Insuring the frontier markets

01 Executive summary
02 Introduction: which are the frontier markets?
06 Insurance in the frontier markets
24 Insuring the emerging and frontier markets
Executive summary

Emerging markets account for around 86% of the world’s population and 40% of global gross domestic product (GDP), but they are under-represented in insurance with a combined share of 18% of global premiums. The rise of emerging markets in the past decades has brought to the forefront large markets, in particular Brazil, Russia, India, China and South Africa (BRICS). The BRICS countries account for over half of emerging market output and 69% of emerging market insurance premiums. These, and other more established emerging markets, will remain major contributors to global insurance growth.

Of late, there has been increasing focus on some smaller and less well-developed emerging markets known as the “frontier” emerging markets. For the purposes of this sigma and from the insurance sector perspective, the frontier markets are typically those emerging countries with smaller-sized economies, lower income levels and insurance sectors in the early stages of development. Another important characteristic is a favourable insurance premium growth outlook, driven by strong fundamentals, impending regulatory changes and the influence of some external trends. Most frontier markets are in Sub-Saharan Africa (SSA). Others are in the Commonwealth of Independent States (CIS), Southeast Asia and the Middle East. Generally speaking, annual growth in real GDP in these countries is forecast to be strong (5% to 10%) in the near future, and total insurance penetration rates are low (less than 1.5% currently).

A key attraction of frontier markets is their catch-up potential. This in turn rests on different drivers including improving socio-political stability, which supports economic growth and insurance market development. Many frontier markets also have abundant natural and human (young population) capital. These favourable conditions will boost economic growth, which in turn will filter through to insurance sector growth in the years to come. Also, regional trade agreements and investment forums are set to provide additional momentum for growth in several markets.

The realisation of growth potential will take years. Investment in frontier markets requires a long-term perspective. Some markets are small and a regional focus may be more appropriate for insurers to build up scale. Frontier markets will likely follow a sequential growth pattern favouring non-life and commercial business over life and personal lines in the initial years of acceleration in insurance penetration. The exception could be personal motor, if supported by enforcement of compulsory third-party liability insurance. Later, as incomes rise, premiums for life products, with their emphasis on savings, are likely to grow more rapidly.

Insurance premium growth is non-linear relative to income growth, following an S-curve. At low incomes, premiums grow along with income, but at middle incomes premium growth is more rapid than income, before slowing at higher income levels. The same will apply in the frontier markets but other factors will also play a role. For instance, the introduction of enabling regulations like mandatory insurance and more sophisticated solvency systems should expedite sector growth. Likewise, the ability to leverage latest technologies can accelerate insurance sector growth, reducing the time from many years in the advanced markets to just a few years in the emerging countries. As a result, the development path of frontier markets will not necessarily follow that of advanced or other established emerging markets.

1 Data are for 2015.
2 China is expected to contribute more than 60% of the expected increase in emerging market total premiums in the next 10 years, based on forecasts by Swiss Re Economic Research & Consulting.
Introduction: which are the frontier markets?

The emerging markets have grown more rapidly than advanced markets in 38 of the last 45 years. Average annual real GDP growth was 5.0% between 1970 and 2015 compared with 2.6% in the advanced markets. In GDP terms, the emerging economies expanded eight-fold in that period. By 2015, they accounted for close to 40% of world GDP, up from around 15% in 1980.

The strong growth in emerging economies has filtered through to their insurance sectors, with the latter collectively growing at around double the rate of the underlying economy in the last 20 years. Insurance penetration, defined as premiums as a percentage of GDP, in the emerging markets rose to 2.7% in 2015 from 1.7% in 1995. However, this increase came from a low base and the emerging markets’ total share of global life and non-life premiums remains below 20%, less than half the markets’ share of global GDP (see Figure 1). In other words, there is significant catch-up potential for insurers in the emerging economies.

Figure 1
Emerging markets’ share of global GDP, non-life and life premiums, %


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9 The designation of the economies in this sigma as "advanced" or "emerging" is generally in keeping International Monetary Fund (IMF) conventions. Advanced markets include the US, Canada, Western Europe (excluding Turkey), Israel, Oceania, Japan and the other advanced Asian economies. With the exception of Czech Republic, Estonia, Slovenia and Slovakia, all other markets are classified as “emerging” in keeping with the IMF’s criteria for “emerging and developing” economies.

4 Unless otherwise stated, all growth rates indicate changes in real terms that have been adjusted for local consumer price inflation.

5 The development of the emerging markets is more dramatic when assessed in terms of purchasing power parity (PPP). For example, latest estimates by the IMF shows that emerging markets were already on par with advanced-market GDP based on PPP terms in 2007-2008. By 2020, they are expected to account for more than 60% of world GDP in PPP terms, but only 43% if GDP is measured in US dollar terms. Source: World Economic Outlook Database, IMF, October 2015.
Insurance growth varies relative to income growth, depending on the level of economic development. Demand for insurance remains limited at low income levels. As households begin to be able to meet basic needs, the ability to afford insurance will typically rise faster than income growth. Rising incomes in the emerging markets, where the empirical income elasticity of insurance demand is typically higher than 1.0 (see Figure 2), enable more people to buy insurance. In non-life, income elasticity in the emerging markets overall has increased over the last three decades but in life, it fell below 1.0 in 2006-2015. This was mainly due to regulatory changes in China and India that negatively affected life premiums in 2011-13. In comparison, the income elasticity of insurance demand in the advanced markets has remained at around 0.9 in non-life, and fell from 1.3 in 1986-1995 to 0.9 in 2006-2015 in life. The financial crisis may have adversely affected demand for insurance in the advanced markets, but the decline in the income elasticity also reflects the lower propensity to buy insurance at higher income levels.

Figure 2
GDP elasticity of insurance premiums in emerging regions

The BRICS have been the most prominent of emerging market country groupings. In recent decades, different institutions have assigned what have become recognised names for groupings of different emerging market countries. The most prominent of these has been the BRICS countries. Collectively, the BRICS accounted for around 55% of emerging market GDP in 2015, and 59% of non-life and 77% of life insurance premiums. Examples of other country groupings are MINT, EAGLE and CIVETS, also collections of economies expected to sustain high growth in the coming years.

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6 The income elasticity of insurance demand measures changes in insurance premiums as a result of changes in GDP, which is used as a proxy for total income. An elasticity of 1.0 means insurance premiums increase proportionally with income. An elasticity of 2.0 means that for every 1% increase in income, premiums grow 2%. Empirical evidence shows that elasticity changes with income levels. See: Rudolf Enz, “The S-Curve Relation Between Per-Capita Income and Insurance Penetration”, *The Geneva Papers on Risk and Insurance*, Vol. 25, no. 3, July 2000.

7 New regulations on bancassurance in China, and for unit-linked insurance distribution in India.

8 MINT = Mexico, Indonesia, Nigeria and Turkey; EAGLE = Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey; and CIVETS = Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa.
Introduction: which are the frontier markets?

The non-BRICS emerging market countries are sizeable, accounting for 18% of global GDP (27% in purchasing power parity terms) and 42% of world population. Their economic growth has consistently exceeded that of the advanced markets. Of late, in insurance a subset of the non-BRICS countries has been gaining increasing attention: the "frontier markets". The term was first used more than two decades ago to denote equity markets that were small and less accessible, but still considered investable. There is no agreed definition of frontier markets. For the purposes of this sigma, they are considered to be the less-established insurance markets in smaller emerging economies, with a promising growth outlook. The markets typically feature the following characteristics:

1. Low insurance penetration. Frontier markets are usually at an early stage of economic and insurance development. Insurance penetration is low and there is high catch-up potential. Some markets may retain major barriers to entry and lack advanced insurance regulations.

2. Low income. Another usual characteristic of frontier markets are low income levels. There are exceptions, for example higher-income emerging markets where insurance is still heavily under-developed due to regulatory and other social and cultural reasons. And there are also low-income-level markets with already more advanced insurance sectors given a history of liberal entry of foreign insurers into the market.

3. Small economies. Frontier insurance markets are usually in smaller-sized emerging economies. Most large emerging markets have well-established insurance sectors with both domestic and foreign players.

4. Strong economic growth potential. Perhaps the most important attribute of frontier markets is their strong growth potential. The potential opportunity in insurance is contingent on projected economic growth.

This sigma uses these criteria to define frontier markets and review the prospects of a select set of countries. Other factors are also evaluated to achieve a better sense of insurance market potential. In particular, regulatory frameworks and the acceptance of foreign insurers to enter the market can greatly influence the development of a country’s insurance sector. Also, insurers in countries undergoing financial sector reform and market liberalisation could experience stronger growth than those operating in more restrictive environments.

Table 1 lists the frontier markets included in this sigma. Many other countries qualify as frontier markets, but sometimes lack sufficient data to assist in analysis. Others are frontier markets, but with low potential due to regulatory and legal issues.
This sigma’s selection of frontier market is - by necessity - arbitrary to a certain degree: not all frontier markets can be included. In addition to the four main criterion, economic reform measures or imminent accession to the World Trade Organisation (WTO) has also influenced selection. In Sub-Saharan Africa, seven frontier markets are of particular interest to insurance: Angola, Cote d’Ivoire, Ethiopia, Ghana, Kenya, Mozambique and Nigeria.9 Meanwhile, Georgia, Azerbaijan and Kazakhstan have been chosen as sample frontier markets from the Commonwealth of Independent States. The latter two display favourable socio-economic fundamentals to support insurance growth in the medium to longer term. Latin American economies are generally too large to be a typical frontier market, with higher incomes and with more established financial sectors. However, there are some (eg, Bolivia, Colombia, Ecuador and Peru) that straddle “established emerging” and “frontier market” status, and are therefore included in this report. From Southeast Asia, the chosen markets are Cambodia, Laos, Myanmar and Vietnam, and from South Asia they are Bangladesh, Pakistan and Sri Lanka.

9 The selection of the seven SSA markets is based on the ranking and assessment of market insurance opportunities by Swiss Re. Hence, Nigeria and Angola are not on the Top 30 list, ranking 37 and 43, respectively. However, they do have close fit with the profile of frontier markets and so are also covered in this sigma.
Insurance in the frontier markets

Sub-Saharan Africa

SSA is a diverse region consisting of 48 independent states. All markets, with the exception of South Africa, can be considered frontier markets. South Africa has one of the most advanced life markets in the world. It is at the forefront of industry innovation, and has the third highest penetration rate globally. This chapter looks at the SSA frontier markets only, with a focus on the insurance sectors in Angola, Côte d’Ivoire, Ethiopia, Ghana, Kenya, Mozambique and Nigeria.

Economic development

Real GDP in the SSA frontier markets grew by an annual average of 6.4% between 2000 and 2014, only slightly slower than peer markets in Asia. The SSA countries differ widely in terms of economic structure, socio-political and cultural background, and also insurance market practices. Nigeria is by far the largest economy with GDP of about USD 520 billion in 2014 (42% of the SSA frontier market total), followed by Angola (USD 130 billion). The other economies are significantly smaller. A key growth driver over the last decade has been high commodity and agricultural prices, although these have been much weaker recently. Other sectors such as financial services, telecoms, real estate and personal services, have also seen strong growth.

Economic growth in the markets has slowed more recently, with Nigeria and Angola particularly hard hit by oil price weakness since early 2015. In both nations, the majority of exports and government revenues are dependent on oil and gas sales, and both countries need to diversify their economies and build infrastructure to support business activity in other areas. Ghana is also a net exporter of oil, alongside gold and cocoa. It had to seek IMF assistance after the government deficit spiralled out of control in 2014.\(^{10}\) For the other markets covered in this chapter – Kenya, Ethiopia, Côte d’Ivoire and Mozambique – low oil prices are a positive factor as they reduce the import bill and the cost of fuel subsidies. Kenya in particular is expected to see sustained solid growth given large investments to upgrade its infrastructure (eg, the construction of Standard Gauge Railway transport system).

\(^{10}\) In April 2015, the IMF offered USD 918 million to Ghana to support medium-term economic reform initiatives, in a three-year arrangement under the Extended Credit Facility.
Despite the overall solid growth since the turn of the century, GDP per capita in SSA remains low. Income and wealth distribution is highly uneven, and poverty is widespread. In 2012, an estimated 390 million people, or 43% of the total population, lived on less than USD 1.90 per day, the lower of two poverty lines adopted by the World Bank. This is an improvement from 1990, when 56.8% of the population lived in extreme poverty. Improved governance has been a factor in poverty reduction, but the degree of progress varies widely between countries.

Although more moderate than in recent years, overall economic growth in SSA is forecast to maintain a healthy pace of around 5% per annum between 2016 and 2020. SSA will remain one of the fastest growing regions in the world, alongside emerging Asia. Agriculture, financial services, telecoms and infrastructure investments are likely to be the main growth drivers, while the ongoing low oil price has dampened ambitions of developing newly discovered oil and gas fields.

**Insurance market outlook**

Since 2000, real premium growth in the SSA frontier markets has been lower than real GDP growth, dampened by years of political instability and civil wars, which affected the insurance sector much more than economic growth. Insurance penetration varies widely among the markets. The degree of under-penetration is more pronounced in life than in non-life insurance. The SSA markets are mostly in the early stages of development, meaning insurance for commercial risks (construction, engineering, mining or oil and gas, group life business) dominate. Motor insurance is gaining in importance, however, due to increasing enforcement of compulsory motor third-party liability (MTPL) cover in many markets.

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**Figure 4**

Premium volumes (LHS) and real growth rate (RHS) in SSA frontier markets, 1998–2014

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13 Insurance in Sub-Saharan Africa: gearing up for strong growth, Swiss Re, 2012.
Insurance in the frontier markets

Kenya is the most advanced among the SSA frontier markets, but there are initiatives to increase insurance penetration elsewhere in the region.

Of the frontier markets, Kenya has the most sophisticated insurance sector and regulatory framework, and also the highest level of insurance penetration. In the other countries, awareness of the importance of insurance for economic and social progress is growing, and governments and regulators are increasing their efforts to foster growth of an effective insurance industry. One area of activity is elimination of malpractices, such as non-payment of legitimate claims, eliminating fake insurance policies/companies, and the enforcement of a "cash and carry" principle (an insurer may only issue a policy after he has received the premium payment). In the western region of SSA, the Inter-African Conference on Insurance Markets (CIMA)\(^\text{14}\) , a supranational organisation, has been driving this trend. At the same time, improved regulation and supervision should eventually lead to industry consolidation and stronger capitalisation, which in turn will also increase consumer trust in insurers.

Table 2
Key economic and insurance indicators of SSA countries, 2015

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP, USD billion</th>
<th>GDP per capita, USD</th>
<th>GDP growth (2016–2020F)</th>
<th>Population, million</th>
<th>Non-life penetration, in % of GDP</th>
<th>Life penetration, in % of GDP</th>
<th>Total penetration, in % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Angola</td>
<td>126</td>
<td>5038</td>
<td>3.9%</td>
<td>25.0</td>
<td>0.98%</td>
<td>0.02%</td>
<td>1.00%</td>
</tr>
<tr>
<td>Cote d’Ivoire</td>
<td>30</td>
<td>1308</td>
<td>6.7%</td>
<td>22.7</td>
<td>0.87%</td>
<td>0.75%</td>
<td>1.62%</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>58</td>
<td>583</td>
<td>6.5%</td>
<td>99.4</td>
<td>0.57%</td>
<td>0.04%</td>
<td>0.62%</td>
</tr>
<tr>
<td>Ghana</td>
<td>39</td>
<td>1412</td>
<td>6.0%</td>
<td>27.4</td>
<td>0.57%</td>
<td>0.51%</td>
<td>1.07%</td>
</tr>
<tr>
<td>Kenya</td>
<td>64</td>
<td>1381</td>
<td>6.2%</td>
<td>46.1</td>
<td>1.91%</td>
<td>1.07%</td>
<td>2.98%</td>
</tr>
<tr>
<td>Mozambique</td>
<td>22</td>
<td>794</td>
<td>6.7%</td>
<td>28.0</td>
<td>1.05%</td>
<td>0.18%</td>
<td>1.23%</td>
</tr>
<tr>
<td>Nigeria</td>
<td>502</td>
<td>2753</td>
<td>6.0%</td>
<td>182.2</td>
<td>0.21%</td>
<td>0.08%</td>
<td>0.29%</td>
</tr>
</tbody>
</table>


Global and regional insurance companies have increased their pace of acquisitions in SSA.

Commercial risks are the main line in many SSA markets, with risks often brokered and underwritten in the international markets.

There has been more M&A activity in the SSA frontier markets of late, with Nigeria and Kenya deemed particularly attractive. Many markets remain highly fragmented, providing ample scope for further consolidation. The region is increasingly attracting buyers from Western Europe, and also from northern Africa and South Africa. The insurance expertise global and regional players bring into the markets will help close some of the human capital skill gaps still prevalent in certain markets.

Due to the importance of large commercial risks (oil and gas, engineering, mining, infrastructure construction) coupled with the small capital base and lack of underwriting skills of local companies in these segments, much of SSA frontier market insurance business is brokered and underwritten in the international markets. Global reinsurers play an important role in providing know-how. Against this backdrop, many regional regulators are looking to build local capacity by developing rules to utilise available local re/insurance resources, pool certain risks and enforce compulsory cessions to national reinsurance companies.

\(^\text{14}\) Members: Benin, Burkina Faso, Cameroon, Central African Republic, Comoros, Congo, Côte d’Ivoire, Gabon, Equatorial Guinea, Guinea Bissau (since 2002, first non-francophone member), Mali, Niger, Senegal, Chad and Togo. CIMA has regulatory and supervisory authority in the member states to prepare for a common insurance market.
Growth outlook
Sustained strong economic development will remain a key growth driver for insurance in SSA countries. Some other emerging trends will also help raise penetration, including mobile-based and micro-insurance, innovative agricultural policies and large infrastructure projects.

Mobile-based and micro-insurance
A middle class to support the expansion of traditional retail insurance is emerging only very slowly in the SSA frontier markets. Most people have very low incomes and small sums insured are very common in personal lines of business. As a consequence, micro-insurance, ie, simple and flexible insurance products with small premiums, has been growing very strongly in SSA and is expected to continue to do so. Community-based (mutual) micro-insurance schemes are still the most common form found on the continent. Increasingly, however, profit-oriented companies are also providing micro-insurance products. Today credit life products are the most common, but the growth potential for other products, particularly health, is very large.

With very small premiums, cost-efficient provision of insurance via mobile phones and other technologies (GPS, satellite imaging enabling index-based products) is key. Today consumers can already obtain quotes, purchase insurance products (and be issued policies by insurers), pay premiums and submit claims using basic mobile phones. These mobile-based offers are often driven by non-insurance players like mobile phone operators and technology companies. Two of the largest technology service providers for mobile micro insurance have reached approximately 28 million customers combined.15 SSA has taken the lead in insurance distribution via basic mobile phones, and survey evidence indicates that mobile insurance is reaching many previously uninsured and low-income consumers. A survey undertaken across five countries in Africa and South Asia in early 2014 revealed that 97% of the mobile micro insurance consumers sampled were living below USD 10 per person per day. Of those, 77% never had any form of private insurance previously, and 42% had no bank savings account.16 With the large low-income population in SSA, micro-insurance and particularly mobile-based insurance products, will become a key focus to increasing the reach of insurance in the region.

Agriculture
A large share of the population in SSA works in agriculture, mostly in small or family farms. Upgrading agricultural production is a central objective of many national economic policy programs, and this will likely filter through into stronger demand for agricultural insurance in the future. Agricultural insurance is a key financial safeguard for farmers, protecting them against a loss of livestock or harvest due to, for example, drought or flooding. These disasters can ruin a family which has only a small amount or no savings. Thus, public-private partnerships providing agricultural insurance are becoming more popular in SSA. Many of the products use mobile technology to handle policy administration and pay outs, and parametric triggers to minimise the cost of claims assessment.

There are many agricultural insurance schemes in the frontier markets. A recent example of innovation is the Kenyan Livestock Insurance Program (KLIP), which has been test-piloted since autumn 2015, and which the government plans to roll out across Kenya’s 14 counties. KLIP works as an index-based livestock insurance scheme, using the Normalized Difference Vegetation Index (NDVI), which measures plant “greenness” or photosynthetic activity. The NDVI is derived from satellite photos of land. The colour of the ground is an indication of how dry the area is – yellow is very dry and green is not dry. Once a certain dryness threshold is reached, the farmers insured under the scheme automatically receive a lump sum payment which they can use to buy feed for their livestock. It is not to compensate for loss of livestock, but to protect the livestock from the effects of the drought in the first place.

16 Global insurance review 2015 and outlook 2016/17, Swiss Re, November 2015.
Insurance in the frontier markets

KLIP is 100% financed by the Kenyan government and is available for free to pastoralists (nomad farmers) registered under the Hunger Safety Net Program. The program covers five tropical livestock units per household.17 Local insurance companies are selling top-up covers for additional livestock.

Engineering insurance for large infrastructure projects, extractive industries
SSA frontier markets lack good public infrastructure, and governments are trying to remedy the situation with support from development programmes or private/semi-private financing. Investment in infrastructure will benefit engineering and property-related lines of insurance business. Other areas of growth are extractive industries, including exploration of new-found oil and gas fields. Due to low oil prices, most of these projects are currently on hold as they would be uneconomical. But if oil prices rebound, many of the oil & gas projects will be back on line. In the meantime, local insurers are vying for a greater involvement in oil and gas. This is being supported by regulators who are introducing or enforcing local content rules for this line of business more vigorously.

17 A tropical livestock unit is a reference unit for aggregating livestock depending on type, age and size, with – for example – a fully-grown camel as 1.0 unit and cattle at 0.7 unit.
Azerbaijan, Georgia and Kazakhstan have potential for above-average economic and insurance sector growth.

**Figure 5**
Azerbaijan, Georgia and Kazakhstan

Azerbaijan, Georgia and Kazakhstan are included in this analysis as example frontier markets from the CIS. Economic development in these countries, although accelerating in recent years, still lags growth in other post-Soviet countries, and their insurance markets also remain underdeveloped. Given their population size, need for infrastructure development, and strategic locations between Europe and Asia, these countries have the potential for above-average economic and insurance premium growth in the coming decades.

**Azerbaijan, Georgia and Kazakhstan**

The three CIS markets vary in economic size, and growth pattern and drivers. Economic development in these countries, although accelerating in recent years, still lags growth in other post-Soviet countries, and their insurance markets also remain underdeveloped. Given their population size, need for infrastructure development, and strategic locations between Europe and Asia, these countries have the potential for above-average economic and insurance premium growth in the coming decades.

**Economic development**

The three CIS markets vary in economic size, and growth pattern and drivers. Economic development in these countries, although accelerating in recent years, still lags growth in other post-Soviet countries, and their insurance markets also remain underdeveloped. Given their population size, need for infrastructure development, and strategic locations between Europe and Asia, these countries have the potential for above-average economic and insurance premium growth in the coming decades.

Azerbaijan's real GDP grew at an average annual rate of 11% between 2000 and 2014, the biggest increase of all CIS and CEE countries, and even outpacing China. Kazakhstan grew by 7.7% on average during this time and Georgia by 5.8%. The growth was driven primarily by demand for natural resources from developed and developing countries. In the case of Kazakhstan, China has become its largest export market. In contrast, Azerbaijan's largest export market is Italy, to which it exports crude petroleum. With their rich natural resources base, from natural gas and oil to plutonium, the CIS frontier markets benefitted from the upturn in global commodity prices that started in the early 2000s. However, they have struggled to diversify their economies away from oil dependency and, given the current low price of oil, their growth prospects have weakened.

In response to the declining oil prices, US dollar strength and dwindling foreign exchange reserves, Kazakhstan and Azerbaijan have abandoned their dollar currency pegs. This has resulted in substantial currency depreciations, with the Kazakhstani tenge losing about 50% of its value since August 2015, and the Azerbaijani manat depreciating by about a third since December 2015. This has helped protect foreign currency reserves but has also led to a drastic increase in inflation and financing challenges. However, the short-term pain should enable medium- to long-term improvements in competitiveness. Georgia has fared better in the low commodity price environment because of its more diversified export portfolio that includes auto components for Western Europe. Still, it is feeling the effects of slowdown in its largest trading partner, Azerbaijan.

18 Georgia was a member of the CIS until 2009, when it withdrew. It remains affiliated to the CIS through continued participation in agreements such as free trade and visa-free travel.
19 Data taken from United Nations Statistical Division (COMTRADE), http://comtrade.un.org/db/
20 Data taken from Bloomberg.
Insurance in the frontier markets

The near-term outlook for the three frontier markets will continue to depend on oil price developments. The current challenges present an opportunity for structural reforms to diversify their economies, but near-term growth will remain constrained. For instance, Kazakhstan is forecast to grow by only 2% in 2016 before picking up momentum to a longer-term growth rate of about 4.5-5%. This compares with Azerbaijan, which is forecast to contract this year and only accelerate towards its potential growth rates of about 4.5% by 2019. Georgia is currently growing slightly faster, about 2.7% in 2016, with a similar growth potential of 4.5% in the long-run.

Table 3
Key economic and insurance indicators for CIS countries, 2015

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<thead>
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<th>Life penetration, in % of GDP</th>
<th>Total penetration, in % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Azerbaijan</td>
<td>51</td>
<td>5229</td>
<td>2.6%</td>
<td>9.8</td>
<td>0.58%</td>
<td>0.14%</td>
<td>0.72%</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>182</td>
<td>10327</td>
<td>4.5%</td>
<td>17.9</td>
<td>0.62%</td>
<td>0.14%</td>
<td>0.66%</td>
</tr>
<tr>
<td>Georgia</td>
<td>14</td>
<td>3466</td>
<td>4.4%</td>
<td>4.0</td>
<td>0.97%</td>
<td>0.06%</td>
<td>1.03%</td>
</tr>
</tbody>
</table>


Despite recent price weakness, demand for energy and commodities, particularly from China, will remain an important growth driver for insurance.

The under-developed markets in Azerbaijan, Georgia and Kazakhstan represent an insurance opportunity.

The longer-term outlook for these markets remains favourable. They are rich in commodities and the energy-rich Eurasian countries generally are receiving increasing attention from China, a trend that will likely be further supplemented by the One Belt, One Road (OBOR) initiative in the coming years. Kazakhstan in particular is well positioned to take advantage of China’s “New Silk Road” initiative, which links China with Western Europe by rail and is already being used by freight trains from China to Germany, and vice versa. All three countries are signatories of the Asian Infrastructure Investment Bank which was established to assist in the financing of OBOR-related infrastructure.

Insurance market outlook
Insurance remains in its infancy in the CIS. The three frontier markets in this study are already the most advanced of the CIS countries (excluding Russia, Belarus and Ukraine). Georgia has a relatively high penetration rate in non-life insurance, at 1.0%, while Kazakhstan and Azerbaijan are at about 0.5% to 0.6%. Compared to this, Russia’s non-life insurance penetration is 1.85% of GDP and the CEE EU member average is 2.3%.22 To a certain extent, this reflects the prevailing mindset of relying on state or family support in the time of need. Many people in the CIS countries view insurance as a luxury. Further, for those private insurers that do exist, the main competition comes from dominant state-affiliated firms such as PASHA in Azerbaijan, and market concentration is high. The following are some common characteristics of insurance markets in the CIS frontier countries:

- Due to small market size, insurance sector development has been highly volatile, but is still closely related to economic and income growth.
- Non-life business is dominant. Over 80% of premiums in Kazakhstan and Azerbaijan are written in non-life insurance, and over 90% in Georgia.
- The non-life business is mostly driven by the introduction of compulsory covers or state initiatives (eg, medical insurance in Georgia).
- The legacy of the Soviet Union remains strong. A prevailing lack of risk awareness and strong reliance on public social services provisions has crowded out private initiatives.

22 CEE EU member average refers to Poland, Hungary, Slovenia, Slovakia and the Czech Republic.
In Kazakhstan, insurance premiums grew in 2015 despite a sharp economic slowdown. Official data show premiums rose by more than 10% as growth in liability insurance and property insurance premiums continued at double-digit rates. However, some lines experienced a decline, such as agricultural and also motor hull insurance. Life premiums growth rebounded to 17% in 2015, after a 17% collapse in 2014. Even so, life insurance remains a very small niche segment. Medical insurance declined by about 5%.

In Azerbaijan, life and non-life insurance premiums have continued to grow in the last few years. Strong growth in life and medical insurance offset a small decline in non-life premiums in 2014, the latter due to weaker demand for property and motor cover. In 2015, total life and non-life insurance premiums were up by about 3%. Non-life growth was weak, at just over 1%, as premiums in motor, the largest line of business, fell 3%. However, there was a more-than 20% increase in liability premiums. The insurance sector is growing slower than before the financial crisis, and current economic difficulties have led the government to downgrade its 2020 premium target from AZN 1 billion to AZN 700 million. Nevertheless, this implies an annual average growth rate of 10% over the next five years, compared with 7.5% annual nominal GDP growth.

Total premium growth in Georgia has been volatile in recent years mainly due to fluctuations in medical insurance, which grew rapidly after the government moved to privatise the healthcare system in 2007. Gross written premiums in medical insurance increased 18-fold between 2006 and 2013. However, thereafter a government decision to reverse liberalisation, removing private insurance companies from the provision of public healthcare and renationalizing the administration of healthcare, resulted in a 61% contraction of medical insurance premiums in 2014. Overall, non-life insurance premiums in Georgia grew by over 10% per annum in the five years to 2014. Life insurance remains at an early stage of development, accounting for just 5% of total premiums.

Growth outlook

There are some common growth drivers for the insurance sectors in the three CIS markets. One is the introduction of new categories of compulsory insurance. In Azerbaijan, additional compulsory requirements, most notably for medical and unemployment insurance, will likely generate premium growth. A compulsory medical insurance system is expected to be introduced on a trial basis as early as 2017 since the government aims to shift the funding of healthcare more towards private means. In Kazakhstan, meanwhile, there has been strong growth in commercial lines. This, underpinned by various compulsory lines such as MTPL, professional indemnity and workers’ compensation, is expected to continue.

Meanwhile, in contrast to the other CIS countries, MTPL insurance is not compulsory in Georgia and to date, the motor segment has remained relatively small there. Georgia needs to make MTPL cover compulsory: not only is it a requirement of the EU association agreement, it also represents a very visible protection gap. A law to make MTPL insurance compulsory is anticipated in 2016 and, once enacted, there will likely be a significant boost to total insurance premiums.
Developments in the regulatory environments of the three countries can also impact insurance sector growth. In Kazakhstan, insurance has benefited from a strong and rigorous regulatory framework, looking to be more or less compliant with EU norms. The use of EU business line classifications has enabled good data collection and monitoring of performance. Meanwhile insurance laws have been made more consumer friendly. For example, tariffs and liability limits have controlled premiums, which has further helped build trust among the population, as reflected in the strong uptake of voluntary insurance. In Azerbaijan, a new, unified system of damage assessment for motor insurance should help improve claims handling, transparency and consumer confidence, although initial reports suggest decreasing claims and some customer dissatisfaction with the new system. Furthermore, the government has passed legislation to make settlements of compulsory car insurance claims more efficient and fraud resistant, and also to increase the use of digitalisation. Meanwhile, Azerbaijan joined the auto insurance Green card system in 2016. From 1 April, Azerbaijani motorists have been able to buy Green card coverage in the EU member states, Switzerland and other countries.

In the case of Georgia, the unexpected changes to the national healthcare policy resulted in a slump in medical premiums in 2014. This highlights the need for legislative bodies to treat insurers fairly and incentivize them to provide attractive insurance solutions. To promote investment and the transfer of foreign capital and knowledge, countries need to provide a stable, supportive regulatory environment. Kazakhstan is investigating the introduction of sharia-compliant Takaful insurance to extend penetration amongst its predominantly Muslim population. Other than mandatory covers, the uptake of insurance among the Muslim population has remained low. Takaful could help overcome religious-belief based hesitations to buying insurance. In Azerbaijan, meanwhile, the government and insurers have made efforts to educate the population about the benefits of insurance. The government is following the lead of Kazakhstan here in attempting to make insurance laws more consumer friendly.

Another common factor in the three markets is a promising economic growth outlook. Insurance penetration in the markets is low and economic growth should lead to more demand for insurance. Comparing real GDP growth with non-life premium growth, the 2000-2014 average premium growth was double; compared to pre-crisis growth rates, as much as four times higher. The three markets have moved slowly into the lower section of middle-income countries in the S-curve analysis, indicating that gains in insurance premiums should continue to outpace income growth. Important structural economic reforms are key to making this happen. Trade-enhancing initiatives can also sustain premium growth momentum. For example, WTO membership should (eventually) help Kazakhstan further open its real economy and financial sector. The latter, including insurance, will remain essentially closed for foreign participation for a transition period of five years. But that is a relatively short period and in the interim, local insurers will seek to improve their underwriting capabilities and product offering so as to be ready to face foreign competition by 2020. A possible outcome of foreign entrants is that they could reduce market concentration: currently the top five insurers in Kazakhstan collect around 50% of all premiums.

23 “The Green Card System is a protection mechanism for victims of cross-border road traffic accidents. It consists of 48 member countries represented by 47 National Insurers’ Bureaux.”
Latin America: Bolivia, Colombia, Ecuador and Peru

The Andean countries of Bolivia, Colombia, Ecuador and Peru form Latin America’s largest block of frontier markets (the other being the much smaller grouping of Central American markets). Their membership in the Andean Community of Nations (Comunidad Andina, CAN) — a customs union dating back to 1969 — underscores their geographical, social and economic cohesiveness. The CAN project has been in abeyance and overshadowed by new groupings such as the Pacific Alliance but nevertheless, the Andean region represents a market of considerable potential.

With a total population of around 100 million people and combined GDP estimated to be around USD 700 billion in 2015 (USD 1.3 trillion in purchasing power parity terms), the four frontier markets are roughly one-third the size of Brazil. Economic growth in the region has been robust, averaging 5.1% per year in the past decade, higher than both Mercosur (3.9%) and the Pacific Alliance (3.3%).

Table 4
Key economic and insurance indicators of Bolivia, Colombia, Ecuador and Peru, 2015

<table>
<thead>
<tr>
<th></th>
<th>GDP, USD billion</th>
<th>GDP per capita, USD</th>
<th>GDP growth (2016–2020F)</th>
<th>Population, million</th>
<th>Non-life penetration, in % of GDP</th>
<th>Life penetration, in % of GDP</th>
<th>Total penetration, in % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td>37</td>
<td>3469</td>
<td>3.5%</td>
<td>10.7</td>
<td>0.87%</td>
<td>0.33%</td>
<td>1.20%</td>
</tr>
<tr>
<td>Colombia</td>
<td>358</td>
<td>7218</td>
<td>3.6%</td>
<td>49.5</td>
<td>1.80%</td>
<td>0.73%</td>
<td>2.54%</td>
</tr>
<tr>
<td>Ecuador</td>
<td>105</td>
<td>6488</td>
<td>3.1%</td>
<td>16.2</td>
<td>1.41%</td>
<td>0.31%</td>
<td>1.72%</td>
</tr>
<tr>
<td>Peru</td>
<td>204</td>
<td>6530</td>
<td>4.2%</td>
<td>31.2</td>
<td>0.97%</td>
<td>0.89%</td>
<td>1.86%</td>
</tr>
</tbody>
</table>


24 Mercosur comprises Argentina, Brazil, Paraguay, Uruguay, and Venezuela. The Pacific Alliance comprises Chile, Colombia, Mexico, and Peru.
Insurance in the frontier markets

The major Andean economies are outpacing their regional peers.

**Economic development**

The near-term economic outlook is mixed, reflecting the Andean countries’ diverse economic policy frameworks, political climates and macroeconomic fundamentals. All four countries rely heavily on commodity exports and are exposed to the current global commodity price down-cycle. However, Colombia and Peru have sound policy frameworks in place, flexible exchange rates, and stable inflows of foreign direct investment and solid currency reserves to finance the current account deficit, that will help cushion the impact of softer commodity prices. Their economies are projected to expand by 3.0% and 3.3%, respectively, in 2016, slower than the annual averages of the past decade but well above the regional average (0.9%). Bolivia and Ecuador, by contrast, have less policy flexibility as a consequence of the high level state involvement in the economy and fixed exchange rates. Furthermore, full (Ecuador) and elevated (Bolivia) dollarization renders their exports less competitive in a strong US dollar environment, and increases their vulnerability to external financial shocks.

**Insurance market outlook**

Premiums written in the Andean region totalled USD 15 billion in 2014, of which two-thirds came from Colombia. This amounts to only 9% of premium volumes in Latin America overall, in which Brazil and Mexico dominate. However, the Andean insurance markets — with the exception of Bolivia — have recorded some of the fastest growth rates in the past decade, together averaging 8.8% per year in real terms, compared to 7.7% for Latin America. There have also been significant strides in deepening insurance penetration, albeit off very low bases. Penetration rates, however, remain relatively low, ranging from 1.4% of GDP in Bolivia to 2.5% in Colombia, compared with 3.4% in Brazil and 4.2% in Chile.

The common growth constraints for the Andean markets have been:

- low income levels, especially in rural areas;
- relatively high market concentrations, reflecting the oligopolistic dominance of large financial conglomerates such as Colombia’s Grupo Empresarial Antioqueno (Suramericana) and Peru’s Breca Group (Rimac) and Credicorp (El Pacifico);
- a recent history of state monopolies and protectionism, including a prohibition on foreign investment in CAN member countries until 1987; and
- recent periods of macroeconomic and political instability, including hyperinflation and internal conflicts in Colombia and Peru.

Peru and Colombia have made better progress overcoming these constraints than Bolivia and Ecuador, mainly by undertaking liberalizing structural and institutional reforms in the 1980s and early 2000s. The regulatory and operating environments in these markets have improved considerably and have encouraged foreign insurers to increase their participation. For example, the market share of foreign insurers in Colombia increased from 34% in 2003 to 41% in 2014. In contrast, foreign participation in the Bolivian market has practically disappeared and the business environment in Ecuador has grown more challenging with the worsening economic climate and steady encroachment of the state into the local re/insurance markets. The public sector is a major buyer of insurance in Ecuador, and the two state-owned insurers (Sucre and Rocafuerte) have first right of refusal on all government insurance transactions. Since this rule was implemented in 2009, the two insurers have grown their market share to 16% from 5%.

Insurance growth has been robust, but penetration remains low.

The business environment is more favourable in Peru and Colombia than in Bolivia and Ecuador.
The prospects for Andean insurance market growth are relatively positive...

...with opportunities across many lines of business.

**Figure 7**
Real growth of insurance premiums, %

**Opportunities**
Insurance market growth in the Andean region is expected to remain robust, albeit slower than in the previous decade. Total premiums are forecast to grow by 7% per year in real terms between 2016 and 2025, slightly faster than the 6% projected for all of Latin America. Most of the growth will come from Peru and Colombia. Both countries are aligning their regulatory frameworks with international best practices while also entrenching open and business-friendly trade and investment regimes. For instance, a European Union (EU)-Andean Community free trade agreement concluded in 2013 is currently being implemented and will enhance market access for European re/insurance firms.25

There is significant prospect for catch-up in virtually all lines of business in these markets, especially for insurers which can tap into lower-income segments. Large public-private partnership pipelines, such as the fourth-generation (4G) transport infrastructure investment program in Colombia, indicate demand for engineering, credit and surety insurance. And an anticipated settlement of Colombia’s long-running internal conflict will further integrate the rural sector into the national economy, creating new opportunities for agricultural insurance.

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25 The agreement currently only applies to Colombia and Peru. Ecuador is expected to join in 2016.
Insurance in the frontier markets

Southeast Asia frontier insurance markets: Cambodia, Laos, Myanmar and Vietnam

CLMV refers to Cambodia, Laos, Myanmar and Vietnam. They are four of the smaller markets in Southeast Asia and have seen significant development in recent years.

Figure 8
Cambodia, Laos, Myanmar and Vietnam

Economic development
The CLMV markets have on average grown by 7.2% in real terms each year since 2000. Vietnam is the biggest of the four markets, accounting for 71% of total GDP in 2015, followed by Myanmar at 18%. Both Laos and Cambodia represent less than 7% of CLMV GDP. Economic growth has remained stable at around 6-7% in the four markets in recent years, supported by stabilising political conditions and despite the global financial crisis and increasing financial volatility. In Cambodia, there has been improved political stability since the opposition Cambodia National Rescue Party (CNRP) ended its 10-month boycott of parliament in August 2014. This is expected to benefit economic growth, lift investor confidence, encourage foreign direct investment, enabling the ruling Cambodia People’s Party (CPP) to focus on state enterprise reforms, tax consolidation and promoting private investment. Further, gradual trade integration into the Association of Southeast Asian Nations (ASEAN) will help exports, which have been dampened by the economic slowdown in China and downturn in Europe.

Laos has rich energy resources.

The diversity of economic development in the region is reflected in a relatively high incidence of poverty in some markets. For instance, despite impressive growth in recent years, Laos remains poor and reliant on international aid. The United Nations reports that 33.9% of the country’s population live on less than USD 1.25 per day. Power shortages, poor transport infrastructure, a low level of human capital, and corruption have dragged on development. On the other hand, Laos is already one of the biggest energy exporters in Southeast Asia and the government believes only 8% of the energy capacity has been tapped. The government’s aim is to build additional hydroelectric dams and eventually become the “battery of Southeast Asia”.

Source: Swiss Re.

Since taking office in 2011, the current government in Myanmar has embarked on a series of economic and pro-democracy political reforms. Key measures include adopting a managed float exchange rate regime, removing foreign exchange restrictions, easing constraints on foreign investment, increasing government spending on health and education, and improving legislation. The US, EU and Japan have abolished most sanctions against Myanmar, and the ASEAN peer states approved its election as ASEAN chair in 2014. These developments have supported rapid economic growth in recent years: GDP grew by 8.5% in real terms in the fiscal year ending March 2015. Myanmar held democratic elections for the first time in 25 years in November 2015, which the opposition National League for Democracy party (NLD) won with an overwhelming majority. A smooth transition will likely result in further inflow of foreign investment and ongoing strong economic growth.

Vietnam’s short-term economic growth outlook also remains positive. The conclusion in August 2015 of the Vietnam–European Union Free Trade Agreement alongside trade deals within the ASEAN Economic Community will likely enable greater market access for the country’s exports and mitigate the impact of economic slowdown in China. In June 2015, the government announced the end of a 49% cap on foreign ownership in a range of sectors, which is expected to open up state-owned enterprises (SOEs) for privatisation, support foreign investment inflows, and enable more investors to enter the country’s capital markets. A lingering problem is the bad debt load in the banking sector. Nevertheless, as of August 2015, credit institutions in Vietnam had settled a combined VND 424 trillion of non-performing loans (NPLs), or 91.2% of the NPLs in existence in September 2012. The fall in NPLs will encourage growth in bank lending, ensuring domestic investment rises alongside foreign inflows.

**Insurance market outlook**

The insurance sector in CLMV is at an early stage of development. The market in Vietnam is most developed and has the highest penetration. Similar to the experience of other frontier markets, the early stage of insurance development is being driven by non-life insurance. Demand for life insurance is emerging, but only slowly.

**Table 5**

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP (2015), USD billion</th>
<th>GDP per capita, USD</th>
<th>GDP growth (2016–2020F), %</th>
<th>Population, million</th>
<th>Non-life penetration, in % of GDP</th>
<th>Life penetration, in % of GDP</th>
<th>Total penetration, in % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>18</td>
<td>1127</td>
<td>7.5</td>
<td>15.6</td>
<td>0.35%</td>
<td>0.00%</td>
<td>0.35%</td>
</tr>
<tr>
<td>Laos</td>
<td>12</td>
<td>1767</td>
<td>7.6</td>
<td>6.8</td>
<td>0.44%</td>
<td>0.01%</td>
<td>0.45%</td>
</tr>
<tr>
<td>Myanmar</td>
<td>76</td>
<td>1406</td>
<td>6.9</td>
<td>53.9</td>
<td>0.07%</td>
<td>0.01%</td>
<td>0.08%</td>
</tr>
<tr>
<td>Vietnam</td>
<td>197</td>
<td>2106</td>
<td>6.6</td>
<td>93.4</td>
<td>0.74%</td>
<td>0.82%</td>
<td>1.56%</td>
</tr>
</tbody>
</table>

Insurance in the frontier markets

While markets are embarking on liberalisation and de-regulation.

These markets are revising insurance and related regulations to enable faster sector growth. For example, a new Insurance Law in Cambodia took effect from February 2015. In Myanmar, where the insurance market has been in state hands since 1963, in 2013 twelve private companies were granted conditional approval to provide insurance services.27 While all CLMV markets allow foreign participation, there is lack of clarity over establishment rules. To date, global insurers have meaningful presence in Vietnam. Insurers from ASEAN member states, mainly Malaysia and Vietnam, are present in Cambodia also.

Premium growth in some CLMV markets is volatile. This is in part due to the small size of the existing premium base, which is susceptible to large fluctuations when major insurance projects go live. For instance, the implementation of large engineering projects in Laos bolstered non-life premium growth in 2012, followed by sharply lower growth the following year.

Figure 9
Real growth of total insurance premiums in CLMV, 1995-2015, %

Furthermore, the CLMV markets stand to benefit from...

Growth outlook
The CLMV economies have benefited from more stable domestic socio-political environments in recent years and further integration into the global economy. Two other developments will likely foster stronger GDP growth, and also potentially act as growth drivers for the insurance market, the ASEAN Economic Community and China’s One Belt, One Road policy.

ASEAN Economic Community
The ASEAN Economic Community (the AEC) was formally inaugurated in December 2015. The objectives are to foster closer economic integration and cooperation among the 10 ASEAN member states.28 The journey started with the signing of a Preferential Trading Agreement in 1997, and there has been much progress since. For example, product and safety standards have been harmonized, investment agreements implemented, and pilots introduced to facilitate customs transit.

28 The 10 ASEAN members include Brunei Darussalam, Cambodia, Indonesia, Lao PDR (Laos), Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.
The creation of the AEC will facilitate free flow of goods, services, investment and skilled labour among the ASEAN states, as well as “freer” flow of capital. The CLMV markets are expected to benefit from the opening up of new market segments, lowering of non-trade barriers and greater inflow of foreign direct investment. The benefit to insurance will be from increased trade and investment flows. And, the expectation of services integration will likely drive further harmonisation of insurance regulations in the ASEAN region and create opportunities for cross-border supply of insurance services. 29

One Belt, One Road

The One Belt, One Road (OBOR) plan championed by China is another undertaking with potential to bring about significant benefits to the ASEAN economies, in the form of increased trade and investments in infrastructure. The “One Road”, or the 21st Century Maritime Silk Road, will likely benefit the ASEAN member states. The initiative aims to revive one of the historic maritime trade routes, and countries along the trading route will receive significant investment in infrastructure in preparation of the expected growth in trade flows. Much has already been done to support the building of the new Silk Road, including the establishment of major financial institutions for funding. These include the Asian Infrastructure Investment Bank, the New Development Bank and the Silk Road Infrastructure Fund. According to China’s Ministry of Commerce, Chinese state-owned enterprises invested USD 10.7 billion in the 48 countries along the OBOR route during January-August 2015, an increase of 48.2% over the same period a year earlier. 30

Table 6 illustrates some of the expected cross-border projects under OBOR. Cambodia, Myanmar, Laos are all involved (as are many Central Asian markets). The projects will likely open up new opportunities in engineering insurance and other lines of business (eg, marine).

<table>
<thead>
<tr>
<th>Pilot projects</th>
<th>Investment destination</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gwadar port construction</td>
<td>Pakistan</td>
</tr>
<tr>
<td>Hambantota port construction</td>
<td>Sri Lanka</td>
</tr>
<tr>
<td>Capacity co-operation plan (investment value USD 23.6 billion)</td>
<td>Kazakhstan</td>
</tr>
<tr>
<td>Sihanoukville port construction</td>
<td>Cambodia</td>
</tr>
<tr>
<td>Indonesia port construction</td>
<td>Indonesia</td>
</tr>
<tr>
<td>China-Laos-Thailand railway</td>
<td>Laos and Thailand</td>
</tr>
<tr>
<td>China-Myanmar railway</td>
<td>Myanmar</td>
</tr>
<tr>
<td>China-Tajikistan highway</td>
<td>Tajikistan</td>
</tr>
<tr>
<td>China-Pakistan highway</td>
<td>Pakistan</td>
</tr>
<tr>
<td>China-central Asia natural gas pipelines line C and line D</td>
<td>Central Asia</td>
</tr>
<tr>
<td>China-Russia natural gas pipelines, west line and east line</td>
<td>Russia</td>
</tr>
</tbody>
</table>

Source: “On the New Silk Road III”, Xinhua, April 2015; HSBC.

29 A journey starts – inauguration of the ASEAN Economic Community. Swiss Re, December 2015.
30 At the same time, OBOR countries have established 224 foreign-invested enterprises in China during January-August 2015, up 54.4% year-on-year. China contracted 2665 OBOR engineering projects with 60 OBOR countries during the same period of time, at a total value of USD 54.4 billion. See “Chinese State-Owned Investment in “One Belt, One Road” Countries Up 48.2% Year-on-Year”. China Go Abroad, October 2015, http://www.chingoaobroad.com/en/article/chinese-state-owned-investment-in-one-belt-one-road-countries-up-48-2-year-on-year
Insurance in the frontier markets

There are 370 million people in Bangladesh, Pakistan and Sri Lanka.

South Asia: Bangladesh, Pakistan and Sri Lanka

Bangladesh, Pakistan and Sri Lanka are home to 370 million people. They are middle-low income markets, with highest per capita income in Sri Lanka (at more than USD 3600 in 2015). Economic growth has remained fairly robust in the past decade, averaging at around 6% in Sri Lanka and Bangladesh, and 4% in Pakistan.

Economic development

The near-term economic outlook for these countries is uncertain given the slowdown in China, the current strong El Nino affecting agricultural output, and financial volatility following the first US interest rate rise in December 2015. For instance, weakening exports and a slowdown in remittances led to a doubling of Sri Lanka’s current account deficit in the first half of 2015 from the previous year. However, these markets have also benefited from the shift of manufacturing production from China to other, including these, lower-cost locations.

Over the longer term, Bangladesh has the potential to achieve high growth, assuming numerous structural issues are resolved. To this aim, the government is targeting a 29.5% increase in tax revenue in 2015/16 to improve fiscal sustainability. The medium-term outlook for Pakistan depends on structural and economic reform also, but needs political stability and an improving security situation. Business and consumer confidence must be bolstered to foster private investment. Support from multilateral agencies like the IMF and Asia Development Bank along with access to the international capital markets will help. Sri Lanka, meanwhile, has benefitted from the peace dividend and political stability since the end of the civil war in 2009. The economy achieved average annual growth of 7.3% between 2010 and 2014. However, slowing exports and rising fiscal deficits are current challenges.

Table 7

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>191</td>
<td>1189</td>
<td>6.2%</td>
<td>161.0</td>
<td>0.19%</td>
<td>0.53%</td>
<td>0.72%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>265</td>
<td>1400</td>
<td>5.5%</td>
<td>188.9</td>
<td>0.27%</td>
<td>0.54%</td>
<td>0.82%</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>78</td>
<td>3623</td>
<td>6.5%</td>
<td>21.6</td>
<td>0.58%</td>
<td>0.48%</td>
<td>1.06%</td>
</tr>
</tbody>
</table>


31 For the current 2016 fiscal year, the World Bank defines middle-income economies as those with gross national income (GNI) per capita of more than USD 1045 but less than USD 12 736.
Insurance is under-developed, and regulations are being tightened.

There is a range of opportunities in these markets, absent disruptive drivers.

Insurance market outlook
Total premiums collected in 2015 ranged from USD 0.8 billion in Sri Lanka to USD 2.3 billion in Pakistan. Overall insurance growth in the three markets averaged 8.8% in nominal terms between 2008 and 2015. Penetration is low, reflecting the early stage of insurance development. While non-life is more developed in Sri Lanka, in Bangladesh and Pakistan penetration is higher in life than in non-life insurance. Apart from low incomes, government initiatives and regulatory challenges are constraining penetration. In Sri Lanka, government provisions of free healthcare and education, and a pension scheme for public-sector employees, have reduced the incentive to sign up for private insurance. At the same time, insurers are facing pressures to meet various new regulatory requirements, including higher paid-up capital, the splitting of composite businesses and the introduction of a risk-based capital regime in 2016. In Pakistan, a low paid-up capital requirement has led to a large number of smaller players which lack the resources to invest in underwriting and distribution. Nevertheless, there could be market consolidation with the pending requirement to increase paid-up capital to PKR 500 million for non-life companies, and PKR 700 million for life players, by 31 December 2017. In addition, a high level of unpaid premiums (mainly in non-life) remains a concern. The Bangladeshi market is similarly populated by many small players. For instance, there are 30 life insurers with the majority writing less than BDT 500 million (USD 6.1 million) in premiums. Consolidation is likely once new rules for solvency and capital take effect.

Opportunities
Insurance growth in these South Asia markets will continue to derive support from stable economic growth, averaging 5-7% over the next five years. Other fundamentals, including high natural catastrophe exposures, increasing urbanisation and a rising middle income class, will add to demand for insurance. The implementation of higher capital and solvency standards among other regulatory measures, will help to improve market efficiency and encourage consolidation.

Figure 11
Real growth of insurance premiums in Bangladesh, Pakistan and Sri Lanka, 2009–2015E, %

Non-life insurance

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth</td>
<td>-10%</td>
<td>0%</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>0%</td>
<td>-10%</td>
</tr>
</tbody>
</table>

Life insurance

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth</td>
<td>-10%</td>
<td>0%</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>0%</td>
<td>-10%</td>
</tr>
</tbody>
</table>

E = estimates.
Source: Swiss Re Economic Research & Consulting.
Insurers have a long history of investing in frontier markets. Global insurance companies are no strangers to frontier markets. Many established emerging markets were considered “frontier” when global players first set foot in them. There have been successes, and also withdrawals when things have not gone to plan. To realise the potential of these markets necessitates a long-term strategy. Insurers enter frontier markets in part to gain the “early-mover” advantage. The aim is to be well-positioned when the markets reach the critical middle-income threshold when consumers and businesses start buying more insurance.

The typical growth path of insurance in frontier markets has implications for entry and operating strategies. The growth of insurance in frontier markets features some common patterns. Understanding these is critical to defining an insurers’ entry and operating strategy.

- Non-life insurance in frontier markets usually makes up the bigger part of premiums in the early stage of development. In non-BRICS emerging markets, non-life accounted for 60.8% of total premiums in 2015. In comparison, in the more developed BRICS countries, non-life premiums were 41.6% of the total.
- The share of life premiums increases as insurance penetration rises. China is a striking example: non-life accounted for almost all premiums in 1980 but just 31.2% in 2003, shortly after its accession to the WTO.
- In non-life insurance, commercial motor, property, fire and marine, aviation and transport (MAT) lines are usually the first to develop. Growth in personal lines comes later.
- The non-life market is typically more fragmented and life more concentrated. The level of concentration will increasingly depend on regulation, including the introduction of more stringent solvency capital requirements in frontier markets.

Insurers can also face scalability challenges in frontier markets. In addition, scalability can be challenging, given the small size of markets in early stage of development. In some cases, insurers focus on a group of regional markets rather than just one country to lower business costs, and take advantage of other economies of scale. Leveraging technology and new business models (eg, collaborating with NGOs to support micro-insurance programs) are other options to build scale.

32 There are, as always, exceptions. For instance, non-life insurance remains the dominant force in Russia, and India has had a strong life sector since the early stage of insurance development.
Entry strategy

Frontier markets can benefit from increased participation of international insurers, both in terms of underwriting capacity and technical expertise. A critical question when considering entering a new market is the feasibility of going in alone, in partnership with a local carrier or acquiring an existing local firm. The choice is contingent on local regulatory regimes, in particular with regards to foreign ownership. Many emerging and frontier markets still have restrictions on foreign entrants through requirements on maximum foreign shareholdings or joint venture requirements. Even some established emerging markets retain certain restrictions.

All entry routes have advantages and associated risks. Some insurers are growing organically as well as through acquisition in frontier markets, as Allianz, for example, has done to increase its presence in Asia, the CEE and Latin America. Other examples are AXA’s recent acquisition of 51% stake in Colpatria’s insurance operation in Columbia\(^{33}\) and Prudential’s acquisition of Ugandan company Goldstar Life Assurance.\(^{34}\) Acquisition of existing insurers provides foreign insurers an already-established platform in the local market, which allows them to “hit the ground running”. However, a starting challenge is that the insurance sectors in emerging markets tend to be relatively concentrated, and the best performing insurers are less likely to be up for sale. A more realistic approach is to acquire a medium-size second tier player with potential for improvement. But then integrating the new company into the insurer’s global operations presents further challenges, such as dealing with legacy portfolios and proper valuations of local assets, particularly in view of the innate volatility of smaller markets.

Joint ventures with local partners or tie-ups with distribution networks can also be used to establish a presence in emerging and frontier markets. This option provides the foreign entity a strong local brand name, market expertise, local skills to tackle location-specific obstacles more smoothly, and wide consumer reach. AXA’s move into Indonesia and Malaysia\(^{35}\), and Zurich Santander’s life distribution arrangement in Latin America\(^{36}\) are examples of global insurers leveraging local partners to establish themselves in new markets. However, in this model the foreign partner still faces integration challenges linked to cultural differences and ease of doing business. At the same time, the strategic interest of the local partner can diverge from that of the foreign partner, creating delay in decision making and potentially erosion of brand value.

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Technology as a disruptive force in emerging and frontier markets

Technology is being used by insurers to simplify processes across the value chain, from designing simpler products, leveraging new sources of data for marketing, partnering with fin-tech players in distribution, and using advanced analytics in claims processing. In this way, technology is accelerating the development of the insurance business in emerging and frontier markets, such that what took many years of development in the advanced markets is being compressed into just a few years in the emerging territories. This can support increased insurance penetration in the emerging and frontier markets, and help domestic and foreign players establish a footprint there.

### Figure 12
The use of technology in the insurance value chain

<table>
<thead>
<tr>
<th>Product development</th>
<th>Marketing</th>
<th>Distribution</th>
<th>New business and underwriting</th>
<th>Claims</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Simplified product design</td>
<td>▪ Customized marketing and segmentation</td>
<td>▪ Make rural distribution</td>
<td>▪ Alternate data for instant verification</td>
<td>▪ Analytics to uncover fraud rings and social networks</td>
</tr>
<tr>
<td>▪ Affordable index-based insurance</td>
<td>▪ Algorithms to analyse mobile data variables</td>
<td>▪ Issue policy without filing application forms</td>
<td>▪ Electronic collection of documents</td>
<td>▪ Drones</td>
</tr>
<tr>
<td>▪ Analytics driven products to cope with unique risks</td>
<td>▪ Start-up engagement</td>
<td>▪ Mix digital sales with high-touch sales</td>
<td>▪ Wearable devices</td>
<td>▪ Biometrics, identity platforms</td>
</tr>
</tbody>
</table>

Source: Swiss Re Economic Research & Consulting.

The use of technology can help facilitate insurance penetration in frontier markets.

The use of mobile technology can help insurers to identify and reach potential clients, ...

**Simplified product design**: Insurers in frontier markets are using mobile technology to develop simple products to get initial access to customers. They offer life or health insurance based on monthly airtime usage on a mobile-service account. The coverage may initially be low, but it helps insurers identify clients who could potentially spend more money on insurance as disposable incomes rise. Crop insurance is also an area ripe for digital innovation, with insurers like Acre Africa offering mobile-based index insurance by partnering with mobile operators and agribusiness.37 Firms are also exploring the feasibility of collecting accurate weather data using mobile-enabled sensors embedded in solar-powered lighting systems.38 Finally, new products are being developed for some risks confronting emerging and frontier-market. For example, insurers reportedly plan to offer cover for diseases like Ebola in Sub-Saharan Africa by 2017.39

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New modes of distribution: Insurers are leveraging digital platforms to enhance their reach, particularly in rural areas. Today, 60% of insurers in Nigeria use Interswitch’s digital platform for insurance distribution or other services. Telecommunications firms will likely remain strong distribution partners for insurers in emerging and frontier markets given consumer trust in the brands. For example, in Ghana, research by Consultative Group to Assist the Poor (CGAP) showed that 70% of consumers prefer to buy insurance from a mobile operator as opposed to an insurer.

New business and underwriting: Using GPS, cell tower triangulation, cameras or biometric data, insurers can verify identity and location. In Bangladesh, Grameenphone has information on its customers’ family members through its “Friends and Family” dialling feature. Partner insurer Nirvoy Life cross-references this data to verify the dependents for life insurance plans. Insurers are also using electronic collection of documents to speed up customer registration and reconciliation of documents. Wearables too are making their way into the consumer segment and wider usage can help provide more data for risk assessment.

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There is no “one-size-fits-all” approach for expansion into the emerging and frontier markets. The diversity of insurers’ strategies demonstrates the importance of paying attention to the unique socio-economic, regulatory and cultural characteristics of different markets. Key characteristics to gauge include:

- Awareness of financial products in general, and insurance in particular, is low in the frontier markets. A lack of financial literacy is most prominent in rural areas. Consumers may not understand the value and benefits of insurance. Demand is mostly driven by compulsory requirements like MTPL cover.
- Affordability is crucial. Products which are popular in mature and advanced markets may not be suitable for emerging and frontier markets. This can limit demand for risk products in the latter, but consumers may nonetheless be interested in insurance as a saving and investment vehicle.
- Fragmented markets, particularly in countries with low levels of urbanisation, increase the difficulty of reaching rural areas where the majority of people typically reside.
- There are also operational issues, including a lack of underwriting data as the social and demographic landscape changes rapidly.

Insurers face a unique combination of challenges when entering emerging and frontier markets. To tackle the lack of consumer awareness around benefits of insurance, and also the price sensitive nature of the markets, some insurers adopt an all-in-one product strategy approach to offer comprehensive protection and savings options. In less developed markets, simple products with high affordability can be more successful. Of late, simple, integrated saving and protection covers have been becoming more popular, while riders are offered for various life events to address customer’s different protection needs. For example in Mexico, MetLife sells a simple universal life product, but with 18 optional riders for different life events.\(^43\)

Investment and savings remain a key motivation for the purchase of life insurance in emerging and frontier markets, as reflected in the popularity of “return of premiums” and investment guarantee features in life and health products. Even in relatively advanced markets with developed equity markets like Malaysia, Indonesia, Thailand and some CEE markets, the product mix is shifting towards unit-linked products with low guarantees. These are deemed more capital efficient with higher margins and shorter pay back periods, and can also cater to a client’s investment needs.

As in advanced markets, an insurer’s distribution strategy is critical. To expand their reach, many insurers in emerging and frontier markets employ a multi-channel distribution approach. In many countries, agents remain prevalent owing to their reach in tier two and three cities. Attracting local talent in the agency framework is a core part of strategy, and insurers have been investing in increasing agent productivity through training and education. In many markets there has been a notable shift to bancassurance, which has become one of the fastest growing channels. Online channels are also being used.

Bancassurance is widely seen as the key enabler of growth. This has been the case post the global financial crisis, after which many banks withdrew from insurance product design to focus on distribution. Insurers are looking to optimise new and existing partnerships to generate additional sales with local and international banks with strong brand value and wide distribution networks. For example, with this aim AXA has partnered with Mandiri in Indonesia, Metrobank in Philippines and UkrSibbank in Ukraine. 44 Similarly, AIA has joined forces with CIMB and BCA in Indonesia, BPI in Philippines and Public Bank in Malaysia. 45 Both life and non-life products are being sold through banks, but most are life and health services. For instance, AXA is selling protection with savings in Thailand and unit linked savings with protection in Indonesia. 46 It is also targeting new customers like SMEs for commercial insurance.

Many frontier markets have a large tech savvy millennial population, and insurers have started to work on their digital infrastructure to leverage this opportunity. The aim is to make use of direct digital distribution channels like telemarketing and online sales to increase consumer reach and engagement, while also providing value added services. For example, MetLife states that direct marketing is one of its strategic growth initiatives in Latin America. 47 It also sees significant opportunity for direct marketing in CEE and the Middle East. 48 The ability to utilise technology can allow emerging markets to leapfrog insurance development. Such as in India, where insurers have increased sales of term-life products making use of behavioural economics concepts to steer more “clicks” and ultimately higher take-up of life protection products.

Learnings from Argentina

Global insurers have established themselves in many emerging and frontier markets, but there have also been incidences of withdrawal from markets due to operational, regulatory and political reasons. Such has been the case in Argentina, where deteriorating domestic macroeconomic conditions have created a challenging operating environment for re/insurers, especially foreign ones. They have faced political and economic instability, exemplified by double-digit inflation and sovereign default, as well as several market restrictive measures introduced during the Kirchner (2003–2007) and Fernandez (2007–2015) administrations. Examples of such state interventions in the re/insurance market include:

- Reforms to the private health insurance system passed in 2011 that extended benefits for policyholders and outlawed the denial of insurance owing to an applicant’s age or pre-existing medical conditions;
- Forced repatriation of foreign assets and minimum requirements for investments in state-directed infrastructure and “productive projects”, such as those of the recently nationalised oil and gas producer YPF;
- The wholesale nationalisation in 2008 of private pension funds and elimination of private pension fund administrators;
- Tight restrictions on cross-border reinsurance. This includes a limit to 40% of total cessions to affiliated companies.

Insurers have withdrawn from emerging and frontier markets due to operational, regulatory and political reasons.

In Argentina, worsening economic conditions and state intervention created severe challenges ...

Direct and digital distribution is emerging rapidly.

... while bancassurance is emerging as an alternative.
These factors have discouraged entry by foreign re/insurers into Argentina, and in some instances, provided the impetus for exit. No global foreign insurers have entered the market since Talanx acquired L’Union de Paris in 2011, and three have exited.\(^{49}\) CNA left Argentina in 2010, followed by Liberty International in 2014.\(^{50}\) Local carriers picked up the difference, growing their market share from 45% of premiums in 2009 to 53% in 2015. The impact on the reinsurance market has been more pronounced. The restrictive measures introduced in 2011 resulted in a decrease of market concentration – the share of the top 5 reinsurers fell from 57% in 2011 to 49% in 2014, – and a shift in favour of local reinsurers. The restrictions have also reinforced a decades-long trend of market exit, with the number of reinsurers falling from 133 in 2012 to 108 in 2014.

The Argentina example highlights the innate uncertainties and risks of emerging and frontier markets, as well as the pitfalls. Another example is China, where foreign insurers have market shares of just 2.2% in the non-life sector and 5.8% in the life.\(^{51}\) Here too, geographic and line-of-business restrictions, as well as strong domestic competition, have limited foreign penetration. However, these markets can still offer significant scale and uplift to insurance premium growth. And global insurers are seeking to enter the markets, taking advantage of increasingly liberal entry regimes, such as in the frontier markets of Cambodia, Myanmar, Colombia and Peru.

Conclusions

The emerging market countries have diverse economies at different stages of development. Collectively, they represent a major share of global output and their contribution will increase in the coming decades. As such, global insurance growth will increasingly be driven by developments in the emerging markets. Apart from the strong performance of the BRICS and other established emerging markets, there is also business potential in smaller frontier markets.

Frontier markets are relatively small and less developed than established and large emerging markets. However, individual markets or blocs of economies can still offer significant scale and uplift to insurance premium growth. There are clear drivers that will likely propel faster insurance development in some markets. In SSA, development of natural resources and economic growth will filter through to increase insurance penetration. In other SSA countries, such as Kenya, a solid regulatory framework and new technologies are driving growth. Meanwhile in Southeast Asia, Cambodia, Laos, Myanmar and Vietnam are set to benefit from the formation of the ASEAN Economic Community and the implementation of China’s One Belt, One Road (OBOR) initiative, which will also present new insurance opportunities. The OBOR will benefit some CIS economies, including Georgia, Kyrgyzstan, Moldova and Uzbekistan, which should see improving growth also due to recovery in Europe. In Latin America, the gradual spreading of market liberalisation policies is benefiting the insurance sector.

Global insurers are seeking to enter the frontier markets, taking advantage of liberalization of entry regimes. There are some common features to the insurance sectors in the frontier markets:

- Non-life products tend to dominate in the early stages of development;
- Commercial insurance leads personal lines;
- A strong emphasis on savings instead of protection products in life insurance;
- Affordability is a prime consideration;
- Low awareness of insurance among the population; and
- Low financial literacy.

Unravelling these location-specific permutations is key to the success of a global insurer seeking to enter a new frontier market. Noteworthy too is that emerging and frontier markets do not necessarily follow the same insurance growth path of the advanced markets. The experience of some established emerging markets like India and China shows decades of insurance sector growth can be compressed into a few years. Technology can also help the industry leap-frog to the latest products or underwriting techniques.
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<table>
<thead>
<tr>
<th>Year</th>
<th>No</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>1</td>
<td>Natural catastrophes and man-made disasters in 2015: Asia suffers substantial losses</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Insuring the frontier markets</td>
</tr>
<tr>
<td>2015</td>
<td>1</td>
<td>Keeping healthy in emerging markets: insurance can help</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Natural catastrophes and man-made disasters in 2014: convective and winter storms generate most losses</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>M&amp;A in insurance: start of a new wave?</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>World insurance in 2014: back to life</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Underinsurance of property risks: closing the gap</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>Life insurance in the digital age: fundamental transformation ahead</td>
</tr>
<tr>
<td>2014</td>
<td>1</td>
<td>Natural catastrophes and man-made disasters in 2013: large losses from floods and hail; Haiyan hits the Philippines</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Digital distribution in insurance: a quiet revolution</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>World insurance in 2013: steering towards recovery</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Liability claims trends: emerging risks and rebounding economic drivers</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>How will we care? Finding sustainable long-term care solutions for an ageing world</td>
</tr>
<tr>
<td>2013</td>
<td>1</td>
<td>Partnering for food security in emerging markets</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Natural catastrophes and man-made disasters in 2012: A year of extreme weather events in the US</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>World insurance 2012: Progressing on the long and winding road to recovery</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Navigating recent developments in marine and airline insurance</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Urbanisation in emerging markets: boon and bane for insurers</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>Life insurance: focusing on the consumer</td>
</tr>
<tr>
<td>2012</td>
<td>1</td>
<td>Understanding profitability in life insurance</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Natural catastrophes and man-made disasters in 2011: historic losses surface from record earthquakes and floods</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>World insurance in 2011: non-life ready for take-off</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Facing the interest rate challenge</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Insuring ever-evolving commercial risks</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>Insurance accounting reform: a glass half empty or half full?</td>
</tr>
<tr>
<td>2011</td>
<td>1</td>
<td>Natural catastrophes and man-made disasters in 2010: a year of devastating and costly events</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>World insurance in 2010</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>State involvement in insurance markets</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Product innovation in non-life insurance markets: where little “i” meets big “I”</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Insurance in emerging markets: growth drivers and profitability</td>
</tr>
<tr>
<td>2010</td>
<td>1</td>
<td>Natural catastrophes and man-made disasters in 2009: catastrophes claim fewer victims, insured losses fall</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>World insurance in 2009: premiums dipped, but industry capital improved</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Regulatory issues in insurance</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>The impact of inflation on insurers</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Insurance investment in a challenging global environment</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>Microinsurance — risk protection for 4 billion people</td>
</tr>
<tr>
<td>2009</td>
<td>1</td>
<td>Scenario analysis in insurance</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Natural catastrophes and man-made disasters in 2008: North America and Asia suffer heavy losses</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>World insurance in 2008: life premiums fall in the industrialised countries — strong growth in the emerging economies</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>The role of indices in transferring insurance risks to the capital markets</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Commercial liability: a challenge for businesses and their insurers</td>
</tr>
</tbody>
</table>
The authors would like to thank Finn Krüger, Arend Kulenkampff and Daniel Staub for their contributions on the analysis of the Commonwealth of Independent States, Latin America and Sub-Saharan Africa regions, respectively. Thanks also to Zerlina Zeng for her work on market data analysis.

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The editorial deadline for this study was 19 February 2016.

sigma is available in English (original language), German, French, Spanish, Chinese and Japanese.

sigma is available on Swiss Re’s website: www.swissre.com/sigma

The internet version may contain slightly updated information.

Translations:
German: Diction AG
French: ithaxa Communications SARL
Spanish: Traductores Asociados Valencia S.L.

Graphic design and production: Corporate Real Estate & Logistics / Media Production, Zurich

Printing: Multicolor Print AG, Baar

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