GENEVA ASSOCIATION
32nd General Assembly Versailles, June 2005

NEW MARKETS – NEW REGULATION

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1. WORLDWIDE ECONOMIC FRAMEWORK

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

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

The table below demonstrates this situation through the GDP growth in different regions of the world in the last decades:

TABLE 1 – GDP ANNUAL AVERAGE GROWTH (%)

	1980-1990	1990-2000	2000-2003
OECD..	3.2	2.7	1.6
RUSSIA......................................	2.4	-3.4	5.7
CHINA..	10.1	10.3	8.2
INDIA...	5.8	6.0	5.9
LATIN AMERICA & CARIBBEAN....	1.7	3.3	0.6

There is an evident contrast between the developed and the emerging countries. Russia suffered a tremendous financial upheaval in the 90´s with the political changes and Latin America has been also deeply affected by financial convulsions in some countries (Argentina, Mexico, Venezuela).

The welfare in the population has also improved in some regions as a consequence of the decrease of the birth rate and the increase of the GDP as it can be observed in the GDP per capita showed in the following table:

TABLE 2 – GDP PER CAPITA (CURRENT US DOLLARS)				
	1990	**2000**	**2003**	**Average growth (%)**
OECD.....................................	**16,700**	**24,600**	**26,300**	**4.4**
RUSSIA..................................	**3,500**	**1,800**	**3,000**	**-1.0**
CHINA....................................	**350**	**850**	**1,100**	**16.4**
INDIA.....................................	**375**	**450**	**600**	**3.8**
LATIN AMERICA & CARIBBEAN	**2,600**	**3,900**	**3,300**	**2.0**

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

TABLE 3 – YEAR OF MEMBERSHIP	
BRAZIL...	**1995**
INDIA..	**1995**
MEXICO.......................................	**1995**
CHINA..	**2001**
RUSSIA...	Ongoing

2. WORLDWIDE INSURANCE DEVELOPMENT

Insurance business has evolved in accordance with the pattern mentioned before. Life and non-life insurance, both commercial and personal lines, have received an extraordinary and significant drive in the new markets under the influence of (a) the economic development; (b) the growing demand of individuals, and (c) as result of the pressure of international insurance players interested in investing in those new markets. Some degree of saturation in western countries and the clear opportunities open in the new economies have prompted an important flow of interest and foreign insurance capital towards some regions. This situation has been improved in recent years by the negative influence in industrialised countries of the financial turmoil and the favourable development of inflation rates in emerging markets. The table below details these movements:

TABLE 4 – PREMIUM GROWTH (%) Inflation-adjusted		
	1997-2002 (Annual Average)	2003
Industrialised Countries............................	3.6	1.2
Emerging Markets..................................	7.3	9.2
World..	4.0	2.1

TABLE 5 – PREMIUM GROWTH (%) Inflation-adjusted				
	LIFE		NON-LIFE	
	1997-2002 (Annual Average)	2003	1997-2002 (Annual Average)	2003
Industrialised Countries.	3.9	-2.2	3.4	6.0
Emerging Markets.........	8.2	9.7	6.2	8.5
World..........................	4.3	-0.9	3.7	6.3

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

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

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

And after all, insurance companies have realised once more that good management of their business is closely linked to principles of sound underwriting, good loss control, cost-efficiency and prudent investments.

3. FOCUS ON NEW INSURANCE MARKETS

Emerging countries are responsible for only about 20% of global economic GDP and nevertheless account for more them 80% of world population. Moreover over the last decade, insurance premiums in those countries have grown about 10% every year far greater than the 3% of industrialised countries. Some saturation in the latter is in contrast to the booming economies and increasing liberalization and privatization in the former. As a consequence, the weight of these markets has significantly increased in the international insurance world from 9.3% in 1998 to 10.9% in 2003. This situation is expected to continue in the next decade as the economic growth foreseen for the emerging countries is about two times (4-6% annually) that for industrialized countries (2-3% annually). Some regions, in particular, (like China, Russia) could have even a higher rate rapidly outpacing other countries.

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

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

TABLE 6 – PREMIUM VOLUME

Emerging Regions	**2003 (billions US $)**
Asia (without Japan, Korea)................	139.0
Africa..	31.7
Eastern Europe...............................	34.5
Latin America..................................	41.8
Middle East....................................	12.9
TOTAL..	259,9

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

4. INSURANCE DEVELOPMENT & REGULATION

Given this extraordinary and positive economic outlook for the insurance industry in these new or emerging markets, which should be the key factors to favour maximum development and to make good use of these conditions?

Let´s try to set up a Decalogue of possible key factors to suggest debate and discussion:

a) Implementation of an internal legal framework (regulatory system) for insurance operation and solvency; strict or open tariff system? Bureaucratic?

b) Legal regulation of the distribution channels to direct efforts of intermediaries and to promote a high level of professionalism amongst agents and brokers. Open or closed market? To foster and regulate bank assurance or not?

c) Privatisation of state-owned insurers. Partial or total? Developing state regulated bodies for natural catastrophes? For agricultural risks? For pension schemes? For workers' compensation?

d) Free entrance of foreign investors to provide financial capacity (i.e. solvency) and operational know-how. With majority shareholding? Free ceded or accepted reinsurance market?

e) Reinforcement of legal institution for controlling and supervision of insurance companies and intermediaries.

f) Promoting free associations between insurers and brokers in order to balance the weight and influence of legislators, supervisory authorities and consumer associations.

g) Regulate compulsory insurance within the framework of the private sector for motor insurance and other lines like dangerous industries or activities? For workers compensation?

h) Regulation for investment of reserves, strict, open? Tax deduction to develop life insurance and pension schemes?

i) Promoting employee professionalism through specific university and professional education, run by the state, insurance associations? Private institutions?

j) Enforcement of corporate rules? Transparency rules?.

5. FINAL REMARKS

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

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

Even, in some cases, new markets can be considered an excellent testbed for technological or business innovations due to their capacity for assimilation and the competition of foreign players coming from markets as different as the US and the EU. In terms of regulation, the different approach coming from these latter regions (GAAP vs. IFRS, R.B. Capital vs.

Solvency II systems, for instance) can make new markets an international battle field with regard to these topics and create a need to reach a common worldwide consensus.

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

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

Economic conditions will probably vary worldwide in the coming years with regard to the currently accepted forecast. This has happened in the past and surely will occur in the future. Fever to invest in new regions has been and will be volatile following the inevitable cycle of the economy and the random new facts and risks that influence human activity (oil prices, terrorism, new discoveries, etc). But insurance activity has the advantage of being non-cyclical and protecting against risks and in this way able to counterbalance economic volatility. This idea has been important in the past but has become even more relevant nowadays as has been shown in terrorist attacks, natural catastrophes and technological breakthroughs, the peak of the iceberg, in an ultra high-risk society. In industrialized countries insurance companies are changing in order to cope with these situations (more solvency, more efficiency and more innovations) but in new and emerging markets the role of insurance can be vital to allow and consolidate economic development and to confront internal risks such as natural catastrophes. And moreover, insurance industry has the advantage of being a solid pillar for the general economic development due to its capacity as institutional investor both in capital markets and real estate field Should an open regulatory system and a stable legal system be the key factors for the development of a sound and beneficial insurance market?

June, 2005