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Maximising the contribution of insurance to economic growth in Asia

The global economic weight of developing and emerging Asia has almost quadrupled from back in 2000 to its current share of 22% of world GDP. In stark comparison, the region's non-life insurance markets still lag behind, as indicated by a global premium share of as little as 10% or about US$200 billion in 2013.

Asia's economic rise over the last decades has led to a spectacular increase in asset values and their concentration, fuelled also by the region's rapid pace of urbanisation.

Twenty Asian megacities expected by 2025

In 2010, the region had close to 900 urban areas with more than 100,000 people residing in each, and China accounts for two-thirds of these, according to the World Bank. Still, much more is to come as only one-third of Asians are living in urban areas, which is below the global average and the average of other emerging regions such as Latin America.

Furthermore, the Asian Development Bank expects the number of Asian megacities, with populations exceeding 10 million, to rise considerably from 12 in 2010 to 20 by 2025. Almost all of them are exposed to storm surge and/or river flooding, exacerbated by an increase in impervious surface area and still insufficient drainage capacities.

Global warming and flood risk exposure

Climate change further compounds the severity of Asia's flood risk exposure. People in coastal regions of Asia could face some of the worst effects of global warming such as rising sea levels and widespread flooding, according to the Intergovernmental Panel on Climate Change (IPCC). These could ultimately dampen economic growth and lower food security.

Flood risk in Asia also has an increasingly important global dimension. The Thai floods in 2011 were, for example, an eye-opener. Due to the country's major role in global manufacturing, the impact of the disaster extended beyond Thailand, and reduced global industrial production by 2.5%.

Bigger role for insurance industry

All these observations suggest that the insurance industry has a bigger role to play in de-risking and mitigating the increasing frequency and severity of risks threatening to disrupt Asia's development.

This is particularly true for China, India and Indonesia where, over the past 40 years, 80% to 95% of all economic losses inflicted by natural disasters remained uninsured. By comparison, the protection gap in mature insurance markets usually falls in the 20% to 40% range.

Against this backdrop, the industry and its core stakeholders need to join forces to drive forward a vision, which sees insurance as a vital and indispensable source of individual, corporate and societal prosperity in Asia. It is our mission to help stabilise the financial situation of individuals, families and organisations by indemnifying those who suffer loss or harm. This affords a sense of financial security, a prerequisite to unlocking the creative and entrepreneurial capabilities of people – to the benefit of society at large.

Building broader and deeper capital markets

Beyond this, insurance is also an integral part of modern economies' financial system. The industry amasses huge funds and, in contrast with commercial banks that often collect short-term deposits and extend short-term credit, insurers usually adopt a more long-term view.

This is particularly true for contractual savings institutions such as life insurers, reflecting the long-term nature of their obligations. As such, insurers are ideal sources of long-term finance for both private businesses and governments, underpinning steady and stable economic growth.

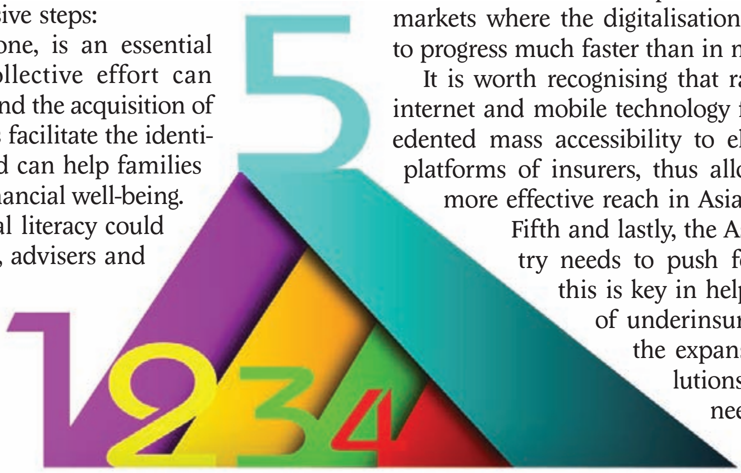
In addition, insurance facilitates the mobilisation of savings, especially through life insurance products, and enhances financial intermediation by helping channel savings to the most productive sectors in an economy. As such, insurers are instrumental in building deeper and broader capital markets.

Five steps to close the protection gap

The vision of a more prominent role of insurance in Asia is compelling but how do we get there?

Given its scale, scope and complexity, any serious attempt at closing the protection gap requires a concerted approach from all relevant private and public-sector stakeholders, in addition to any necessary isolated efforts by insurers, governments and businesses. It sounds simple but, as a necessary condition for success, all stakeholders must, for a start, recognise the gap, and from there, assume responsibility and take ownership.

Let us look at five progressive steps:



Financial education, for one, is an essential cornerstone that such a collective effort can champion. Financial literacy and the acquisition of basic financial planning skills facilitate the identification of insurance gaps and can help families maximise their longer-term financial well-being. Measures to promote financial literacy could be jointly funded by insurers, advisers and governments. The respective programmes could also be introduced in school curricula, for example.

Secondly, with approximately four billion people or 55% of the world's population not protected by insurance, microinsurance is definitely something that the industry needs to push for.

Within Asia, the territories in Southeast Asia, India, Bangladesh and Pakistan offer significant potential to grow the currently low coverage ratios. In order to fully capture these opportunities, we need to start from the basics and introduce the very concept of insurance to large segments of the population in these territories.

The industry also needs to make a strong and long-term commitment to dealing with the many challenges ahead such as how to best reach the potential customer base (more often than not in distant rural areas) and building the necessary infrastructure to process claims, among others.

In the face of trends such as globalisation, climate changes and ageing population, there is much room for emerging risks such as supply chain, environmental and health risks in Asia to be managed through insurance solutions. On the supply side, there is no shortage of (re) insurance capital potentially available to cover uninsured exposures.

However, the third consideration, and perhaps one of the main issues to be tackled, is the need for governments and private insurers to team up to stimulate demand. Effective partnerships between insurers and governments can go a long way towards achieving this objective. Governments and international/regional development banks can stimulate insurance demand through national and regional pool solutions, conducive risk-based regulation, subsidies and incentives, while allowing the private insurance industry to perform its vital risk selection, pricing and management roles.

This also applies to compulsory schemes which, in a number of emerging markets, have contributed greatly to narrowing the protection gap. When introducing such systems, lawmakers and regulators need to keep in mind the need to minimise moral hazard and adverse selection, through risk-based pricing and deductibles, for example. Using such underwriting tools can also help address one of the biggest challenges facing compulsory insurance - their perception as taxes.

Fourthly, if insurers want to maintain their relevance, they need to move fast in launching products, which address the needs and exposures of the digital age, in addition to the many uninsured exposures in the traditional bricks-and-mortar areas. This is particularly true for emerging markets where the digitalisation of economies seems to progress much faster than in many mature markets.

It is worth recognising that rapid advancement in internet and mobile technology further offers unprecedented mass accessibility to electronic distribution platforms of insurers, thus allowing far wider and more effective reach in Asia.

Fifth and lastly, the Asian insurance industry needs to push for data collection as this is key in helping to identify areas of underinsurance and facilitating the expansion of insurance solutions precisely, where it is needed. It also allows for more precise exposure definition and risk pricing in order for insurers to become sustainable bearers of Asian risks.

A special emphasis must be placed on gathering cross-sector and cross-regional data covering various risk exposures such as natural catastrophes, pandemics and health. Where insurance markets are still immature, non-governmental organisations can play an important role in relevant exposure data collection. Industry associations, for example, can coordinate joint data collection efforts, and team up with other partners such as international organisations. Such cross-border and regional collaborations are important, in addition to well-established communication and collaboration channels among regional regulators.

In summary, the industry needs to band together and chart a cohesive course towards making a more meaningful contribution to mitigating risk in Asia's high-growth markets. Otherwise, the cost of relief and reconstruction after natural catastrophes, for example, will continue to fall on governments, non-governmental organisations, charities and worse, the affected households and companies, setting back what could have been an even more spectacular growth story for Asia.