regardless of the products they underwrite. In jurisdictions with broader support for risk-based capital frameworks, executives echoed the need for better coordination and communication among regulators, insurers and legislators to smooth the path towards RBC.

Other markets, notably several in Southeast Asia as well as Colombia, have finalised the implementation of RBC or are moving forward quickly. While insurance executives in these markets pointed to their positive experience with these frameworks, they noted a weakness in proper implementation and enforcement. In other markets, notably Chile, the bill introducing RBC has been under discussion in parliament since 2011. The current minimal capital requirements, however, have worked well for the industry, even in times of stress, such as during the 2008 financial crisis and the severe 2010 earthquake [71], with no insurance failures since 2004.[72]

> We are positive about the efforts to implement risk-based capital, but better implementation is needed. In several lines, competition is fierce and rates are insufficient. ***–Allan Santos, President & CEO, National Re, Philippines***

65 IAIS 2007.
66 Imboden 2020.
67 Melecky, Cihak and Mare 2016.
68 MAPFRE Economics 2017.
69 Swiss Re 2022. South Africa has been excluded from this calculation given its exceptionally high and institutionally driven life insurance penetration of almost 14%.
70 Enz 2000.
71 Swiss Re 2011. The 2010 earthquake in Chile resulted in approximately USD 30 billion in economic losses and USD 8 billion insured losses.
72 Caused by financial crime conducted within the financial conglomerate, which included the insurance entity.

5.1.3 *Rate and form regulation, and innovation in insurance markets*

Many regulatory authorities aim to ensure in advance that new products entering the market are viable and prices are set in an actuarially sound manner. At the most stringent extreme of the spectrum lie models requiring prior product authorisation and rate (i.e. premium) regulation. More moderate regimes are based on 'file & use' whereby a product can be launched directly after registering it. Earlier research has indicated that the pre-approval requirement for new products makes it difficult for insurers to 'issue new products that adapt to the specific circumstances of the moment and new needs of customers'.[73] Our interviews confirm this: the approval requirement is problematic as is the time needed, as it can range from several months to more than a year.

Thailand is a highly regulated market, (and) all policy wordings and prices are subject to approval… (and) these are holding the market back. ***– Kheedhej Anansiriprapha, Executive Director, TGIA, Thailand***

Insurers in markets with less stringent regulatory approaches to rate and form, such as India and Morocco, indicate that their regimes positively affect innovation and the insurers' abilities to meet customer needs. The Moroccan regulatory authority (ACAPS), for example, facilitates the proactive development of new insurance products by not applying any pre-approval requirements and through price liberalisation. In fact, some interviewees stress that further liberalisation in the area of digital product development and distribution is needed. Regulatory sandboxes could further accelerate innovation and the efficient testing of new products.

There is huge development potential within the non-life segment which is currently mostly composed of automotive insurance products. Insurers should undertake commercialisation and innovation efforts to diversify the segment. They could also develop new products in areas that show growth potential, such as health. ***– Senior Manager, ACAPS, Morocco***

73 MAPFRE Economics 2018.

5.1.4 *Microinsurance regulation*

Through microinsurance, many emerging economies have undertaken efforts to bring insurance protection to segments of the population that are underserved and unable to afford standard insurance products. Microinsurance can be defined as 'a financial arrangement designed to protect low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of risk involved'.[74] To facilitate the supply of microinsurance, several governments have introduced dedicated microinsurance regulatory frameworks that have different requirements, such as lower capital and reporting requirements, and special licencing schemes. These frameworks aim to incentivise the provision of microinsurance, which would, considering the low premiums and high cost of distribution, be less feasible under existing regulatory frameworks.[75] Although many such initiatives have had a tremendous impact in reaching the most vulnerable in emerging economies and boosting their resilience, our interviews suggest that the success of microinsurance schemes has been mixed. This is because microinsurance regulatory regimes do not always address all of the challenges, such as licencing, product approval and distribution.

As mentioned before, regulatory authorities may pursue market development goals in addition to protecting insurance customers and ensuring financial stability. A related objective is 'the protection of those that cannot access insurance'[76] which can be seen as part of the remit to promote financial inclusion. This is obviously crucial in the context of microinsurance.

To foster an environment in which microinsurance can grow, regulators should allow new players to enter the market and sales through new distribution channels. They can also apply proportionate regulatory requirements while protecting customers that are the most vulnerable and lack the financial knowledge to evaluate (micro)insurance offerings.[77]

At the same time, dedicated microinsurance regulatory frameworks alone are not a guarantee of success. While an effective microinsurance regulatory framework is vital, such as in Indonesia, it may not be sufficient to address commercial challenges. For example, insurers may find they have little incentive to offer these products due to the low premiums, which are not always commensurate with the risk and high distribution cost.

> Regulation has helped to increase awareness and to enhance financial inclusion, but at the same time, some criteria such as the requirement to provide the insured with a paper copy of the policy hinders insurers to scale, which is particularly problematic for the economics of microinsurance. Regulation needs to embrace the huge potential of digital solutions. ***– Lina Vongsa-ath, Chief of Partnerships and Emerging Customers, Mandiri AXA, Indonesia***

In jurisdictions where financial inclusion is a government policy goal, the insurance regulatory authorities take the development of inclusive insurance seriously and adopt a more holistic approach to developing microinsurance frameworks (e.g. by allowing distribution through payment institutions). This is important because 'last-mile costs' are a severe and sometimes prohibitive barrier to reaching the uninsured, especially in rural areas. In some cases, these costs total up to half of the premiums for policies sold in remote areas.

In jurisdictions where financial inclusion is a government policy goal, the insurance regulatory authorities take the development of inclusive insurance seriously and adopt a more holistic approach to developing microinsurance frameworks.

74 Biener, Eling and Schmit 2012.
75 Wiedmaier-Pfister & Chatterjee 2016.
76 Churchill 2007.
77 IAIS 2007.

The following cases spotlight regulatory reforms pertaining to microinsurance in Peru and the Philippines.

SPECIAL FOCUS: How legal and regulatory frameworks relate to market development – Microinsurance as a case in point[78]

Insurance executives emphasise the importance of a well-developed legal and regulatory environment when it comes to decisions on where and how to deploy insurance capital. Yet there are questions about the evidence available to demonstrate that improvement in the legal and regulatory environment leads to market development.

The Access to Insurance Initiative (A2ii) in collaboration with the International Labour Organization (ILO) has done some of the leading work in this area. In 2017 they released two studies with a focus on regulatory reforms and the subsequent growth of microinsurance markets in the Philippines and Peru. These studies revealed some interesting insights.[79]

Both markets launched significant legal and regulatory reform initiatives which were intended to enhance the development of microinsurance. In Peru, the reforms took place from approximately 2007 to 2016 and in the Philippines, from 2004 to 2016. In both countries, the result was an increase in the number of insurers in the market, product offerings and policies issued.

Some of the key success factors identified by these studies are as follows:

- Broad and coordinated political support from the top of the government is essential in setting the tone and the rationale for microinsurance;
- Developing a deep understanding of the vulnerabilities and the risks the reform is attempting to address is important;
- Legal and regulatory reform requires a holistic approach and must address fundamental issues such as rule of law, who can enter the market, what products can be offered (and the process for introducing new products), how to best regulate intermediaries and distribution channels, and the use of technology;
- Proportionality in regulation is required, particularly to accommodate new, smaller entrants to the market;
- Consumer education/enhancing financial literacy is critical, and regulators can and should play a role in this, alongside the objectives set by government;
- Consultation with industry leads to the development of more effective rules and a greater degree of industry buy-in.

Although the A2ii studies were focussed on the development of microinsurance markets, these findings are applicable to insurance markets as a whole, for both personal lines and commercial insurance.

The studies also identified some of the difficulties and deficiencies in obtaining empirical data on the interrelationship between regulations and market growth (or lack thereof). This includes a critical look at what other factors could have driven development of the insurance markets in Peru and the Philippines during the period studied. There is also the need to consider any existing data gaps, including the metrics used to define 'market development' e.g. the number of policies sold, level of product diversity, growth in written premiums, volume and/or percentage of losses covered in the country.

78 Access to Insurance Initiative (A2ii) 2017. The full paper Regulatory Impact Assessments: Microinsurance Regulations in Peru and the Philippines can be accessed through the following link: https://a2ii.org/en/media/134/download

79 IDF 2017.

5.2 Broader public policies and legal frameworks

The following section presents findings on the role of broader government policies and legal frameworks in promoting or hindering insurance development in emerging markets. We will explore the importance of financial literacy and risk awareness, trust-building legal frameworks, tax incentives, mandatory insurance and government subsidies as well as the accessibility of domestic markets to foreign insurers and reinsurers.

5.2.1 Financial literacy and risk awareness

Higher levels of financial education help people make better financial decisions and manage risks accordingly.[80] In effect, higher levels of financial literacy may lead to an increase in demand for insurance products and therefore an increase in insurance penetration.[81] Earlier research has shown that default inclusion of coverage for natural catastrophe risk could be an effective way to enhance risk awareness. This is because policyholders explicitly need to opt-out, and the process of opting out triggers a conversation about the risk and the need for protection.[82] A related key factor determining insurance demand is risk awareness.[83]

In the context of this report, the distinction between idiosyncratic and covariate risk is crucial. In many emerging countries, individuals heavily rely on informal protection mechanisms that exist in their villages and communities, whereby the majority looks after the well-being of the minority. Such mechanisms typically work well in case of idiosyncratic shocks such as the illness of a community member. However, when that entire community gets hit by a covariate shock, such as a natural catastrophe or pandemic, individuals can no longer rely on other community members for support.[84] Awareness of covariate risks therefore becomes the main driver of insurance demand.

Insurance literacy would mean a better understanding of risk and vulnerability so that people are able to distinguish between idiosyncratic and covariate risks. Understanding this positively correlates with appropriate coping strategies under different shocks and demand for insurance. ***– Arup Chatterjee, Principal Financial Sector Specialist, Asian Development Bank***

In all markets covered, the low level of financial literacy was seen as problematic and a critical barrier to increasing insurance penetration. In most markets, initiatives are underway to increase the level of financial literacy among the population. These initiatives tend to be government led, sometimes in partnership with the financial industry, yet few seem to yield the intended effects. Projects are often not completed due to a change in political priorities or under-funding.

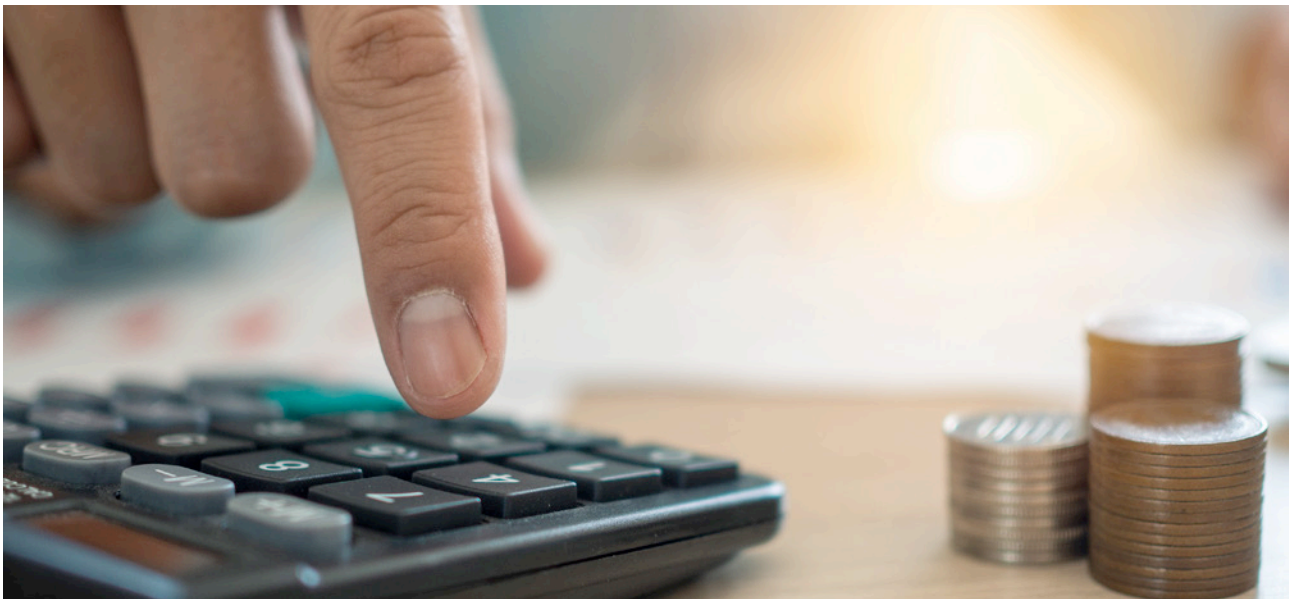
In all markets covered, the low level of financial literacy was seen as problematic and a critical barrier to increasing insurance penetration.

In Chile and Mexico, financial education is part of childhood education. In the Philippines, the department of education – through the Insurance Institute for Asia Pacific – has asked the insurance industry to support the development of basic life and non-life insurance modules that will be inserted in school curriculums. In Vietnam, industry-led and -sponsored financial education programmes have successfully helped reach large parts of the population, but more government cooperation is essential to extend the reach. The need for more government involvement across markets is clear, as is making financial education a mandatory part of the school curriculum. There is also recognition that insurers should become more engaged.

We need more government-backed financial literacy programmes. ***– Arup Chatterjee, Principal Financial Sector Specialist, Asian Development Bank***

The government should take the lead in making a country more financially literate. However, we should not forget that the insurance industry is a vital stakeholder in developing a financially aware marketplace and should contribute to such initiatives actively and consistently. ***– George E. Thomas, Professor, Insurance Institute of India***

80 Stoian et al. 2021.
81 MAPFRE Economics 2017.
82 OECD 2021.
83 Swiss Re 2017.
84 Pradhan and Mukherjee 2016.



5.2.2 Trust-inspiring legal frameworks

The degree of trust affects both the demand and supply of insurance. On the demand side, it can be defined as 'a customer's bet on an insurer's future contingent actions, ranging from paying claims to protecting personal data and ensuring the integrity of algorithms'.[85]

General laws play an important role in enhancing trust in the insurance industry. Beyond them, contract law provisions govern the formation and enforcement of contracts, fraud prevention and dispute resolution mechanisms, to name a few.[86] In all countries featured in this paper, interviewees indicated that a trust-inspiring legal framework is in place. Many jurisdictions have established clear and easy access to redress mechanisms for consumers by establishing an insurance ombudsman.

The issue in several of the emerging markets studied is not so much absent or dysfunctional legal frameworks and laws, but rather insufficient understanding of insurance on the side of attorneys and judges. In several Latin American countries in particular, this issue has resulted in a lower uptake of mandatory insurance.

The issue in some emerging markets is not so much absent or dysfunctional legal frameworks and laws, but rather attorneys' and judges' insufficient understanding of insurance.

5.2.3 Tax incentives

Tax incentives are an important, proven instrument with which policymakers can spark demand for insurance products. They primarily serve the purpose of stimulating savings by offering citizens a tax break for the purchase of specified pension or life insurance products. Several of the interviewed insurance executives urged their governments to implement tax incentives.

> I would like to see a lot more tax incentives that encourage people to buy insurance cover and close the protection, health and retirement gaps. Tax breaks would massively increase participation.
> ***– Sang Lee, CEO, Manulife Vietnam***

In several jurisdictions – notably Chile, Nigeria, Morocco and India – tax incentives exist mostly in the form of deductions related to life, health and retirement savings products, as well as VAT exemptions for certain lines of (mandatory) insurance. Although these incentives have worked well, there is a strong view across jurisdictions that further expansion is an important policy lever to enhance insurance penetration. In certain jurisdictions such as the Philippines, premium taxes are high, which reduces affordability.[87] World Bank research shows that although fiscal relief from life insurance premiums has had a positive effect on buying behaviour in certain markets, it is one of many influences on consumer purchasing decisions. This instrument should therefore be used in conjunction with other measures to stimulate the uptake of (life) insurance.[88]

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85 The Geneva Association 2019.
86 IDF 2021.
87 OECD 2020.
88 World Bank 2020b.

There are no incentives for the population to buy insurance i.e. there are no sufficient tax incentives. This is something the sector along with the relevant government authorities should work on.
– Rubem Hofliger, Head Public Sector Solutions Latam, Swiss Re, Mexico

5.2.4 Government subsidies

As affordability is one of the biggest hurdles to insurance market development in emerging economies, some governments have implemented premium subsidies for certain types of cover. The experience with subsidies is mixed, however. In some markets, subsidies did not change the take-up of insurance, suggesting that other, more important factors affect insurance demand.[89]

In the markets covered in this report, premium subsidies are most common for agricultural insurance. Several public-private partnerships between the government in India and the insurance sector have led to subsidised agricultural insurance schemes, which have succeeded in making agricultural insurance one of the most important business lines in the non-life sector. Other markets with subsidies include Chile, Morocco, Peru and Thailand. Although Mexico used to have a subsidy programme for agricultural insurance, this program was cancelled following government questions about its impact. A new subsidy scheme is being developed with the help of the IDF.

Executives in Colombia and the Philippines have called upon their governments to establish subsidy schemes to better reach the vulnerable.

On the one hand, premium subsidies can serve to enhance affordability of insurance protection for the most vulnerable. It can also nudge those unfamiliar with the concept of insurance, and who can afford it, to buy protection and experience the benefits of insurance firsthand. In these cases, the challenge with many of these schemes is that they are not limited in duration. This creates the expectation that subsidies will always be there, which defeats the purpose if the aim is to introduce the uninsured to the benefits of insurance protection. For subsidies to work well, a government would need to limit their duration and communicate this clearly.

Case study: An effective subsidy scheme from India

As part of India's national objective to enhance financial inclusion, the Pradhan Mantri Jan Dhan Yojana (PMDJDY) scheme was introduced, featuring the Jan-Dhan or 'common man's savings accounts'. These accounts are free and can be opened though a network of participating banks by anyone who does not currently have access to a (standard) bank account. A key feature is that these accounts come with free basic personal accident insurance. The government purchases the insurance, banks provide the account as well as distribution, and insurers provide accident insurance cover. This scheme, reaching roughly 50% of India's rural population, is a good example of how governments, banks and insurers can work together to enhance financial inclusion.

The scheme is extremely powerful. It lifts people out of poverty, makes them part of the formal economy, fosters the habit of taking insurance and raises risk awareness. ***– Srinivasan Kalambur, Former Member of IRDAI, India***

5.2.5 Mandatory insurance

Mandatory insurance serves several purposes, mainly to protect public interests by insuring third-party motor liability. It is also used as a policy instrument to expand the use of insurance in societies and enhance risk awareness, endowing it with an implicit educational function. Mandatory insurance has the potential to contribute to market growth, particularly when expanded to risks beyond third-party motor liability.[90] But research across both developed and emerging markets has shown that the pace of market growth is unrelated to the existence of mandatory insurance. On the contrary, the overreliance on mandatory lines of business (mostly motor) is found to negatively impact innovation and result in low claims ratios.[91]

In effect, mandatory insurance is not as widespread in emerging markets as it is in mature markets. In several Asian and Latin American countries, mandatory insurance is associated with bank loans. Either the government has made certain types of insurance compulsory for a bank loan (e.g. crop or property insurance), or commercial banks require this by themselves. As a consequence,

89 Swiss Re 2017.
90 Ibid.
91 World Bank 2020a.

the common perception is that the role of insurance is to protect the loan, rather than the customer. For mandatory insurance to serve its purpose and avoid mis-selling scandals or low claims ratios, fair consumer outcomes must be considered.[92]

In several markets, mandatory insurance is either subsidised (Peru) or subject to strict price regulation (India and Chile). In Indonesia, there is currently no mandatory insurance except for a government-orchestrated health scheme. While legislative proposals are underway to require natural disaster as well as third-party motor liability insurance, sufficient enforcement will be key to their effectiveness.

I am not convinced that making insurance mandatory is an efficient solution, but rather we should create the right incentives for people to buy insurance, for example through taxes. ***– Rubem Hofliger, Head Public Sector Solutions, Swiss Re Mexico***

5.2.6 Market access barriers

Markets require a sufficient number of insurers to provide the necessary capacity, expertise and competition to best serve consumers. Rarely can adequate competition be achieved through domestic insurers alone. Beyond enhancing market competition, in the context of emerging economies, global insurers and reinsurers are often needed to provide capital, as well as technological and managerial knowledge. Other potentially positive side effects of foreign insurer participation include the creation of high-quality jobs and societal loss reductions.[93] Foreign insurers also provide a mechanism for transferring some of the risks outside of the country, mainly through globally active reinsurers, which has proven to be particularly beneficial to countries that are prone to natural catastrophes,[94] and is increasing in relevance in light of emerging global risks, including pandemics and cyber and supply-chain disruptions.

Foreign insurers can serve markets primarily through the establishment of local operations. This can take several forms. Establishment via a subsidiary involves the creation of a new domestic insurer or the acquisition of an existing domestic insurer. Except for ownership, such subsidiaries are legally identical to other domestic insurers and therefore subject to host-country regulation. A branch office, on the other hand, is not a stand-alone insurer, but an extension of a foreign insurance company that is subject to regulatory oversight by the regulator in the foreign jurisdiction.

Most developing countries limit foreign insurer market access to protect and nurture the local insurance industry. Even when markets are accessible, foreign-owned insurers may experience an unlevel playing field. Branch offices pose particular challenges because as risk-bearing entities, host-country rules typically require local investment of assets backing local liabilities. In addition, a substantial guarantee fund – similar to minimum capital and surplus requirements for domestic insurers – may be mandated. For foreign insurers, such rules fragment assets and decrease overall capital efficiency.[95]

Another market access issue arises with the rapidly developing use of insurance linked securities and related capital markets solutions to provide risk-bearing capacity to insurance markets. These products mainly use parametric triggers. The additional risk capacity and the dynamics of parametric covers can deliver significant benefits in the form of more attractive pricing, speed and efficiency in claims handling and fraud prevention. They have been used for a variety of risks, from large commercial risks to crop insurance policies for small family farms, as well as for sovereign and sub-sovereign risks and private sector risks. These new market players and products need to be accommodated within the relevant regulatory regimes.

92 IAIS 2021.
93 Skipper 1998.
94 OECD 2020.
95 Skipper 1998; Skipper and Kwon 2007.

Reinsurance can be especially beneficial in helping to develop an insurance market. Large reinsurers that operate on a global basis provide the vast majority of reinsurance capacity. They have the financial strength and underwriting expertise to support both the growth of nascent markets and development of innovative products. Due to their global diversification, reinsurers increase capacity and reduce cost for catastrophic events, as well as help to alleviate financial stability risk as catastrophe risks are not concentrated domestically. For reinsurance to be able to play its economically and societally beneficial role, reinsurers need a regulatory and legal environment that allows for the provision of cross-border services without unreasonable hurdles. Another prerequisite is the free flow of capital without restrictions such as local deposit requirements. Although the value of reinsurance was affirmed by our executive interviews, many markets still have varying forms of barriers in place.[96] Markets without reported barriers include Chile, Mexico, Morocco and Peru.

> Limited options of local reinsurers as well as their capacity hinder insurance market development as more reinsurers would increase capacity and help increase insurance penetration. ***– Lina Vongsa-ath, Chief of Partnerships and Emerging Customers Mandiri AXA General Insurance, Indonesia***

> There is protectionism in many countries on the African continent. Not only is this a barrier to growth and improved services. The biggest risk of closed markets is systemic risk when there is concentration of exposures. ***– Corneille Karekezi, Group Managing Director & CEO Africa Re***

The following trade barriers identified by the Global Reinsurance Forum (GRF) can hinder market development:[97]

- Restrictions on cross-border reinsurance transactions e.g. barring domestic insurers from purchasing reinsurance from a foreign reinsurer unless it operates a branch in the country, or imposing capital charges for credit risk applicable to placements with overseas reinsurers;
- Minimum deposit, collateralisation or asset localisation requirements which prevent global reinsurers from efficiently moving capital to where it is needed;
- Restrictions on foreign ownership or local operations, such as equity caps or an outright ban on establishing branches, restricting the ability of reinsurers to provide local underwriting expertise and direct services;
- The use of discriminatory measures, such as compulsory cession to national reinsurers or 'right of first refusal', which limit the competitive capacity of global reinsurers and constrain their ability to provide value to domestic insurance markets.

5.2.7 The crucial importance of government support

A core challenge in insurance market development is the right attention at the policymaker level. Both the industry and regulatory authorities have an important stake in achieving this. This section provides examples of effective collaboration with governments to close protection gaps. Some of these are multilateral initiatives, with cooperation among several governments to pool risks or address a common exposure. In other cases, they focus on a specific country or even a geographic region or city within a single country, or on a particularly vulnerable part of the population such as farmers.

Examples of these programmes include the African Risk Capacity (ARC), which was founded in 2012 by the African Union, and the Caribbean Catastrophe Risk Insurance Facility (CCRIF), which was established by several Caribbean nations in 2007. Both longstanding entities offer risk mitigation and risk-sharing facilities to enable member countries to better plan, prepare for and respond to climate-related risks and natural disasters. They came about because the governments of nations vulnerable to the impact of climate change banded together to pool their risks, strengthen their risk mitigation expertise and secure financial resources to provide capacity where it did not exist. These two programmes have received substantial support from donor countries, the World Bank and other multilateral organisations, as well as the insurance industry.

The Tripartite Programme is an example of a public-private collaboration with sovereign and sub-sovereign governments aimed at increasing their resilience to climate risks and natural disasters. Co-financed by industry members of the IDF and the German Government (BMZ), through the InsuResilience Solutions Fund (ISF), the Tripartite also includes the UNDP as an important development partner. The initiative is driving a number of projects, two of which are:

96 GRF 2021b also offers an inventory of specific barriers in more than 50 jurisdictions.
97 GRF 2022.

- Medellín, Colombia: A consortium, formed by insurance sector entities and a development and humanitarian aid organisation, is working with the Colombian city of Medellín and its disaster risk management team to develop a parametric flood and earthquake insurance product, as well as landslide protection for the municipality. While the city will be the policyholder, the product will protect its population, with mostly vulnerable areas as beneficiaries. Beyond the risk-financing benefits, key goals include raising the risk awareness and literacy of local stakeholders (e.g. local government entities, civil society, private sector, broader communities); transferring knowledge from international re/insurers to local insurers; and designing a programme that could be replicated in other municipalities in the country and across Latin America.
- Mexico: The Ministry of Finance and Ministry of Agriculture are working with the private insurance sector to ensure access to a parametric insurance product that will protect smallholder farmers from the impacts of excess rainfall and drought, tracked via satellite. While the ministries will be the policyholders, the beneficiaries will be the farmers, initially from 15 municipalities. The programme will rely on local facilitators, farmer data and distribution channels to help the farmers receive fast payouts directly (with no intermediation), based on a per hectare value with a cap per farmer. The ministries are working on a pilot with the private insurance sector as a first step, before the broader programme is designed. As in Medellín, there is close collaboration between the government, insurance industry and local entities to make sure the programme responds to community and smallholder farmers' needs. The project also has a strong focus on increasing local risk awareness and literacy.

It is important to note that realising the gains from public-private partnerships is not always easy. The public sector often has competing interests. Budget constraints and priorities must be balanced, and changes in government or within the relevant ministries and agencies can derail, if not terminate programmes. Governments also have to contend with the politics of short-term costs versus long-term benefits when investing in disaster risk finance and reduction.

As mentioned in the above examples, however, success is possible and can lead to results that are unachievable when the public and private sectors act on their own. The critical factor is often involvement, not only of national, regional or city governments, insurance supervisors and the insurance industry, but also of respected and trusted third parties, such as donor country development agencies, NGOs and multilateral organisations such as the UN. As these parties often have years of experience in engaging with the relevant country, they bring in pre-existing relationships with key government officials as well as local knowledge of the country needs and resources on the ground that can help with planning and execution.

There is substantial potential for sovereign and sub-sovereign governments to engage in insurance programmes and reap the many benefits.

programmes and reap the many benefits. This is why the challenges outlined above deserve to be tackled. Lessons learned from previous programmes indicate that success will be based on:

- Clear understanding of the risks, with access to risk data at a granular level
- Commitment to education and insurance/risk literacy at all levels
- Sharp focus on the specific needs of the local community
- Taking steps to establish trust and support, potentially leveraging critical third parties
- Appropriate government engagement, which factors in the different public entities' disaster risk management and response, economic development, finance, health and human safety, and insurance supervisors, among others

6. Recommendations for policymakers, regulators and insurers

Insurance is vital to economic development, and robust re/insurance markets are critical to economic growth, making societies more resilient by protecting lives, livelihoods and assets. As stated by the UN Conference on Trade and Development: 'Insurance is not merely a characteristic of economic growth; it is a necessity.'[98] Despite the clear benefits of insurance, massive protection gaps still exist, with insurance penetration rates low in emerging markets when compared to more mature markets. Part of the problem stems from the difficulty in quantifying the importance of insurance for economic and societal prosperity. As a result, the insurance sector does not always receive the necessary attention and appreciation from policymakers.[99]

Against this backdrop, our research findings and the growing urgency caused by climate change, pandemics and other risks, we put forward the following recommendations for policymakers, insurance regulators and insurers in emerging markets, with the aim of increasing the insurance penetration rate and closing protection gaps:

For governments/policymakers

- Consider closer collaboration with the insurance regulator and insurance sector, and take a more holistic approach to risk management, including disaster risk management at the national level;
- Provide regulatory authorities with a clear mandate (including market development) and appropriate resources, including adequate funding, training and technical support in designing, implementing and enforcing insurance laws and regulations;
- Dismantle overly burdensome market-access barriers to insurers and reinsurers to reap the full benefits of competition, innovation and global risk diversification;
- Make the improvement of financial literacy at all levels of society a policy priority, for example by integrating financial education in core school curriculums, as increased risk awareness and understanding are likely to significantly increase the demand for insurance products;
- Rebuild or establish subsidy schemes and tax incentives with a view to effecting sustainable changes to insurance purchasing behaviour.

98 UNCTAD 1964.
99 Skipper 1997.

For regulators

- Embrace an insurance market development mandate in addition to policyholder protection and maintaining financial stability;
- Adopt a more holistic approach to insurance market development, catering to both low-income segments (through microinsurance) and the middle class;
- Take a more active role in educating policymakers on the economic and social value of insurance;
- Engage in active dialogue with the insurance industry on how to build a better insurance market for the country, including:
  - Relaxing or abolishing rate and form control to foster insurance product innovation
  - Accommodating (with appropriate regulations) insurance-linked products and coverage with parametric triggers
  - Supporting and facilitating the use of technology and data analytics to better serve consumer needs
  - Enabling digital and alternative forms of distribution to allow insurers to reach more customers in remote areas cost effectively
- Implement risk-based regulations that are minimally intrusive and applied in a proportionate manner, and evolve to meet changing markets needs and capabilities;
- Support initiatives to enhance financial literacy and risk awareness, partnering with the industry and other government agencies.

For insurers

- Take responsibility in educating policymakers and other government officials on the role of insurance in protecting societies, supporting economic development and increasing resilience;
- Engage with regulators in an open, constructive manner to discuss market issues and possible solutions;
- Take a proactive role in raising risk awareness and financial literacy;
- Focus on the insurance needs of specific market segments and deliver simple and cost-effective products that are needed.

Achieving the appropriate level and quality of legislation and regulation is a challenge, especially in emerging market environments. Based on an extensive review of existing research and in-depth expert and executive interviews, we have developed recommendations which we believe deserve universal consideration. At the same time, additional research efforts are required to examine the effects of specific policy and regulatory measures on insurance market development metrics, such as penetration levels and protection gaps.

Appendix
Insurance penetration rate of markets in the scope of this study

Insurance penetration of markets

Country	2005	2020	Δ 2005-2020
Argentina	2.18%	2.17%	-0.01%
Brazil	2.60%	4.10%	1.50%
Chile	3.38%	4.05%	0.66%
Colombia	1.91%	3.06%	1.15%
India	3.48%	4.20%	0.72%
Indonesia	1.37%	1.93%	0.57%
Mexico	1.57%	2.58%	1.02%
Morocco	2.37%	4.49%	2.12%
Nigeria	0.34%	0.30%	-0.04%
Peru	1.32%	2.02%	0.71%
Philippines	1.25%	1.77%	0.52%
South Africa	13.49%	13.66%	0.17%
Thailand	3.30%	5.33%	2.03%
Vietnam	1.18%	2.29%	1.11%

Source: Swiss Re Sigma database[100]

100 Swiss Re 2022.

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Insurance is considered vital to economic stability and growth as well as making societies more resilient. Many emerging economies, however, face critical protection gaps. Addressing the low level of insurance penetration in emerging economies has become more urgent in light of the growing risks related to climate change, pandemics and economic instability. Building on research and expert interviews conducted in 14 emerging economies, this joint report by The Geneva Association and Insurance Development Forum examines the role of public policy and regulation in developing a robust and competitive re/insurance market to help protect societies, support economic development and increase resilience.

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