

A Synopsis of

***Insurance in the emerging markets:
Overview and prospects for Islamic Insurance
by Swiss Re (Sigma No 5/2008)***

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Insurance in the emerging markets: Overview and prospects for Islamic Insurance

The department of economic research & consulting of Swiss Re published this report in the December issue of their research series “sigma”.¹ This report consists of two parts: the first part focuses on the latest developments in the insurance sector of the emerging markets while the second part is about insurance markets in Islamic countries and insurance models that are shariah-compliant.

The emerging markets

In the first section, the authors of this study define the term emerging markets and point out that insurers should seriously consider doing business in the emerging markets because of rapid economic growth and the sheer market size of the emerging national economies. According to the definition of Swiss Re, the term emerging markets encompasses the aspiring national economies in Asia², Latin America and the Caribbean, Eastern Europe, the Middle East, Central Asia and Turkey as well as Africa. Swiss Re mentions in a footnote that this definition is not consistent with the definition used in one of its former publications about the emerging markets³, but corresponds with the definition of the IMF. It would be preferable if the reader was provided with the criteria used to define an emerging market instead of just mentioning that the IMF’s definition is used, especially because even within the IMF there are discussions about their definition of an emerging market.⁴

The authors describe recent developments in the insurance sector of the emerging markets in terms of growth and total size. Between 2002 and 2007, the total premium volume has more than doubled and adds up to \$422bn. Swiss Re found that the “ten biggest countries accounted for 80% of all additional premiums”⁵. Unfortunately, the term “biggest countries” may be misinterpreted, because the term “big” could either refer to an emerging country’s GDP or to the size of an emerging country’s insurance market. A comparison of the gross domestic products of the emerging countries shows that the term “ten biggest countries” refers to insurance market size.⁶ However, the growth has been strong in both the non-life (11.6%) and the life insurance sector (14%) in 2007. The following table is based on Swiss Re’s findings and shows that overall growth in premiums was strong for most emerging regions:

¹ http://www.swissre.com/resources/6ec4e5804c24db9cbf44bf32638cee3c-MI_sigma_5_2008_en.pdf

² Japan, Hong Kong, Singapore, South Korea and Taiwan are excluded from Asia; Israel excluded from the Middle East

³ “Insurance in the emerging markets”, Swiss Re, sigma No. 1/2007

⁴ What is an emerging market?, IMF working paper, Ashoka Mody, September 2004

⁵ See graph on page 8 of the report

⁶ E.g. the GDP of Malaysia is smaller than the GDP of Saudi Arabia (another emerging market), but Malaysia is listed in figure 4 on page 8. Thus, the authors refer to insurance market size

	Premium volume in millions (USD)	Real growth in 2007
Asia	180,759	17.6%
Latin America	89,280	11.2%
Eastern Europe	64,643	13.3%
Africa	53,810	1.0%
Middle East	23,000	12.2%

The African insurance market grew only at 1.00%, although the African economy grew at a rate of more than 4% since 2000⁷. The authors mention a “significant slowdown” in the South African insurance market as a reason for the decrease in life insurance penetration, but developments in the life insurance market of a single country cannot explain the low insurance market growth rate of the entire African continent. Unfortunately, no research can be found that explains the slow insurance market growth in Africa.

The insurance expenditures per capita have increased in 2007, but they are still very small compared to industrialized markets. According to the report, \$39.1 per capita were spent on life insurance and \$34.9 on non-life insurance – representing only 1.8% or 2.4% of the per capita spending in industrialized markets respectively⁸. Per capita spending on non-life insurance was highest in Eastern Europe (\$173.5) while per capita spending on life insurance was highest in Latin America (\$63.4). Also because of religious concerns, per capita spending and insurance penetration were lowest in the Middle East in 2007. In terms of total premium volume, China is leading both in the category of life insurance (\$58,673m) and non-life insurance (\$33,810m). A comparison of the top ten countries for life insurance and non-life insurance shows considerable differences: Russia, Turkey and Venezuela are not part of the top ten countries for life insurance, although they are part of the top ten for non-life insurance.

The authors of the report also point out the major insurance trends in the emerging markets: distribution of insurance via banks, stricter solvency requirements and insurance coverage for low-income groups. Insurance coverage for low-income groups seems to be a way to target large parts of the emerging markets’ population, since many of them cannot afford to buy the regular products. Moreover, today’s low-income groups may be part of the growing middle class of the emerging countries tomorrow. However, correctly assessing the price of risk for low-income

⁷ Africa Development Indicators 2007 - The Little Data Book on Africa 2007, World Bank, p. 23

⁸ Own calculations based on table 1 on page 11 of Swiss Re’s report

individuals and keeping administrative costs for microinsurance low will be crucial to be profitable in this sector.

Islamic insurance

A comparison of the data provided by the report reveals that Muslim countries⁹ accounted for 23% of the emerging markets' GDP while only 11% of the emerging markets' premiums were written in these countries in 2007. Thus, while growth opportunities can be assumed, one can also infer from this discrepancy that there must be some factors that complicate the insurance business in these countries. First of all, the authors accentuate that insurers must offer Islamic insurance versions since conventional insurance is not aligned to the shariah - the body of Islamic religious law. Moreover, varying interpretations by different schools of thought within the Muslim world make it difficult for insurers to offer generally shariah-compliant products. Depending on the prevailing school of thought in a certain country, an insurance concept that is not accepted in one country may be accepted in another country. However, there are some generally accepted exclusion criteria¹⁰ that prohibit conventional insurance from being compatible with the Islamic principles: The payment/receipt of interest (Riba), excessive risk taking (Maisir), uncertainty and unclear terms in contracts (Gharar) and investments in non-permissible industries focusing on drugs, pork or pornography (Haram). Apart from that, western insurance companies will have to find qualified employees that have both insurance and shariah knowledge in order to guarantee shariah conformity *and* profitability. Moreover, the authors state that many Muslims may fear that insurance contradicts their faith and that they consider their family as the primary institution that provides help in case of an accident. To educate customers and raise awareness, significant efforts would have to be made. The authors also mention that a lack of regulation, available reinsurance and shariah-compliant investment opportunities could weaken growth.

It is likely to assume that all these complicating factors and prohibitions lead to higher costs of Islamic insurance compared to conventional insurance. I assume that this could prevent some insurers from offering Islamic microinsurance products, because the additional cost will further decrease the small margin of these low-priced products.

However, the authors underline that companies selling Islamic insurance mostly use two forms: The first form is mutual insurance, because it is predicated on voluntary contributions and mutual assistance. Social insurance is the second form, since a realization of profits is not aspired

⁹ Countries with a Muslim population of 50% or more

¹⁰ See page 19 of Swiss Re's report

and mutual protection is desired. The authors found that the fastest growing market in Islamic insurance is based on the principles of mutual insurance – the takaful market. In 2007, the size of the takaful market was estimated at \$1.7bn, grew by about 25% and experts estimate the potential takaful market at \$35-45bn in Muslim countries.¹¹ According to the report, all different takaful models available are based on four main requirements: Segregated funds for shareholders and policyholders, responsibility to distribute technical profits to policyholders, no investments in non-permissible industries and the establishment of a shariah supervisory board in each company to assess shariah compliance. Takaful products are both sold by fully Islamic companies and special subsidiaries of conventional insurers. The authors describe the different takaful models in detail, but actually they only differ on how insurance sellers are paid: performance-based (mudarabah), fixed proportion of the insureds' premium (wakalah) or a mixture of both (hybrid model). I assume that the wakalah model has the advantage that it is relatively easy for insurers to determine their revenues, because the revenues only depend on the total amount of premiums collected by the takaful fund instead of underwriting and investment decisions. However, this may cause principal-agent problems and thus, the authors mention that some institutions recommend combining the wakalah model with the mudarabah model to have a hybrid model.

The authors analyze five different insurance markets in Muslim countries: Malaysia, Indonesia, Saudi Arabia, United Arab Emirates and Bahrain. Malaysia is the biggest insurance market (\$9.2bn) followed by Indonesia (\$6.9bn), United Arab Emirates (\$4bn), Saudi Arabia (\$2.3bn) and Bahrain (\$0.4bn).¹² They chose these markets, because “they represent best practice and/or reflect the challenges and opportunities for takaful in emerging markets”¹³. Indeed, the markets analyzed differ a lot in terms of size, regulations and macroeconomic environment, but it is questionable whether these insurance markets represent most takaful markets in emerging countries or Muslim countries respectively. Out of the ten countries with the biggest Muslim population only Indonesia has been analyzed¹⁴ while other countries with a big Muslim population like Pakistan (160m) or Bangladesh (132m) have not been analyzed. Moreover, no African country has been analyzed and especially African countries among the ten biggest Muslim countries (Egypt, Turkey, Nigeria, Algeria and Morocco) may be hardly comparable with Asian or Arabian markets. It would be interesting to know whether there is indeed a price difference for comparable coverages between Islamic insurance and conventional insurance in relatively progressive and secular Muslim countries like Turkey (sixth biggest Muslim country in the world).

¹¹ See pages 25 and 38 of the report

¹² See pages 28 to 37 of the report

¹³ See page 27 of the report

¹⁴ Table „By largest population“, http://en.wikipedia.org/wiki/Islam_by_country