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New Markets – New Regulation

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With the world economies becoming increasingly liberalized and interlinked, there is much room for the growth of insurance and strong regulatory and supervisory frameworks in the developing economies.
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Worldwide economic framework

In the last two or three decades, the world has become a true global market in most economic activities. Social, technological and political achievements have triggered a tremendous flow of interaction among different countries and regions in the world which had been until then on the sidelines or with a poor inter-relationship. Political changes and events occurring in Eastern Europe and other regions of the world, the EU enlargement and other circumstances have accelerated this process, boosted by the huge influence of the modern media, especially TV, mobile phones and the Internet. Western economies have proved to be much more efficient than other economic models, provoking a strong tendency worldwide toward a liberal economic system. The growing sensation of an increasingly unified economic market along with the financial turmoil that took place at the turn of the new century have prompted at the same time the necessity for more common rules and regulations for the business field and the strengthening of supra-national bodies. A new legal and institutional architecture has been implemented in the last few years with a worldwide focus, and the existing international bodies have emerged reinforced in their functions and authority.

As a consequence, an era of increasing economic growth has started for many regions in the world fed by political stability, free market rules, flow of foreign capital, financial stability, and economic development.

Table 1 below demonstrates this situation through the GDP growth in different regions of the world in the last decades.

There is an evident contrast between the developed and the emerging countries. Russia suffered a tremendous financial upheaval in the 1990s with its political changes, and Latin America has also been deeply affected by financial convulsions in some countries (Argentina, Mexico, Venezuela).

The welfare of the population has also improved in some regions as a consequence of the decrease of the birth rate and the increase of the GDP as it can be observed in the GDP per capita and shown in Table 2.

Table 1 GDP annual average growth (per cent)

	1980–1990	*1990–2000*	*2000–2004*
OECD	3.2	2.7	2.0
Russia	2.4	−3.4	6.1
China	10.1	10.3	8.5
India	5.8	6.0	6.2
Latin America and Caribbean	1.7	3.3	1.8

Table 2 GDP per capita (current U.S. dollars)

	1990	*2000*	*2003*	*Average growth (per cent)*
OECD	16,700	24,600	26,300	4.4
Russia	3,500	1,800	3,000	−1.0
China	350	850	1,100	16.4
India	375	450	600	3.8
Latin America and Caribbean	2,600	3,900	3,300	2.0

Table 3 Year of membership

Brazil	1995
India	1995
Mexico	1995
China	2001
Russia	Ongoing

At the same time, international financial bodies like the IMF, The World Bank or regional Banks (LA, Africa or Asia) are conditioning the loans to economic reforms or the setting up of a better legal and financial structure in order to tap maximum resources from the countries themselves and international investors. The WTO has carried out intense activity to include in its frame most of the significant countries in the world focused on the sound principles of international trade. The latest achievements are shown in Table 3.

Worldwide insurance development

Insurance business has evolved in accordance with the pattern mentioned before. Life and non-life insurance, both commercial and personal lines, have received an extraordinary and significant drive in the new markets under the influence of (a) economic development; (b) the growing demand of individuals; and (c) as a result of the pressure of international insurance players interested in investing in those new markets. Some doubtful degree of saturation in Western countries and the clear opportunities opening up in the new economies have prompted an important flow of interest and foreign insurance capital towards some regions. This situation has been improved in recent years by the negative influence in industrialized countries of the

Table 4 Premium growth (per cent) inflation-adjusted

	1997–2003 (Annual Average)	*2004*
Industrialized countries	3.3	1.7
Emerging markets	7.6	7.5
World	3.7	2.3

Table 5 Premium growth (per cent) inflation-adjusted

	Life		*Non-Life*	
	1997–2003 (Annual average)	*2004*	*1997–2003 (Annual average)*	*2004*
Industrialized countries	2.9	1.7	3.9	1.7
Emerging markets	8.6	7.4	6.4	7.7
World	3.5	2.3	4.2	2.3

financial turmoil and the favourable development of inflation rates in emerging markets. Tables 4 and 5 detail these movements.

The low profit margins and fiscal reasons, in some cases, are responsible for the recent fall in life insurance in industrialized countries. In contrast, in the emerging countries life insurance demand is rising due to better living standards.

Non-life insurance in the whole world has been favourably influenced by the increase of prices as an aftermath of the terrorist attack of 9/11 and its financial consequences. 2003 and presumably 2004 have been in most cases two good years for insurance markets after having suffered from high losses in operations and in stock markets in the preceding years. Although interest rates have not risen by the expected amount, economic growth, stock market gains and the increase of prices have been an extraordinary help to restore profits and confidence in the insurance sector and a renewed interest in international expansion.

On the regulation side, Western markets are suffering the consequences of a new regulatory impetus coming from international and supranational institutions like the EU (Solvency II and new directives), IASB (International Financial Reporting Standards), IAIS (new rules on supervision), SEC and similar organisms (corporate governance rules like the Sarbanes – Oxley Act), etc. This over-regulation implies an extra-cost and internal bureaucracy in the insurance company though it will have a beneficial effect on solvency, internal risk control and external transparency.

Insurance companies have realized once more that good management of their business is closely linked to principles of sound underwriting, good loss control, cost-efficiency and prudent investments.

Focus on new insurance markets

Emerging countries are responsible for only about 20 per cent of global economic GDP but nevertheless account for more than 80 per cent of world population.

Table 6 Premium volume

Emerging regions	*2004 (billions US $)*
Asia (without Japan, Korea)	160.9
Africa	37.6
Eastern Europe	41.7
Latin America	49.3
Middle East	14.0
Total	303.5

Moreover, over the last decade, insurance premiums in those countries have grown about 10 per cent every year – far greater than the 3 per cent of industrialized countries. Some saturation in the latter is in contrast to the booming economies and increasing liberalization and privatization in the former. As a consequence, the weight of these markets has significantly increased in the international insurance world from 9.3 per cent in 1998 to 11.5 per cent in 2004. This situation is expected to continue in the next decade as the economic growth foreseen for the emerging countries is about two times (4–6 per cent annually) that for industrialized countries (2–3 per cent annually). Some regions, in particular, (like China, Russia) could have even a higher rate rapidly outpacing other countries.

The inflation rate has been reasonably controlled in the last years and is expected to be so maintained in the coming future. This will favourably affect the development of life insurance as, in a similar way, the per-capita income increase strengthens demand for both life and non-life products.

Five emerging regions can be considered in a quick look worldwide: Asia, Africa, Eastern Europe, Latin America and Middle East, accounting for the premium volume shown in Table 6.

Nevertheless some of the big countries included in this picture are developing at a high rate and are steadily going from being thought of as "emerging markets" to being considered as "new markets" with a high growth potential. China, India, Brazil and Mexico account for nearly 3 billion people and have shown a tremendous capacity for economic growth in recent years. Insurance development could also be a huge field in which foreign players could play a significant role. For instance, insurance demand is between 2 and 4 per cent of GDP in those four countries in contrast to 9 per cent in OECD countries.

Insurance development and regulation

Given this extraordinary and positive economic outlook for the insurance industry in these new or emerging markets, which should be the key factors to favour maximum development and to make good use of these conditions? Let us try to set up a decalogue of some possible key factors:

(a) Implementation of an internal legal framework (regulatory system) for insurance operation and solvency with an open rather than a strict and reduced bureaucracy tariff system.

(b) Legal regulation of the distribution channels to direct efforts of intermediaries and to promote a high level of professionalism among agents and brokers. An open rather than a closed market and the fostering and regulation of bancassurance.
(c) Privatization of state-owned insurers as much as possible and developing state-regulated bodies for natural catastrophes and agricultural risks. Regulate pension schemes and workers' compensation covers.
(d) Free entrance of foreign investors to provide financial capacity (i.e. solvency) and operational know-how even with majority shareholding. Allow free ceded and accepted reinsurance market.
(e) Reinforcement of legal institutions for controlling and supervising of insurance companies and intermediaries.
(f) Promoting free associations between insurers and brokers in order to balance the weight and influence of legislators, supervisory authorities and consumer associations.
(g) Regulate compulsory insurance within the framework of the private sector for motor insurance and other lines of dangerous industries or activities and for workers' compensation.
(h) Regulation for investment of reserves; include tax deduction to develop life insurance and pension schemes.
(i) Promoting employee professionalism through specific university and professional education, run by the state, insurance associations or private institutions.
(j) Enforcement of corporate rules and governance and transparency rules.

Final remarks

When talking about new insurance markets, we should not forget that in some cases, as in Latin America, there is an old tradition and history within the countries themselves of insurance activities and changes, although necessary, must be implemented while taking into account the market's peculiarities and special circumstances. Perhaps it could be much more a matter of "fine tuning" and a firm will to comply with existing regulations.

Also, the role of foreign insurance groups cannot be considered an easy task as social conditions and local market practices diverge greatly from the original ones of the industrialized countries. In fact, many international groups have failed or have needed too many years to reach a state of efficient insurance activity in new markets due to the difficulties in adapting to local conditions and not to the current legal environment.

In some cases, even new markets can be considered an excellent testbed for technological or business innovations due to their capacity for assimilation and the competition of foreign players coming from markets as different as the U.S. and the EU. In terms of regulation, the different approaches coming from these latter regions (GAAP vs. IFRS, R.B. Capital vs. Solvency II systems, for instance) can make new markets an international battle field with regard to these topics and create a need to reach a common worldwide consensus.

An interesting question could be posed by the legal form of new insurance companies in the new markets, in particular in the case of cooperative or mutual systems. In developed countries, mutuals have a long tradition and account for a significant part of insurance activity. Unfortunately in emerging countries, this legal structure is not always well accepted or regulated. International Associations like AISAM and ICMIF are trying to promote these forms in new markets linked to associations or groups of social interest, but much more effort should be made.

International or regional banks for the developing or emerging countries are fostering economic activity by requiring legal reforms and regulations (also in the domain of insurance) to allow these developments. Perhaps a closer collaboration between these financial institutions and the international insurance bodies would be more appropriate in order for them to speak with one voice and with the same principles.

Economic conditions will probably vary worldwide in the coming years with regard to the currently accepted forecast. This has happened in the past and will surely occur in the future. Fever to invest in new regions has been and will be volatile following the inevitable cycle of the economy and the random new circumstances and risks that influence human activity (oil prices, terrorism, new discoveries, etc.). But insurance activity has the advantage of being non-cyclical and of protecting against risks, and in this way able to counterbalance economic volatility. This idea has been important in the past but has become even more relevant nowadays as has been shown in terrorist attacks, natural catastrophes and technological breakthroughs (the peak of the iceberg) in an ultra high-risk society.

In industrialized countries insurance companies are changing in order to cope with these situations (more solvency, more efficiency and more innovations) but in new and emerging markets the role of insurance can be vital to allow and consolidate economic development and to confront internal risks such as natural catastrophes. Moreover, the insurance industry has the advantage of being a solid pillar for the general economic development due to its capacity as institutional investor both in capital markets and in the field of real estate. An open regulatory system and a stable legal system should be the key factors for the development of a sound and beneficial insurance market.

About the Author

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