Evolution of Insurance Sector: A Global Perspective

Niranjan Nayak  
IIPM-School of Management  
Kansbahal, India  
Email: nnayak13@gmail.com

Rohita Kumar Mishra  
IIPM-School of Management  
Kansbahal, India  
Email: rohitjrf@gmail.com

Received Sep. 3, 2013, Revised Sep 19, 2014, Accepted Nov. 17, 2014

ABSTRACT

Insurance markets have changed radically in the last 20 years. There are some key developments in insurance as well as financial services market which has a greater impact on global scale. It influences globally with some constraints. The insurance marketing has become a vital part of some national as well as international market. The incremental development focuses on cultural, legal, institutional, and demographic consideration that impact the emerging global trends. The authors attempt to address the global similarities of national insurance market and the local contingencies that create differences among markets. The purpose here is to analyze the global insurance industry and to show the diversity of insurance market at large.

Keywords: Insurance marketing, global scale, development
INTRODUCTION

The World insurance markets are described having various key economic indicators like annual premiums, the relative importance of life and non-life products, insurance concentration, and insurance density. World insurance premiums represent US$ 3,723 billion in 2006 (Swissre). International insurance markets can also be differentiated by their insurance penetration. Some insurance markets are characterized by high levels of insurance penetration.

The world’s Insurance market have some important global similarities such as deregulation, intensification of competition generally rapid growth in insurance sales, the emergence of new distribution channels and the convergence of Insurance banking and other formerly separate segments of the financial services industry. However, there remain many important “local” differences among insurance markets across the world. The first known insurance product in history was hull and cargo insurance, which was created in Mesopotamia. The idea was to insure the vessels and their contents for their national and international travels. Still today, hull and cargo insurance is mainly underwritten under international rules, i.e. with international contract specifications largely shared by the international competition. Other types of insurance are also structurally global. Space satellite insurance, aircraft insurance, and insurance of large risks are shared by international insurers. Furthermore, the high insurance concentration in which the top five countries, the United States, Japan, The United Kingdom, France, and Germany, represent 67.3 per cent of the world insurance premiums, leads to the phenomenon of risk concentration. The insurance sector is also structurally global through the mechanism of reinsurance and insurance financing. The reinsurance market is quite concentrated, with eight countries (Germany, the United States,
Switzerland, the United Kingdom, Bermuda, France, Japan, and Ireland) representing 89 per cent of the global reinsurance premiums (Standard and poor’s, 2006). Other emerging countries such as India and China are experiencing increased foreign participation in their insurance markets. Indeed insurer internalization has been facilitated by the world wide process of deregulation. Starting in the 1980s, two countries, the United Kingdom and the United States, were pioneers in the deregulation process. Following their example, significant deregulation at the national and regional levels has occurred elsewhere, e.g., in Europe and in Japan. This deregulation has facilitated the integration of previously fragmented segments of the financial services market, primarily insurance, banking, and securities dealing and underwriting. The European Union’s banking and insurance directives, implemented during the 1980s and 1990s, had the objective of creating a single European financial services market. The directives have led to widespread consolidation in the financial services markets in Europe, with large number of intra sector and cross sector mergers and acquisitions (Cummins and Weiss, 2004). The EU directives also deregulated insurance markets, with the expectation of solvency regulation, which is carried out by each insurer’s home country. This led to the introduction of true price competition in European insurance markets, where prices were previously strictly regulated at the nationally.

For example in Germany, since the deregulation of the Insurance Supervision Law in 1994, the products offered by licensed insurance companies are no longer subject to prior approval by the supervisory authority. There is no direct price regulation for any line in the German insurance market, and the suppliers of insurance coverage are, in general, free to compete on premiums as well. The EU member states have experienced an
increase in cross border insurance competition. In France, the market share of foreign insurers has doubled between 1990 and 2006. The European directives could have some significant influence on other non European members. For example, Norway despite being not a member of the European Union is largely influenced by the EU regulatory changes.

Similarly, in Japan, the ‘Big Bang’ financial reforms of the late 1990s aimed to make the Tokyo financial market comparable in scale and in the variety and sophistication of financial products to markets in London, New York, and continental Europe (Dekle, 1998; Hoshi and Patrick, 2000). Among the reforms primarily affecting the insurance industry is the elimination of the ban on financial holding companies (FHC), which can now own firms dealing in various types of financial services, including insurance. The reforms also eliminated restrictions that prevented financial services firms from competing in each other’s markets, so that banks, life insurers, and property casualty insurers can now offer financial products other than their traditional offerings. The reforms are expected to lead to more competition in financial markets, although research on the effects on insurance markets has been limited thus far.

The passage of the US Financial Services Modernization Act of 1999 (the Gramm-Leach-Bliley Act) removed most of the remaining barriers that restricted competition across sectors of the financial services industry and allowed the creation of FHC, which can engage in bank and non bank financial activities through subsidiaries. Although there has so far been minimal merger and acquisition activity between the banking and insurance industries, banks and insurers compete intensely on the sale of annuities, life insurance, and mutual funds at the retail level and in pension fund and asset management at the wholesale level. The United States has long been a hospitable environment
for foreign insurers to enter the market, primarily through acquisitions of US insurance companies, and major global financial services firms have made major in roads in the United States, particularly in the market for annuities (Cummins, Eckles, and Zi, 2006).

Another major trend is that various supranational agencies, including the World Bank, the Inter American Development Bank, and the WTO have been key promoters of globalization throughout the world. The WTO was created in 1995 to promote free trade through international negotiations between various nation states and members of the organization. In the 1990s, protest demonstrations during the various WTO meetings were characteristic of the misconceptions about globalization.

The effect of the WTO on insurance markets is apparent in the Chinese market. With China’s entry into the WTO in 2001, the Chinese government made significant commitments with respect to liberalizing the insurance sector and thus led China’s insurance industry into a new stage of development. The current stage is characterized by an over all opening of the market instead of the previously limited and restricted opening. Due to the changes facilitated by the WTO, it is now much easier for foreign financial firms to enter the Chinese insurance market, and foreign firms have begun to compete intensely in China. Although the competition currently is mostly in terms of joint ventures, China’s WTO commitments will make it even easier for foreign firms to enter the market in the coming years.

In addition to the developments in China, various international bodies such as the World Bank have influenced insurance and financial markets in South East Asia, with significant intervention triggered by the Asian currency crisis of 1997. The creation of a European single market has accelerated the internationalization of insurance companies. This is
particularly true in Europe where national insurers initiated cross border expansion when the single market was created. Thus, the internationalization of European insurers increased in the mid 1980s and accelerated in the 1990s following the introduction of the Third Generation Directives in 1994. Some insurance companies reoriented their international exposure from their historical roots (e.g., in Africa) to become more European based.

Another major trend is the privatization of the international insurance market. Many countries which previously relied on government insurance companies and programs now have private insurance companies as dominant economic actors. Many such countries have witnessed major waves of privatization. The number of government owned insurance companies is becoming smaller, and some countries have almost entirely eliminated government run insurance companies. Presently, this trend is occurring not only for some developed countries such as France but also for former Eastern block countries and emerging economies (Venard, Halek, and Dorfman, 2008). The Indian government authorized the development of the private sector in 2000. Since 1988, China has also seen the gradual dismantling of the former government insurance monopoly, the people Insurance Company of China. Brazil had a “nationalization” program in 1937 in which all insurance companies had to be Brazilian, no company could be fully controlled by foreign partners, and local majority participation became the rule. In 1996, the Brazilian market was opened again to international investors. The impact was immediate with an increase in the foreign company market share from 6 per cent in 1996 to the current figure of 30 per cent.

Insurance globalization has also been facilitated by the technical revolution in transport, communication, and data processing. In the eighteenth century, it took 4 days for a letter to go from London to a city 300 Km away (O’Rooke and Williamson,
1999). In nineteenth century France, an insurance contract needed three weeks to be sent from Paris to Bordeaux and back (Venard & Hanafi, 2008). To handle important articles, insurance companies needed vast work forces and significant bureaucracies.

When the information revolution began, insurance companies and other financial intermediaries were among the earliest adopters of computer technology to automate the internal processing of financial transactions. Previously labor intensive back office and front office functions are now organized through computer technology and telecommunication networks. Between 1994 and 1999, for example, the real cost of recording, transmitting and processing information declined by more than 95 per cent. The emergence of around the world, around the clock financial markets represents a classic example of space time compression. The insurance industry is characterized by the central role played by information processing. Therefore, more than in any previous era, the growth of international communication, the development of computer power, the spread of information technology, the reduction in telecommunications costs, and the socialization among customers promoted by the Internet are major driving forces behind the changes in today’s global insurance companies.

Among the global trends, the need for health insurance and pension reforms is present in many countries and forecasted to occur very soon in others. Health systems are in need of huge transformations, both in developed countries where the systems are too expensive and in developing countries where health services are insufficient. Because many government social security programs have been based on pay as you go funding schemes, decrease in the ratio of working age persons to retired persons has forced many countries to consider scaling back their public pension systems. This provides an opportunity for financial firms
to exploit the growing demand for supplemental retirement programs funded by life insurance and annuities and should provide growth opportunities for insurers in many markets.

Of course, local contingencies play an important role here in terms of widely varying tax incentives for private savings through insurance and annuities. For example in France, due to tax incentives, insurance savings products grew from 42.2 per cent of total consumer investment flows in 1990 to 76.1 per cent in 2000. Less attractive incentives in the taxation of life insurance revenues for the duration of the policy have resulted in a relative decline of insurers’ share of net investment flows by about 20 per cent from their peak in 2000. Another example is the Netherlands, where in 2001 the maximum tax credit for life annuity premiums was significantly reduced. As a result of the tax changes, tax driven life insurance purchases decreased substantially.

The continuing evolution of insurance product distribution system is another common element among many national insurance markets, although this does not mean that distribution channels are similar everywhere. Particularly in the consumer lines of insurance, direct marketing and bancassurance are likely to play increasingly important roles. The principal advantage of direct and bank distribution of insurance is that the marketing costs tend to be lower than they are through the traditional insurance distribution channels such as brokers and agents. The result is that direct and bancassurance marketers can offer lower prices and higher rates of investment return on savings based products, giving them an important competitive advantage. In the commercial property casualty lines, it is likely that intermediaries such as brokers and agents will continue to play an important role in helping commercial buyers access the increasingly complex and global markets for risk transfer.
LOCAL PARTICULARITIES

If globalization is making the world a more homogeneous place, there are still many local particularities. Indeed the convergence of insurance markets worldwide and the convergence between insurance and other segments of the financial market are far from complete and many differences among countries continue to exist.

The investment relationship between insurance companies and financial markets is also quite heterogeneous. For example, during the bubble period, Japanese life insurers invested large amounts of funds in foreign securities markets. As life insurance contracts are denominated in Japanese Yen, foreign investments are accompanied by foreign exchange risks. When the yen appreciated against the US dollar, Japanese life insurers suffered extensive foreign exchange losses. A different example is provided by the Brazilian market. In this emerging market, only one insurance company invested its assets in the Brazilian stock market, Porto Seguro. In fact, Brazilian insurance companies invest over 90 per cent in government bonds.

All countries have their own political systems, and this diversity has an impact on the insurance industry. For example, at the end of apartheid in South Africa in 1994, a Black Economic Empowerment Program was set up. Its mission was to transfer equity ownership in firms throughout the economy to the black community. The South African Financial Sector Charter requires that 25 per cent of the equity of financial companies must be transferred to black, because the former segregation implied that most of the country’s assets were in the hands of the white minority. In South Africa lobbying from civil servants has considerable influence on their pensions, where they pay as little as possible to get as large a payout as possible.

Most developing nations have age distributions that are generally much younger than in the developed world. The consequences of demographics are especially significant for the pension market and
therefore the life insurance market as well as the health insurance market. However, significant demographic differences exist even within developed country. In Europe, Ireland and France are experiencing a minimum level of growth in their populations, while Italy and Germany are witnessing population declines. Without taking into account migration, these intra European differences are even more significant.

Thus India has a Tariff Advisory Committee, called IRDA (Insurance Regulatory Development Authority) which is in charge of setting a minimum price. When third party liability became unlimited, the premiums should have increased, but political pressure from transporters prevented the premium rise (Malhotra, 1994).

Another example is Ireland, which is the only country in Europe in which insurers are required by national health regulation to offer open enrollment, community rated premiums, lifetime coverage, and minimum benefits policies. Open enrollment provides that insurers must accept all applicants for insurance coverage under the age of 65, regardless of health status, subject to prescribed waiting periods. There is no penalty for those individuals who would like to transfer from one insurer to another the principle of community rating requires that insurers must charge consumers the same price regardless of age, sex, or health status. Lifetime coverage means that insurers must renew contracts as long as they continue to operate within the market. Health insurance contracts must also provide benefits above a prescribed level, which referred to as the “minimum benefits level”.

The role of ecommerce in the insurance industry varies widely among countries. For example, in many developing countries, a large share of the population has no access to telephones or bank accounts, and, therefore, ecommerce in insurance has a long way to go. In Germany, hopes about selling insurance through the Internet seem to have been dampened by the fact that most insurance contracts have complicated structures and require a considerable amount of consultation which is difficult to provide via the Internet.
An interesting example is in Brazil, where brokers are required for any insurance transaction. When a Brazilian bank decides to distribute insurance products, the bank is required to create a brokerage company. Therefore, brokers have officially 100 per cent of the market share of the Brazilian distribution channels. For example, the US market has various types of agents such as exclusive agents, independent agents, and career agents (the last only for in life insurance), whereas other countries have only one type of agent, such as France (in fact only exclusive agents).

In life insurance, brokers are very important in insurance distribution in the UK with 61 per cent market share in 2003, and in Canada, with 44 per cent of the market but have limited influence in Germany, with 28 per cent market share, and even lower in France, with nine per cent market share (2003), and Italy with 0.8 per cent (2003).

In the non life business brokers have a very large market share in Canada, with 70 per cent of the market and in the United Kingdom with 55 per cent of the market. However, brokers have only 7.5 per cent of the market in Italy, 11.4 per cent in the United States, and 19 per cent in France. Agents are the principal distribution channel in Japan for non life insurance, with 91.6 per cent market share in 2002, and in Italy with 85.2 per cent in 2003. They are less important in other markets such as France, with 35 per cent market share in 2003, and Canada, with 25 per cent share also in 2003. Comparing international statistics could be difficult since the same word could correspond to different distribution channels. For example, in the United Kingdom, direct sales include sales through telephone, internet, etc. (22 per cent market share in 2003) but also employees from companies when in France direct sales does not include the employees (with therefore a much lower market share than in the United Kingdom, three per cent in 2003).
The diversity of distribution channels is increasing, with a growing number of new distribution channels being created. For example, in the Netherlands, different kinds of ‘exotic’ intermediaries such as oil companies, supermarkets, football clubs, car dealers, and drug stores have entered the Dutch insurance market. The degree convergence between banks and insurance companies is heterogeneous across the globe. Bancassurance is small in Germany, but important in France, Spain, and Italy. Banks are now the main insurers in the French life and non life insurance markets. French banks increased their market share in the life business from 39 per cent in 1990 to 62 per cent in 2003. In Spain, bancassurance is the most important channel with 62 per cent of life premium volume in 2002 and 74 per cent of new production of life premiums. But in the non life insurance segment, Spanish banks account for only 5 per cent premiums. In Italy, banks represent 59 per cent of the life insurance market (in 2003) but only 1 per cent of the non life market. In India in 2004, private insurers sold more than 30 per cent of their life policies through banking channels.

In Germany the idea of a conglomerate offering both banking and insurance services (also called Bancassurance) might be another driving force for merger and acquisition activities. However, the prospects for bank insurance mergers were damaged by the unfavorable experience in the Allianz/Dresdner Bank case. Following the Allianz acquisition of Dresdner, the banking subsidiary experienced losses in its core activities and achieved only limited cross selling advantages for the insurance business. In the United Kingdom, Bancassurers held 20 per cent of life insurance and 25 per cent of the non life insurance market in 2003. In the United States, banks have captured a significant share of the annuity market, primarily by selling annuities manufactured
by unrelated insurance companies rather than serving as insurance underwriters.

We should stress that in most countries, supervision is different between insurance and banking. For example, in the United States, insurance markets are regulated at the state level, whereas banking regulation is primarily a federal activity. However, this is not the case everywhere. For example in the Netherlands an Authority of Financial Markets was created in 2004 to supervise all banks, insurance companies, pension funds, and the investment sector in general. Similar supervision convergence has taken place in the United Kingdom (since 2000), Japan (since 2000), France (since 2003), and Ireland (since 2004).

The portfolio of insurance products in various countries shows important variations. Some countries have a buoyant life insurance market, reaching sometimes two thirds of the insurance market share. In India, for example, the life insurance market is almost four times as large as the non-life market. In other markets, automobile insurance remains the primary insurance product. Thus, in 2003, as a proportion of total non-life insurance premiums, automobile insurance accounted for 50 per cent in Canada, 48 per cent in Japan, 44 per cent in France, 41 per cent in Germany, 40 per cent in the United States, 22 per cent in the United Kingdom and 62 per cent in China. Furthermore, some countries have low insurance penetration while others are witnessing more significant penetration, especially in developed countries. Tax laws, which differ significantly across countries, are critically important in the development of the life insurance market in particular. Demand for life insurance and annuities as savings, investment, and pension products are heavily dependent upon tax incentives provided by governments.

Some countries have unique insurance products, which exemplify the world’s insurance product diversity. In Brazil,
unique product is the capitalization, a savings account that features planned periodic payments into a fund with a national lottery attached. Typically half of the face amount is returned after 1 year with a fixed interest rate and the other half is used to finance the lottery winnings. Offered by private insurance companies and linked to the federal government’s lottery, it is the only authorized private gambling product in Brazil.

Within the various national insurance markets, insurance companies have adopted a diversity of strategies. For example, AXA has maintained a heterogeneous portfolio of life and non life insurance products, while ING and Prudential have decided to focus on life insurance. Some companies, despite being quite important in their home markets, have marginal international activities. For example, MACIF a French mutual society is a leader in the car insurance business in France but has no foreign subsidiary. On the contrary, Allianz has an ambitious world expansion strategy. Also, some companies have a world wide dominant distribution channel strategy such as Prudential, while others have invested in a variety of distribution networks, such as Generalli, Allianz, or AXA.

Another example of strategic policy diversity is the existence of various investment strategies of insurance companies. For example, loans accounted for a quarter of total assets of Japanese life insurance companies in 2004. For many years, loans were the largest component in Japanese life-insurer’s investment portfolios. The share of loans was 67.9 per cent in 1975, consisting mainly of loans to blue chip companies. As blue chip companies have accumulated sufficient retained earnings and increased their dependency on securities markets, it became difficult for insurers to find appropriate borrowers. In India, loans from life insurance companies to state and central governments and their corporations and boards has steadily fallen from 42 per cent in
1980 to around 18 per cent at present. Loans are usually a marginal asset for insurance companies in other markets. The percentage of life insurance company investments in bonds is also diverse: 95 per cent in Brazil (2004), 70 per cent in France (2003), 50 per cent in the United States, 41 per cent in Canada, and 35 per cent in Japan.

In 2003, the top 10 life insurance companies held a market share of 99 per cent in India, 87 per cent in China, 78 per cent in Japan (for individual insurance), 64 per cent in France, 62 per cent in Germany, 54 per cent in Italy, 55 per cent in the United Kingdom, 47 per cent in Canada, and 40 per cent in the United States. The same heterogeneity of market concentrations is present in non life insurance. In 2003, the top 10 non life insurers held a market share of 96 per cent in India, 94 per cent in Japan, 92 per cent in China, 79 per cent in the United Kingdom (accident and health), 60 per cent in Germany, 57 per cent in France, 58 per cent in Italy, 53 per cent in Canada, and 39 per cent in the United States. Far from being homogeneous, today's insurance markets are characterized by significant diversity, creating challenges and opportunities for insurance companies. Analysis of the world insurance market shows that there is still no convergence in terms of firms' strategies.

CONCLUSION

The insurance market and its operation is very dynamic. Here we analyzed the growth of insurance market of different countries. It has been observed that country like UK, USA, France, Canada, Brazil, the insurance market has its own base. The international insurance markets show their significant diversity. This heterogeneity contradicts the common belief that
globalization has already homogenized the various national markets around the world. In fact, today’s insurance markets are both influenced by global trends and also local constraints and difference. Before describing the various key global and local insurance, we provide a discussion of globalization.

REFERENCES


http://www.corporatecriteria.standardandpoors.com
http://www.swissre.com/investors/financial_information/