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Development Issues of Insurance Markets

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Annotation: This article reveals the development issues of insurance in business sphere. We have done some statistical analysis on this theme and contemplated some concepts about insurance.

Main body: The insurance market is a vital component of any economy, serving as a mechanism to transfer risk and provide financial protection to individuals and businesses. However, like any industry, the insurance sector faces various development issues that impact its effective functioning and long-term sustainability. This work aims to analyze and explore these development issues within insurance markets, highlighting their causes, consequences, and potential solutions.

The development issues of insurance markets are multifaceted and encompass a range of challenges that hinder the growth and efficiency of the industry. These issues can arise from both internal and external factors, including regulatory frameworks, government policies, market competition, technological advancements, and economic conditions. Understanding and addressing these issues is imperative for policymakers, insurance companies, and consumers to ensure the overall stability and profitability of insurance markets.

This work will provide a comprehensive understanding of the development issues faced by insurance markets and their implications for stakeholders involved. By examining these challenges and exploring potential solutions, we hope to contribute to a more sustainable and efficient insurance industry that can effectively cater to the risk management needs of individuals and businesses in an ever-changing world.

Global picture of insurance services (Lakshmi Puri[1])

We are all aware of the essential role that insurance services play as a commercial and infrastructural service. From an infrastructural perspective it promotes financial and social stability, mobilizes and channel savings, supports trade, commerce and entrepreneurial activity and improves the quality of the lives of individuals. In a fast-globalizing world economy, Governments the world over are faced with challenges relating to the regulatory environment, emerging global trends in the insurance sector, technological innovations and liberalization of the insurance sector. The impact of these trends is perhaps more pronounced in the case of developing countries, who stand to benefit from liberalization of the insurance sector provided due consideration is paid to putting in place an efficient and well-functioning institutional and regulatory framework, tailored national policies and well-planned sequential commitments on insurance liberalization.

[1] Director, Division on International Trade in Goods and Services, and Commodities, UNCTAD.

One finds that there is a positive correlation between a country's level of development and insurance coverage. Developed countries tend to have better developed and well functioning insurance services sectors both domestically and in terms of insurance exports, as compared to developing countries. This is perhaps most evident when one compares the share of industrialized countries in the world insurance markets, which in 2020 stood at 88.5 per cent as compared with 11.4 per cent for emerging markets, the majority of which are developing countries. Another good indication of insurance penetration is the premium volume generated as a percentage of gross domestic product (GDP). For developed countries this figure stood at 9.02 per cent in 2020, whereas for developing countries it stood at 3.94 per cent. What is interesting to note here, however, is that emerging markets have a far higher overall real growth rate, at 7.5 per cent, than industrialized countries, where it is 1.7 per cent, indicating the existence of substantial potential within emerging markets.

Challenges for developing countries. Developing country challenges in relation to insurance services sector arise essentially from five areas. First is the impact of insurance liberalization on developing countries. While liberalization and privatization is likely to lead to the admission of foreign insurers with substantial financial strength, technological and industry know how and good risk management and asset liability management skills vis-à-vis global markets, it also raises.

Insurance services and their contribution to development. The insurance sector is an infrastructural pillar of the financial services sector and the economy as a whole. It plays a key role in economic development. Several empirical studies suggest a strong correlation between the development of financial intermediaries and economic growth. According to Patrick (1966[2]) there are two, possibly coexisting, relationships between the financial sector and economic growth. The first is the case where the financial sector has a supply-leading relationship with growth, and where economic growth can be induced through the supply of financial services. The second is a demand-following relationship where the demand for financial services can induce growth of financial institutions and their assets. Developing countries have supply-leading patterns of causality of development and have considered locally incorporated insurance institutions or State-owned monopolies an essential element of economic development.[3]

Recently, the economic importance of the insurance sector has been increasing in most developed countries and some developing ones. Insurance companies form a growing part of the domestic financial sector. They have also become significant players in the international capital markets. During the 1990s, the total assets of insurance companies in developed countries grew faster than the assets of banks, mainly through M&As. Other reasons for the sector's increasing importance are the liberalization of financial systems (including privatization), financial consolidation, the increasing use of contractual savings products and market-seeking approaches.

The insurance sector is closely linked with macroeconomic factors (e.g. inflation, currency controls and the national income of a country), regulation and supervision, and the achievement of national development objectives, as well as the international trade regime. Given its dual infrastructural and commercial role, the sector has attracted great interest in the context of privatization and liberalization. There are several ways in which insurance services contribute to economic development:[4]

Insurance promotes financial stability for both households and firms. Insurance services transfer and pool risks, thereby encouraging individuals and firms to specialize, create wealth and undertake beneficial projects they would not otherwise consider.

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[2] Patrick (1966), Financial Development and Economic Growth in Underdeveloped Countries, Economic Development and Cultural Change, Vol. 14 (2), pp. 174–189.

[3] The stream of literature on the interrelationship between economic growth and the financial services sector also includes Levine Ross, Financial Development and Economic Growth: Views and Agenda , October 1996.

[4] Das, Davies and Podpiera (2003), Insurance and issues in financial soundness, IMF Working Paper WP/03/138.

- Life insurance companies mobilize and channel savings. They mobilize savings from the household sector and channel them to the corporate and public sectors. As the maturity of life insurance liabilities is generally longer than the maturity of bank liabilities, life insurers can play a large role in the equity and bond markets. In addition, their portfolios are less prone to liquidity crises. Countries with higher savings rates tend to show faster growth.
- Strong insurance can relieve pressure on the government budget. Because life insurance can play an important role in personal retirement planning and health insurance programs, and to the extent that private insurance reduces demands on government social security and health programs, it can relieve pressure on the government budget.
- Insurance supports trade, commerce and entrepreneurial activity. Given the heavy reliance of all economic activities (e.g. manufacturing, shipping, aviation, medical, legal, accounting and banking services) on risk transfer, insurance services play a key supporting role. More broadly, insurance can give investors the financial confidence to make investments, since they know they will be able to recover their investment.
- Insurance may lower the total risk faced by the economy. This risk reduction arises from the portfolio diversification and incentives to better measure and manage the risks to which they are exposed, as well as to promote risk mitigation activities.
- Insurance improves individuals' quality of life and increases social stability. It does this through, for example, individual health and life insurance, pension funds and workers' compensation.

Table 1 Business models of insurance and banking[5]

Area	Insurance	Banking
Business scope	Risk pooling and risk transfer Long-term savings	Payment services Short-term savings Lending
Funding	Liability-driven Up-front premiums Limited issuance of securities Limited use of inter-company borrowing/lending Assets and liabilities mostly linked	Liability and market funding-driven Mostly short-term funding Issuance of securities Interbank borrowing/lending significant Assets and liabilities not closely linked
Balance sheet cyclicality	Business cycle influences balance sheet to a limited extent Possible insurance cycles	Assets and liabilities exposed to business cycle
Risks	Substantial interest rate risk Low liquidity risk Low interconnectedness among primary insurers Assumed risk can be transferred through reinsurance	Substantial credit risk High liquidity and funding risk Substantial exposures among institutions (interbank and repo) Assumed risk transferred.

Business models involve collecting premiums in advance and payout (much) later under defined conditions. Therefore, IUs can be suppliers of liquidity and associated instruments, e.g. through securities lending. Especially when banks face the prospect of tough net stable funding requirements, IUs could be important sources of longer-term funding. Indeed, some have

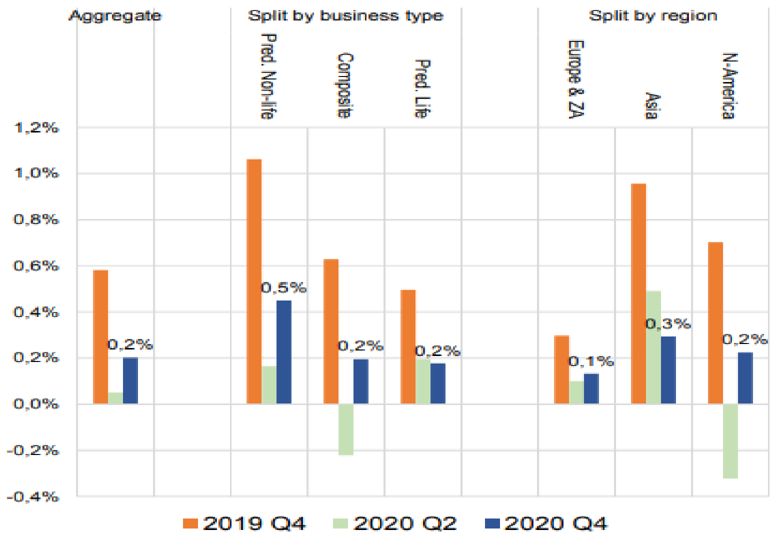
[5] Committee on the Global Financial System, "Fixed income strategies of insurance companies and pension funds", CGFS Papers No 44, July 2021.

suggested that IUs and pension funds have a strong comparative advantage relative to banks or even bond markets, in the funding of longer-term projects such as major infrastructure projects with little cyclicality in returns or credit risk, but large funding risk. The main elements of the business models of IUs differ substantially from, and perhaps complement, those of banks.

The structure of total insurance premiums by world markets and regions in 1980, 2018, and 2029 (forecast)[6] (%)

The structure of the world insurance portfolio in terms of insurance premiums is shown in figure above. Life insurance accounts for almost half of the world insurance market («Savings insurance» - 48%). Most scientists noted that it is the growth of life insurance happens to be one of the driving forces of economic growth. The services of motor (transport) insurance and accident insurance also account for a significant share (15% each).

In terms of outlook, insurers expect solvency positions to remain stable, noting, however, the high degree of uncertainty as solvency depends on the future path of financial markets and interest rates, which in turn depends on further government support measures and developments with respect to the Covid-19 pandemic. Insurers note that financial markets over the second half of 2020 already reflected economic growth expectations, based also on successful vaccination campaigns that may be unevenly distributed across countries (and hence the heterogeneous impact across subsidiaries in different countries).



Return on assets (per cent)[7]

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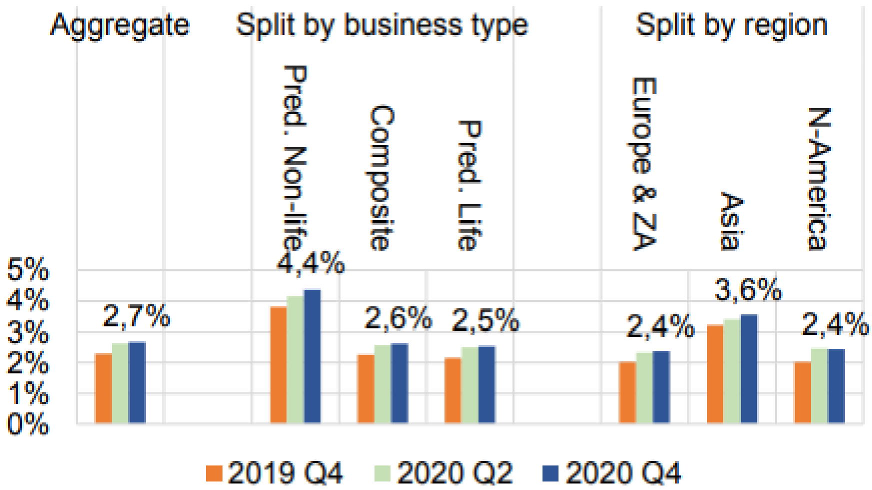
[6] Same as previous source.
[7] IIM Covid-19 Q4 2020

Overall, insurers report that liquidity positions have remained stable in 2020. The impact of Covid-19 on the liquidity of insurers' investments was moderated by significant central bank interventions. Some insurers observed that liquidity positions were affected by the impact of Covid-19 on some lines of business, such as through premium deferrals and higher claims. However, the overall impact on liabilities is assessed to be limited, due to the offsetting effect of lower claims in other business lines. The group-level liquidity positions of some insurers were impacted, for example due to financing subsidiaries as part of capital management policies or from providing for subsidiaries' liquidity guarantees. Some insurers note that liquidity positions were affected by central clearing collateral posting requirements, as a result of changes in financial markets (notably changes to interest rates).



Share of cash on assets (per cent)[8]

Insurers' cash positions, as a percentage of total assets, generally increased over 2020. A comparable share of cash in balance sheets can be observed across business types (2.6%– 2.9%).

Sovereign and corporate debt levels reached historically high levels, which could lead to credit spreads widening, defaults and rating (outlook) changes. Relatedly, some insurers may be taking on more credit risk following a search for yield in the current low interest rates environment. As substantial fixed-income investors, insurers need to manage this risk in their asset and liability portfolios.

In conclusion, the development issues of the insurance market are complex and multifaceted. The main challenges faced by the insurance industry include regulatory barriers, lack of consumer awareness, limited access to insurance products, and inadequate risk assessment and management. One of the key development issues is the presence of regulatory barriers. These barriers can include excessive capital requirements and stringent licensing regulations, which hinder new entrants into the market. Such barriers limit competition and innovation, thereby impeding the overall growth and development of the insurance sector. Another significant challenge lies in the lack of consumer awareness regarding insurance products and the benefits they provide. Limited knowledge about insurance prevents individuals and businesses from adequately protecting themselves against various risks. Addressing this issue requires initiatives aimed at educating the public about the importance of insurance and its role in ensuring financial security. Limited access to insurance products, particularly in low-income and underdeveloped regions, is another critical concern. The insurance market should work towards developing affordable and customized products that cater to the specific needs of these underserved populations

[8] Same source as previous one. Reported according to the jurisdictional capital standard

Furthermore, the insurance industry must improve its risk assessment and management practices. Enhancing underwriting processes, data analysis capabilities, and predictive modeling can enhance insurers' ability to accurately assess risk and price policies accordingly. This would contribute to the sustainability and profitability of the industry.

Overall, the development of the insurance market requires a collaborative effort from stakeholders, including regulators, insurers, consumers, and technology providers. Addressing regulatory barriers, improving consumer awareness, expanding access to insurance, and enhancing risk assessment practices are crucial steps towards the sustainable growth and development of the insurance sector.

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