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Reducing Vulnerability Through Insurance

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2017 was an outlier year in terms of number and severity of natural catastrophes. According to Swiss Re,[1] a global reinsurer, the havoc caused by natural and man-made catastrophes was $337 billion,[2] of which $144 billion were losses paid by the insurance industry worldwide. Over the past 10 years, catastrophic losses adjusted for inflation have reached about 0.3 percent of global GDP.[3] However, there is an enormous gulf between the advanced and the emerging insurance markets. Whereas insurance density (i.e., annual premiums per capita) is $3,517 in advanced markets,[4] the emerging markets[5] reach a mere $166 (Figure 1).[6]

Figure 1
Annual Premiums per Person

$3,517
Advanced insurance markets

$166
Emerging insurance markets

MICROINSURANCE

One step to correct this imbalance that has been successfully taken in many regions is "microinsurance." In a microinsurance arrangement, low-income people are typically protected against specific perils in return for a premium commensurate with the likelihood and risk cost.

Microinsurance is not a new concept; the term itself dates to the late 1990s. Support by nonprofit organizations, including the World Bank, the International Labor Office, the International Fund for Agricultural Development, the German Corporation for International Cooperation and a host of private sector foundations have helped spur the growth of microinsurance in many regions of the world.

INCLUSIVE INSURANCE

Insurance companies compete vigorously to provide coverage to high- and middle-income individuals as well as medium and large companies. But not everyone enjoys ready access to insurance. A second corrective step is to make insurance available to all, and this is what inclusive insurance is all about.

The International Association of Insurance Supervisors (IAIS) defines inclusive insurance as "all insurance products aimed at the excluded or underserved market, rather than just those aimed at the poor or a narrow conception of the low-income market."[7] In less economically developed countries, most of the population is either uninsured or underinsured; thus, inclusive insurance is a mainstream topic in the development of the retail insurance markets.

HOW CAN INSURERS OFFER INCLUSIVE PRODUCTS?

The IAIS and other nonprofit organizations have developed tools and guidelines mainly aimed at insurance supervisors who are tasked with the promotion of insurance inclusiveness in their markets. The common features that inclusive insurance products should have are as follows:

- **Offer products with relatively low premiums.** This may be achieved through the reduction of administrative and distribution expenses, which are often onerous in traditional forms of insurance. New technologies may motivate ways in which premium charges can be significantly minimized.

- **Design products with a defined and limited cover.** The idea is to keep insurance products simple in order to encourage sales. A limited cover helps maintain the risk portion of the premium at a relatively low level.

- **Limit policy terms.** Shorter duration translates into reduced exposure, thus lower risk.

- **Limit or remove policy exclusions.** Having little or no exclusions may make products more appealing to potential policyholders.

- **Adopt group underwriting whenever possible.** This may contribute to simplified products and lower premium charges.

- **Pay claims promptly.** Inclusive insurance is also about building trust with policyholders. Rapid claims processing may help companies to be perceived as fair, appealing to players in the insurance marketplace.

The global insurance community is responding to the challenges of financial insecurity that the uninsured or underinsured face. Global awareness of climate risk, new technologies and a better skill set to model risk have spurred innovation in insurance.

Microinsurance has proven to be a viable tool to bring insurance to low-income individuals. Inclusive insurance goes beyond that.

HOW TO NARROW THE GAP

The large insurance protection gap that exists between advanced and emerging insurance markets will probably never be closed. However, certain measures may help in narrowing the gap and bring coverage to a greater part of the population (Figure 2).

These measures are as follows:

- **Promote insurance culture and financial inclusion.** The fact that products are seemingly complex can be addressed by government action such as funding programs that promote financial knowledge and allowing access to financial services to millions who do not currently have the possibility to buy insurance covers.

- **Work on regulatory change.** Copying and pasting regulatory solvency regimes from developed insurance markets is a recipe for failure. Risk-based regulation is taking hold in Latin America, where many countries are in the process of overhauling solvency regimes. However, it is important to balance the need of solvency regulation with the incentives for insurance companies to introduce new and innovative products without becoming ensnared in an overly complex process. Solvency regimes must be adapted to the features of the market in question.

- **Strengthen product innovation.** Insurers need to focus on the development of products that cater to the needs of policyholders, and not merely spend their full energy in designing "antifraud" products. Insurers can tap into the

Figure 2
Five Ways to Narrow the Gap Between Advanced and Emerging Insurance Markets

experience available from global reinsurance players, who offer not only capacity but also knowledge transfer. A win-win situation may be achieved.

- **Improve the ability to assess risk.** Actuarial skills are urgently needed in most emerging insurance markets. Also, it is important to build robust modeling skills, where other insurance professionals may also play a crucial role.

- **Create partnerships between government and the private sector.** This is probably a "catch-all" category. The preceding measures would greatly benefit from fruitful relationships between government and players in the insurance sector. This is not only about regulation; it is about creating more fertile ground to sow the seeds of strong insurance market growth.

> Building partnerships between governments and the private sector may be the most effective way to narrow the insurance protection gap.

ACTUARIAL CONTRIBUTION

Actuaries can play a critical role in designing products that meet real needs, particularly in those countries where insurance density and penetration are relatively low. Innovation and the use of technology may help ease the burden, but building partnerships between governments and the private sector may be the most effective way to narrow the insurance protection gap. ■

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ENDNOTES

1 Staib, Daniel, and Mahesh H. Puttaiah. 2018. *Sigma 3/2018: World Insurance in 2017: Solid, but Mature Life Markets Weigh on Growth.* New York: Swiss Re Institute. *https://www.swissre.com/institute/research/sigma-research/sigma-2018-03.html* (accessed March 25, 2019).

2 In fact, $330 billion were attributed to natural catastrophes, and $7 billion to human-made catastrophes.

3 Staib and Puttaiah, supra note 1.

4 Advanced insurance markets are hereby defined as the U.S., Canada, Western Europe (excluding Turkey), Japan, Hong Kong, Singapore, South Korea, Taiwan, Oceania and Israel.

5 Emerging insurance markets are hereby defined as Latin America, Central and Eastern Europe, South and East Asia, the Middle East (excluding Israel) and Central Asia, Turkey and Africa.

6 Staib and Puttaiah, supra note 1.

7 International Association of Insurance Supervisors. *Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets.* Oct. 9, 2012. *http://cenfri123.wpengine.com/wp-content/uploads/2014/09/Application-paper-on-regulation-and-supervision-supporting-inclusive-insurance-markets_IAIS_October-2012.pdf* (accessed March 25, 2019).