

## News from the Europe Chapter

by Anthony L. Cabot, CPCU



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Things have really been active for the chapter since the CPCU Society's 2005 Annual Meeting and Seminars.

Certainly the biggest news is the upcoming Europe Chapter mid-year meeting. Why would this be big news, you ask?

Because for the first time ever, this chapter and a Society interest section are combining their meetings.

Well, that's no big deal.

They're combining their meetings in Paris! Paris, France!

Well, that's kind of interesting.

Europe Chapter members are coming from seven different countries to attend the meeting, and more than 10 International Insurance Section Committee members are coming from the United States to attend the "April in Paris" combined Europe Chapter and International Insurance Section Committee meeting.

Now you've got something going here.

The president of the CPCU Society, **Millie Workman, CPCU, CPIW**, will be there. The keynote speaker will be Jean Paul Thierry from the Board of Directors of one of the world's largest insurance companies, the Allianz Group. Educational events will focus on enterprise risk management and on ethical considerations for insurance professionals. We will visit the international offices in Paris of AGE, AIG, and Ernst & Young. Several CPCU "Connection" visits will include top insurance professionals in Paris, and we will also have some time to visit one of the world's most exciting cities.

Wow, this is a big deal!

The chapter has been working on the more mundane matters as well . . . we held our quarterly virtual chapter meeting in February, as well as two virtual task force meetings. (Membership and Visibility task forces met by teleconference in January and February.)

We have had our first-quarter Executive Board meeting, another "virtual" meeting in January to discuss the objectives of the chapter and to finalize the 2006 Balanced Scorecard/Circle of Excellence activities.

Our treasurer, **Pierre Fonteyne, CPCU**, organized an educational webcast on the subject of captive insurance in Luxembourg in early February. The webcast was attended by 10 members of the chapter. The presentation was made by Mrs. Nicolet, partner of KPMG and an expert on captive insurance companies. This was a very lively session and very informative for all that attended.

The chapter is very excited about the upcoming combined meeting in Paris, and we hope that this will be the first of many combined meetings. ■

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# From the Editors

by Peggy A. Ellis, CPCU, CLU, ChFC, CPIW, and Robert J. Gibbons, Ph.D., CPCU, CLU



■ **Peggy A. Ellis, CPCU, CLU, ChFC, CPIW**, a recently retired State Farm vice president, earned her CPCU designation in 1979. She is currently completing studies toward a doctoral degree in international business with a research focus on insurance viability in developing countries. She lives in McKinney, Texas.



■ **Robert J. Gibbons, Ph.D., CPCU, CLU**, is executive director and president of the International Insurance Foundation, a non-profit center for independent research and education furthering global standards for insurance markets worldwide. He earned his CPCU designation in 1980 and spent 18 years in the Curriculum Department of the Institutes. When not overseas, he now divides his time between Wayne, PA, and Washington, DC.

In addition to the news from the Europe and Japan Chapters, this issue offers some provocative insights on insurance in Latin America. As we try to ascertain and understand the needs of others in our global society, an obvious question is “Why isn’t the whole world insured?” We know the value of insurance in helping people recover from losses, but in much of the world people suffering catastrophes never recover. In a predictable world it would still be difficult to overcome poverty. In our unpredictable world, uninsured losses bring recurring setbacks and continually widen the gap between rich and poor.

So “Why isn’t the whole world insured?” In fact, this question served as the theme for the most recent International Insurance Foundation Annual Meeting Symposium, and Latin America provided the clearest illustration of the security gap arising where insurance markets are underdeveloped. Since both editors attended the event, we are pleased to share three presentations from the symposium that focus on Latin America.

The first article summarizes research sponsored by the Inter-American Development Bank to identify the obstacles restraining the development of insurance markets in Latin America. The second article discusses new risk management tools for addressing natural disasters. The third article explores the possibilities for extending the benefits of insurance to situations in which it is not feasible for claimants to produce evidence of their losses.

Taken together these three articles testify to powerful changes sweeping Latin America, enhancing its capacity for more efficient management of risk and strengthening its economy. Arriba! ■

## CPCU Sections’ Symposium at NAIC Meeting

*Mark Your Calendars  
and Support Your  
CPCU Society*

### Challenges to Developing Microinsurance

**June 10, 2006  
Washington, DC**

The CPCU Society’s International Insurance Section Committee and the Regulatory & Legislative Section Committee are pleased to announce a joint symposium on the “Challenges to Developing Microinsurance,” which will take place on June 10, 2006, at the NAIC meeting in Washington, DC. The event will be open to the public with no registration fees.

Alessandro Iuppa, president of the NAIC, will give opening remarks followed by introductions from moderator **Eric C. Nordman, CPCU**, chairman of the Regulatory & Legislative Section of the CPCU Society. Speakers will include: **Gail B. Burns, CPCU, CIC**, chairman of the International Insurance Section, **Richard Koven**, president of Juris Benefit Strategies, and **Edward Potter**, executive director of The Americas Association of Cooperative/Mutual Insurance Societies.

# Development of the Insurance Markets in Latin America and the Caribbean: An Empirical Analysis

by Pietro Masci, Luis Tejerina, and Juan A. Giral

- **Pietro Masci** has been chief of the Infrastructure and Financial Markets Division of the Inter-American Development Bank since 1999.
- **Luis Tejerina** is an economist at the Poverty and Inequality Unit of the Inter-American Development Bank.
- **Juan A. Giral** is an economist specializing in fiscal, financial, and social security matters.

This article analyzes several economic and non-economic variables affecting insurance market effectiveness across the countries of Latin America and the Caribbean using a survey of insurance participants: insurance companies, superintendents, and associations of insurance companies.

## Introduction: The Current Situation in Latin America

The Inter-American Development Bank (IADB)—together with the Regional Association of Insurance Companies (Fundación Interamericana de Empresas de Seguros, FIDES) and the Regional Association of Supervisors (Asociación de Supervisores de Seguros de Latinoamérica, ASSAL), and the International Insurance Foundation—is coordinating a policy-oriented research initiative on the status of the insurance industry in Latin America. The first systematic survey of insurance players and participants in the region analyzes the factors that affect the development of insurance markets. The IADB-FIDES-ASSAL-IIF research effort will support the formulation of policy recommendations with a longer-term view. Its aim is to highlight the role of insurance in the development of capital markets and, thus, on overall economic growth.

Insurance markets in Latin America and the Caribbean are relatively underdeveloped, with significant differences between relatively developed countries, such as Brazil and Mexico, and poor countries, such as Bolivia and Honduras. Nevertheless, throughout the region there is a growing demand by the private sector, insurers, and related agents for a stronger insurance sector. Premium volumes totaled about 2 percent of the region’s gross domestic product (GDP)—vis-à-vis Europe’s 7 percent, Asia’s 4 percent, and the United States’ 8 percent—and just 1.6 percent of insurance business worldwide. Most of the insurance business is concentrated in a few countries; Argentina, Brazil, Chile, Colombia, Mexico, and Venezuela accounted for more than 90 percent of premiums (Swiss Re 2004). This pattern implies that there is room not only for more insurance market penetration, but also for a better, more effective insurance market.

The level of insurance premiums in Latin America does not match other indicators for the region, such as population (which represents about 6 percent of the world’s population), and GDP (which is about 8 percent of the world’s GDP), showing the relative underdevelopment of the insurance industry in the region.<sup>1</sup> The challenge is to identify which factors hinder and which promote the development of insurance.

## The Policy Framework of the 1990s

The 1990s witnessed drastic policy shifts in Latin America, which opened the way for privatization, liberalization, and deregulation—efforts aimed at strengthening financial markets in the region, among them the insurance market. A brief summary of these efforts follows.

**Table 1**  
**Market Share of (≥50%) Foreign-Owned Insurers**

Latin America	Life	Non-Life
Brazil	32%	43%
Mexico	75%	58%
Chile	62%	63%
Argentina	53%	35%
Venezuela	39%	50%
Colombia	38%	46%

## Privatization

State involvement in the economy and the number of state-owned enterprises diminished considerably in the region in the 1990s. With the exception of the state-owned insurer La Previsora in Colombia and the reinsurance monopoly in Brazil, none of the major insurers in the large Latin American and Caribbean markets remain state-owned. Private insurers now write workers compensation insurance in Argentina and Chile, and Chile recently introduced a privately-run unemployment insurance scheme (Swiss Re, 2004).

## Liberalization

Latin American financial markets (including stock markets) and the capital account of the balance of payments were liberalized to open the door for more foreign capital. In particular, foreign insurers were expected to provide new capital and know-how in the form of more sophisticated insurance products, and distribution channels for reaching a broader spectrum of people. The reduction of barriers to entry prompted many international insurers to enter Latin American insurance markets. Mergers and acquisitions accelerated, and the market share of foreign insurers now ranges from 30 percent to 75 percent. (See Table 1.)

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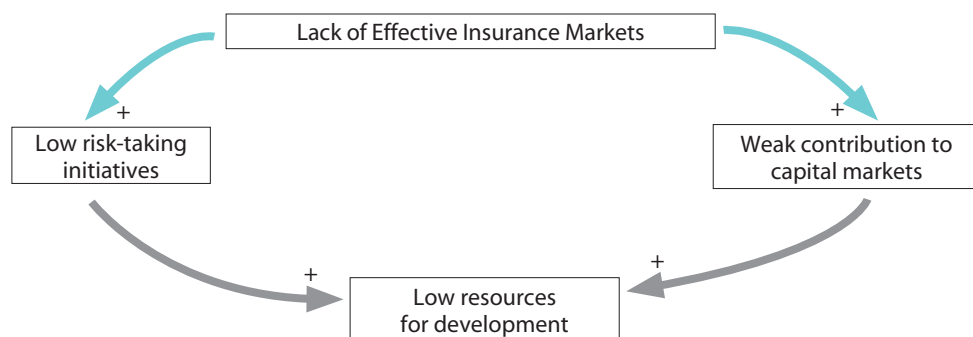
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**Table 2**  
**Response Distribution to Questions about the Effectiveness of Insurance Markets in LAC (Percentage)**

	Insurance coverage is too costly.	Insurance products are too complex and not too well explained.	Process of submitting claims is uncertain and unreliable.
a) completely agree	19.23	21.29	5.81
b) agree	55.77	54.84	34.84
c) neutral	17.31	13.55	31.61
d) disagree	5.77	10.32	27.10
e) completely disagree	1.92		0.65

Source: IADB/FIDES/ASSAL Survey

**Figure 1**



## Deregulation

Across the region, reforms in securities markets supervision, governance, and market infrastructure accelerated rapidly in the 1990s. With new trading platforms and lower transactions costs, the region as a whole seemed market ready.

Despite these changes, insurance markets remained shallow, and insurance penetration remained low. For example, recent household surveys that ask about access to health insurance show that only 8 percent of the households in the seven countries surveyed have some type of private health insurance. (The average for poor households was

2 percent.) Compared to developed countries (United States, 68 percent, and Australia, 45 percent), these numbers highlight the relative underdevelopment of insurance markets in the region.

Moreover, beyond the low levels of market penetration, the quality or effectiveness of insurance also remains weak. Our survey identified three principal shortcomings for insurance markets in Latin America: insurance products are considered too expensive, they are too complex for consumers to understand, and the process of submitting claims seems too uncertain. (See Table 2.)

## The Role of Insurance Markets

In general, the existence of insurance markets facilitates economic activity. Risk-averse individuals are willing to pay a fair premium to ensure compensation against the occurrence of a specific event in the future. For each insurance company, the law of large numbers predicts that when the number of contracts increases and the policy is appropriately priced, the company profits in the long run and is motivated to undertake the risk. This activity promotes economic growth.

Insurance not only facilitates productive activities but also contributes to the development of the financial sector. (See Figure 1.)

Insurers enter the market with equity capital and issue policies, which are a form of debt capital. They invest the funds raised until needed to pay claims. An effective insurance sector facilitates risk sharing, but it also plays a crucial role in the investment of savings, an essential component of financial reform, and capital market growth.

The liabilities of insurance companies are mostly long-term, and thus constitute a natural complement of capital market development. Insurer assets are partly invested in equities and government and corporate bonds, all typical instruments of a developed capital market. The investments that insurance companies make in corporations and other capital assets not only help improve capital allocation but also help enhance monitoring performance.

On the other hand, insurers are exposed to several risks. *Solvency risks* involve technical and investment risks. *Technical risks* consist of two types of risk: underpricing and under-provisioning. Underpricing is a situation in which the insurer attracts buyers by setting rather low premiums, and then the reserves set aside are not adequate to cover potential



claims. In an under-provisioning case, the technical reserves are inadequate to meet the insurer's obligations. *Investment risks* are generated by the insurer's role as a financial intermediary, a risk similar to those of banks with respect to insolvency. Furthermore, there are: the risk of default by a partner (e.g., reinsurer), risk of mismanagement, and systemic risk. The information and data needed to assess the insurer's solvency are usually unavailable to buyers of insurance. Thus, they cannot assess the financial strength of their insurer and the quality of the insurance contract, which partly explains the lower coverage in some countries.

Insurance buyers' perceptions of the quality of supervision as well as the requirements for capital adequacy have an important impact on the development of insurance markets. Therefore, public policy matters, particularly in identifying when the government should intervene to avoid under-provisioning and other potential financial disruptions. Even though the argument for regulating the banking business is stronger because banking is subject to liquidity crises (i.e., systemic runs on banks and the so-called contagion effect), whereas the insurance business can diversify its risk portfolio through reinsurance, insurance requires supervision as well. In addition, good insurance supervision is needed for the integration of world insurance markets, which depends on an adequate regulatory framework in each individual country.

## Important Factors to Foster the Development of Insurance in Latin America and the Caribbean

Specific variables linked to insurance and financial market development include the legal system, governance, enforcement, and institutional aspects. Swiss Re (2004) has analyzed these factors mostly from the point of view of the opportunities for business. According to their analysis, among the main economic factors that determine the growth of insurance are: (1) the level of savings; and (2) GDP per capita. They have a positive impact on insurance but also benefit from

the existence of insurance contracts. Nevertheless, Enz (2000) studied the relationship between demand for insurance and GDP, concluding that other factors (e.g., taxation, regulation, insurance provided by the government) limit insurance penetration.

Along with the distribution of wealth, the legal system and property rights, the availability of insurance products, regulation and supervision, trust, and risk awareness, the Swiss Re analysis found that other non-economic factors also influence the development of insurance: religion, culture, and education among them. In a further step of the analysis, specific factors are identified for life insurance and non-life insurance. For life, they include economic stability (e.g., inflation, exchange rate), demography, the tax system, the savings rate, and the pension system. For non-life, they include regulation (e.g., compulsory insurance), claim awards, exposure to natural disasters, and the public sector's role in health.

The "dependent" variable of the analysis is the extent to which the insurer successfully facilitates the insurance process and becomes the overarching criterion for effectiveness. How quickly, how cheaply, simply, and reliably an insurance company administers its policies determines how effective it is in satisfying the policyholder's needs.

In deep insurance markets, such as those of Europe or the United States, profit maximization and competition encourage insurance market effectiveness. In relatively shallow insurance markets, such as Latin America and other emerging regions, improving the groundwork for a more effective market warrants more attention.

## Empirical Analysis of Insurance Markets in Latin America and the Caribbean

The analysis that follows explains the factors—both economic and noneconomic—that hinder the

development of the insurance markets and their effectiveness in the region. Some factors are exogenous; others are within the scope of public policy. Two different empirical models, using data from the survey, identify the effect of particular variables on insurance effectiveness. Since the research is still at an early stage, any conclusion or recommendation derived from it should be taken with caution.

The analysis suggests that countries with a strong rule of law, more rigorous supervisory agencies, and more political and economic stability tend to exhibit more "effective" insurance markets. Economic and political stability influences the development of the insurance industry in several ways. First, the demand for insurance depends on customer confidence in obtaining real benefits in the event of a claim. This confidence is weakened by high inflation, depreciation or devaluation of the currency, changing currency and monetary restrictions and/or guidelines. Second, governments need a minimum of economic and political strength to be able to support the insurance market, which is in itself a long-term goal of many developed countries.

## The Survey: Data, Methodology, and Results Data

A regional survey obtained data from industry superintendents, associations, and insurance companies about the various variables. Responses came from 18 industry superintendents, 19 industry associations, and 126 insurance companies that make up the insurance market in Latin America and the Caribbean. The analysis of the survey seeks to establish the impact of changes in the independent variables on the effectiveness of insurance markets in Latin America, which represents the dependent variable.

Each individual question measured one or more variable of the country's insurance market. To simplify the quantitative analysis, all the survey questions are

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closed. A scale in which items or variables represent different subconcepts of the uncovered variable or factor and responses are covered to indicate different degrees of agreement or disagreement with the item. The majority of the responses are ranked on a scale of 1 to 5 (e.g., five categories of agreement and disagreement). Some questions are based on categories (e.g., income and education); others are yes/no questions (e.g., gender); and still others are list questions related to what can influence a certain behavior (e.g., buying insurance if income increases). The questions and the scale are designed so that items and variables can be used in regressions and also combined in factors for use in other types of analyses.

## Methodology

In order to measure the relationship between the factors mentioned in the previous sections, two approaches were followed. The first was to construct indices for each factor based on the mean of the values assigned to the relevant questions. For example, for the dependent variable, the Insurance Effectiveness Index was formulated from questions designed by insurance specialists, which covered effectiveness, information, funding, independence, enforcement, supervision, external events, and internal events. The items that best capture the notion of effectiveness of insurance markets were combined. The next step was to average the scores given to each item. The result was a continuous indicator of each one of the items included in the analysis.

The parameters of the equation were estimated using ordinary least squares (OLS) between the index and the independent variables making up the index. In addition, and because the items that make up the index are based on a ranking of values, it is more appropriate to estimate the effect using maximum likelihood (ordered probit). For the ordered probit estimation, it was also possible to estimate the marginal effects of a change in the independent variable

on each of the values that the dependent variables can take.

An additional equation was estimated including interactions of all the variables with dummies corresponding to the type of specialist interviewed (i.e., supervisor, FIDES, company).

## Results

With respect to the various factors relevant for insurance markets, the analysis presents a number of interesting conclusions:

- a. **Information.** The impact of this variable is not significant when taken for the composite indices, but it is significant in the context of the statement: "They are paying too much for insurance coverage." An interpretation of this effect could be that better informational quality increases industry costs. Marginal effects show that an increase in the information index would raise the probability that respondents agree with the statement. The inclusion of other controls, such as income (measured as GDP per capita) and education (measured as the percentage of population with primary education), does not change the results.
- b. **Enforcement.** The most robust result from the pooled regression indicates that legal enforcement is strongly related to the effectiveness of the insurance market. The law enforcement variable is also significant in increasing the effectiveness index, as well as for two of the three variables that make it up independently. Because it is highly probable that the effects of all the independent variables are nonlinear, the interpretation of marginal effects should be taken with caution. In the sample, the effect of an increase of 1 in the enforcement index would be an increase of 0.17 in the effectiveness index.
- c. **Supervision effectiveness.** A major finding of the survey is that the more rigorous the supervisor, the greater the effectiveness of insurance markets as a whole. Specifically, the marginal effect of an increase in the "effectiveness of supervisor" index would be to increase the effectiveness index by 0.09. Although small, this is significant at the 10 percent level for the effectiveness index as a whole and at the 5 percent level for one of the individual components. Concretely, the marginal effect of an increase in the supervisor effectiveness index would be to increase the probability that people "disagree" with the statement "Insurance products are too complex and not well explained" by 1.3 percentage points. For the statement "The process of submitting claims for payment from an insurance company is uncertain and unreliable," the marginal effect of an increase in the effectiveness of supervisor index would be to increase the probability that people disagree by almost 7 percentage points. With the inclusion of other control variables,

For the individual variables, it is possible to calculate the marginal effect for each option provided in the survey. For the statement "Insurance products are too complex and not well explained," the effect of a marginal increase in the law enforcement index would be to increase by 5 percent the probability of people disagreeing with the statement. For the statement "The process of submitting claims for payment from an insurance company is uncertain and unreliable," the marginal effect of an increase in the enforcement index would be to lower the probability of people choosing "completely agree" or "agree" by 6.6 and 2.3 percentage points, respectively. The inclusion in the analysis of the control variables weakens the significance of the enforcement variables, but they are still significant for the effectiveness index.

the supervisor indicator becomes insignificant at conventional levels.

d. **External events.** The effect of external events was found to be as robust as the effect of legal enforcement; however, the marginal effects for this variable are larger. For the effectiveness index as a whole, the effect of an increase in the external events index (where a higher value represents less vulnerability to a mixture of external events, including economical, financial, and political issues) would be to increase the effectiveness index by 0.24. The effect is significant at the 5 percent level for two of the three components of the effectiveness index independently (the same ones used for the legal enforcement index). As an illustration of the results, the marginal effect of an increase in the external events index would be to lower the probability that people disagree with the statement “Insurance products are too complex and not well explained” by almost 6 percentage points. For the statement “The process of submitting claims for payment from an insurance company is uncertain and unreliable,” the marginal effect of an increase in the external events index would be to lower the probability that people disagree with this statement by more than 14 percentage points. With the inclusion of other control variables, the significance of the external events index is only affected for the statement “Insurance products are too complex and not well explained,” which becomes insignificant.

e. **Differences between factors in the insurance market.** When looking at the different effects of the variables between factors in the insurance industry, it becomes clear that there are differences in the perception of relevant factors between supervisors and the rest of the sample. It is worth noting that the significance of the “effectiveness of the supervisor” impact on the effectiveness of the market becomes significant only for the supervisors.

## Conclusions

The results of the study and the discussion with the industry and the supervisory entities allow us to formulate policy recommendations aimed at making the insurance markets in Latin America and the Caribbean more effective and to better serve the people at the “bottom of the pyramid.” Recognizing the diversity of the region’s markets, the recommendations emphasize the following areas: (1) institutional strengthening that requires a commitment through both improved rules and a legal and judicial environment adapted to the characteristics and ad-hoc measures of each country; (2) effective regulation and supervision that comply with the Core Principles of the International Association of Insurance Supervisors (IAIS); (3) political and economic stability coupled with interventions to mitigate and transfer the risks of the natural environment; and (4) competitiveness to be promoted through measures such as standardized collection of reliable market information and broader coverage of social needs (e.g., obligatory insurance, agricultural insurance, and natural disasters insurance).

In that context, there is also a need to further develop the indicators of effectiveness for each country in the region; and undertaking the diagnostics of the current situation for specific countries.<sup>2</sup>

So far ASSAL, FIDES, and IDB agreed on a joint agenda for maximizing the effectiveness index of the insurance sector. ■

## Endnotes

1. Swiss Re 2002.
2. In Peru, for example, a survey was undertaken with the results showing that individuals’ access to financial services is limited to large companies and a limited number of individuals, and thus that there is a large untapped market.

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# Responding to the Needs Created by Natural Disasters in Latin America and the Caribbean

by Ian Webb

■ **Ian Webb** oversees research and publications at the International Insurance Foundation (IIF). The research agenda includes country studies on emerging insurance industries, expositions on regulatory best practices, and papers expounding on the role of insurance in economic development. He also manages technical assistance projects funded by donor agencies aimed at regulatory reform and market strengthening. His responsibilities include advising, training, and coordinating technical assistance on solvency, asset/liability management, actuarial standards, and risk management, and contributing to insurance regulatory training seminars.

Following an M.B.A. in finance from the College of Insurance, Webb received his master's in economics, and doctorate in risk management and insurance from the internationally recognized actuarial and risk management school, Georgia State University. Previous to the IIF, he served as a consultant in the Financial Sector Development Department of the World Bank, and recently completed a two-year secondment to the Infrastructure and Financial Markets Department of the Inter-American Development Bank. Webb also served as insurance consultant to the Multilateral Investment Guaranty Agency of the World Bank.

Natural disasters have had a growing impact on economies worldwide in recent decades. While developed nations such as the United States have felt the huge economic losses that usually arise from such disasters, the strength of their economies and use of loss-mitigation infrastructure allow them to rebound fairly quickly. Developing countries, on the other hand, such as Honduras, which was swept by Hurricane Mitch, endure much greater and persistent damage to their economy and infrastructure. This fact has precipitated increasing attention toward how to better prepare and protect developing countries from these cataclysms. The need for knowledge and preparation is much greater than the supply, and efforts to date have only begun to address the huge gap in acquisition and implementation of knowledge, due to the size of the region and huge demand extending from federal to provincial to town level in risk management planning.

An analysis of the last 30 years confirms the fact that the rate of natural disasters appears to be increasing. Following this trend is a parallel increase in total economic losses due to disasters. The Latin America and Caribbean region has experienced its share of this worldwide growth in natural disaster losses. The United Nations Environmental Programme (UNEP) reports that economic losses caused by disasters in this region increased by almost 230 percent between the 1960s and the 1990s, reflecting a global trend. The 65,260 deaths reported in the region due to natural disasters in the 1990s were mainly the result of floods (54 percent), epidemics (18.4 percent), storms, cyclones, and hurricanes (17.7 percent), earthquakes (5.2 percent), and landslides (3.2 percent).



Not surprisingly, the region's development bank, the Inter-American Development Bank, has in the past four years approved \$1.5 billion in new financing to help affected countries in the region recover from disasters. This amount represents a ten-fold increase in its average annual disaster-related lending compared to the previous 15 years. These huge sums of money required to bring countries back on their feet after disasters has helped crystallize the realization that after-the-fact approaches to address disasters are unsustainable—prevention and risk management must be adopted as central tools for development.

A review of development and disaster-related policies in previous decades would show that aid has largely focused on emergency response, leaving a serious underinvestment in natural hazard prevention and mitigation. Having recognized this fact, aid agencies have generally re-focused their efforts toward taking a more proactive stance to reducing the toll of disasters in the region, such as by implementing more comprehensive pre-disaster risk reduction and post-disaster recovery frameworks.



These frameworks typically include the following sets of activities:

- risk analysis to identify the kinds of risks faced by people and development investments as well as their magnitude
- prevention and mitigation to address the structural sources of vulnerability
- risk transfer to spread financial risks over time and among different actors
- emergency preparedness and response to enhance a country's readiness to cope quickly and effectively with an emergency
- post-disaster rehabilitation and reconstruction to support effective recovery and to safeguard against future disasters

A natural disaster risk management tool that has received particular attention is a set of risk indicators that were developed to allow policymakers to identify how well local and federal governments were addressing the natural disaster risks facing their populations. One of the system's four main indices, the Risk Management Index (RMI), takes into account factors such as how countries monitor and map hazards, enforce construction codes, coordinate emergency operations, and implement social safety nets. Another of the risk indicators, The Disaster Deficit Index (DDI), considers from a macroeconomic standpoint the risks countries face due to possible disasters of different magnitude and probability, comparing them against their financial capacity to face up to such catastrophes. A third index, The Local Disaster Index (LDI), evaluates the social and environmental risks stemming from recurrent small-scale disasters, looking at deaths tolls, numbers of affected people, and damages to housing and crops. Unlike the DDI, this index takes into account events that often involve few victims and occur in remote areas, rarely attracting media coverage. The Prevalent Vulnerability Index (PVI) gauges a country's exposure to human and economic losses from natural disasters, its social and economic fragility and its capacity to absorb impacts and finance recovery. The three composite indicators

that make up this index consider factors such as demographic growth, population density, poverty and unemployment levels, soil degradation caused by human action, social expenditures, and insurance of infrastructure and housing. Together these indices have provided measuring sticks for how well developing countries have identified and addressed the natural disaster-related risks facing them.

Other activities and resources developed by the principal aid agencies to reduce the negative consequences from natural disasters include educational plans, self-assessment guidelines, task forces, advisory groups, and case studies. The Provention Consortium, a network of private and public sector organizations interested in providing tools and resources to mitigate and manage natural disaster risk in developing countries, was formed to help facilitate the organization of resources. Other agencies that have been involved in natural disaster planning for the region include USAID and the World Bank. Some of their efforts include developing national education plans for disaster prevention, producing instructional guides and manuals, conducting seminars for teachers and students, strengthening the capacity of municipalities to prepare for and mitigate natural disasters through participatory planning, and forming municipal emergency operations committees to ensure balanced representation among women, vulnerable groups, and other stakeholders.

In spite of the high level of analysis and activity on natural disaster planning, the efforts undertaken so far by aid agencies have only begun to satisfy the need that exists at the local, state, and federal governments in the region. Having visited many countries in the region, and spoken to insurance industry professionals in the public and private sector, I can say confidently that any professional with risk management, loss mitigation, safety, or related expertise who wished to share his or her knowledge and perspective with a town in one of the countries south of the border would

no doubt be greatly appreciated by the town mayor. Professionals with such knowledge take for granted what they know, and don't realize the extent to which their knowledge would be helpful to many. Such an experience would also no doubt sharpen the awareness of the need of individuals with expertise to be alert to the ever-present danger that the government officials may overlook some crucial weakness of disaster prevention framework. It is individuals who are right in front of the problem, such as the proverbial Dutch Boy who stuck his finger in the dam to prevent the levees from breaking, that sometimes can make all the difference. ■

# Insurance: A Privilege of the Rich?

by Carlos Bölsterli



■ **Carlos Bölsterli** grew up in Colombia. After finishing school he went to Switzerland, where he studied at the university in Bern, and in 1989 he graduated as economist and business administrator.

In October 1989, he joined Swiss Re in Zurich and started working for various marketing units within the Latin American Department. In 1991, he was transferred to Colombia, where he was responsible for Swiss Re's business in that country for almost five years. In 1996, he went back to Zurich, where he assumed responsibility over different South American countries.

In 1997, he was once again transferred to Colombia, where he first participated in the regionalization of our office in that country and then assumed the general direction, becoming responsible for the attention of our clients in Colombia, Ecuador, Peru, and Bolivia.

In January 2004, he was transferred to Mexico as general director of Swiss Brokers Mexico.

All economic activities are connected with some sort of risks. Attempting to circumvent risk can hardly result in any type of progress. This is particularly true for emerging economies, most of which are exposed to aggravated problems and risks and also, unfortunately, very often saddled with insufficiently developed capital and insurance markets.

One main risk that these emerging economies face is over-reliance on just a few goods, mainly raw materials and agricultural products. This over-reliance makes these countries much more vulnerable to bad weather or other meteorological phenomena.

Additionally, many emerging economies lack any effective mechanisms to protect themselves from exposure to natural catastrophes. This is demonstrated by the frequency and severity of catastrophic events affecting these nations annually, and the high number of victims left behind. Inadequate emergency warning and rescue systems, as well as lax construction codes, contribute to this high casualty count.

Furthermore, the unstable nature of emerging economies' financial matters begets meager levels of social security, which, in turn, leads to political instability and crises. The political instability and subsequent crises inhibit overall development of the emerging economy. Nearly nonexistent long-term saving rates in these nations also preclude establishing a sustainable economic model conducive to investments.

Insurance in emerging economies, including those of Latin America, often illustrates these pitfalls. Emerging economies generally spend less than 3 percent of their GDP on insurance—as opposed to a 9 percent average in industrialized countries. Those statistics indicate that generally, this kind of risk management tool remains the privilege of only a few wealthy individuals and/or corporations.

## Low Penetration of Insurance in Emerging Economies and Challenges for the Insurance Industry

While there are several reasons for the low penetration of insurance in emerging economies, it is necessary to differentiate between two groups:

- those individuals and/or corporations that can afford to buy insurance protection but chose not to do so
- the vast majority of the population that lacks the sufficient earning power to buy insurance protection

Among the reasons the first group cites for not buying insurance are the limited perception of risk, inadequate products, price perceived as too high, or, simply, lack of trust in insurance industry. To respond to these concerns, insurance companies should make their case to potential clients by improving three specific areas:

- **transparency and data quality**
  - appropriate assessment of risks/definition of prices
  - clear and timely definition and execution of contract wordings
- **sophisticated underwriting**
  - increase retention levels
  - increase independence in underwriting (i.e., non-proportional covers)
- **innovative products**
  - new products (insurance-linked securities, agricultural products)
  - new distribution techniques with sound underwriting (i.e., electronic platforms)
  - new administration and more sophisticated pricing tools

## An Additional Obstacle to Insure the Poorest: Lack of Information

In addition, another major “technical” obstacle makes the vast majority of the population in emerging economies uninsurable: lack of information!

Overcoming this obstacle is not possible by implementing one simple solution. If it were possible to get each person to purchase insurance and even find sponsors to subsidize premiums for the poorest segments of the population, lack of information would still inhibit the entire process. Why? Because the ability to offer insurance cover for any kind of risk requires a certain baseline amount of information, or business cannot be written.

Basically, the information needed to underwrite risks exposed to natural catastrophes are:

- Hazards that will be covered, such as earthquake, flood, hurricane, etc. In the case of an earthquake, for example, it is necessary to know the seismic activity in a certain location.
- Vulnerability of the assets to be covered by hazards such as natural catastrophes. This information is essential to assess how much of the insured risks would be destroyed after each of those disasters. Fully comprehending the quality of construction remains paramount.
- Location of the assets to insure, their respective insured values, and distribution by lines of business covered
- Insurance conditions of the book of business, especially deductibles, limits, coinsurance, etc.

The first three areas mentioned above help to estimate the expected economic loss, while the fourth one will help gauge the insured loss. By running the model, we generate the so-called “loss frequency curve,” which is used to estimate the expected losses. This information is essential to calculate the technical premium.

However, as mentioned before, even if a sponsor for the premiums were located, traditional insurance would not be the best vehicle to insure the poor, as it would be almost impossible to fulfill three of the four information requirements mentioned above.

## Parametric Triggers: A Possible Alternative

There are ways to mitigate this lack of adequate information given that we do not have information for three of the four abovementioned points, it is necessary to concentrate on the only area for which we have information: the hazards to cover. By combining the knowledge about the hazard with a parametric trigger, we would be able to offer an insurance or reinsurance solution for certain natural hazards/catastrophic events.

The parameter has to be accurately measured by an independent entity in order for this solution to work. This requirement, however, limits the hazards that can be covered, as not all hazards in all countries are currently being measured by third-party entities.

There are different kinds of parametric triggers—from the pure parametric trigger, which only considers the actual reported physical event, to the more refined parametric index, which uses more complicated formulas and more detailed measuring locations.

Traditional insurance works with indemnity covers—the amount paid by the insurer corresponds to the actual losses of the insured. One major drawback to parametric triggers, since they are not based on the losses incurred by the insured, is that the cover purchased could either be greater or smaller than the actual losses suffered in a given event.

On the other hand, the use of parametric triggers presents many advantages, including:

- providing a mechanistic claims recovery and unambiguous payment terms
- representing a possible solution for insuring natural catastrophe exposures that were not insurable by alternative methods, providing relief in case of a major event
- offering increased transparency, making the product viable to alternative international markets

Looking at the kind of triggers used for catastrophe bonds (“cat bonds”) issued from January 2003 to June 2004, one can see that these investment tools provide a variety of triggers to manage the tradeoff between transparency and coverage basis risk. Parametric index and indemnity are the most common types of triggers in the current environment.

In general, investors have a preference for parametric and index-based triggers, as they provide a degree of transparency that translates into more favorable pricing (lower spreads) for transaction sponsors.

## Mexico: Pioneering a Viable Alternative in Latin America

The Mexican Federal Natural Catastrophes Fund (FONDEN) has been working a couple of years on a deal, and finally, early this year, started a bidding process for a cover with the following main characteristics:

- a three-year contract with part of the cover being supported by reinsurers and the rest placed in the capital markets as cat bonds
- coverage for three different zones, each of them with U.S. \$150 million, where the trigger is a predefined magnitude of earthquake occurring in any of those zones

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# Insurance: A Privilege of the Rich?

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In this case, if an earthquake triggers the cover, FONDEN will receive the full amount of the cover bought for the affected zone. This amount will not be directly correlated, and most probably only represent a fraction of the actual losses suffered in the affected zone. Nevertheless, it represents an efficient way for the government to access risk transferring markets and multiply the scarce resources they have to come to the rescue of the poor after a natural disaster.

It is obvious that emerging economies, including those of Latin America, do have many obstacles to overcome in order to not only improve their economic standing in the global arena, but to learn to mitigate the host of ever-changing risks that they, along with the rest of the world, face today.

The global insurance community has two main options in working with emerging economies. The first is to wait for the GDP of these developing nations to improve, which could take several years, if it is to happen at all. The second option is to attempt to implement tools such as the parametric triggers and, this way, make it possible for the poorest to get an indirect access to insurance and capital markets.

Granted, there are issues to be solved; current legal frameworks within some of these economies are not a perfect fit for these triggers. Developing solutions like parametric triggers does take time and effort—and they are not complete solutions. They are, however, a step in the right direction and can become part of the path to risk mitigation. ■

## International Insurance Section Develops Annual Meeting Seminar



CPCU Society • Annual Meeting & Seminars • September 9-12, 2006 • Nashville, TN

### China and India: Insurance Marketplace Response to Their Fast-Growing Economies

**Tuesday, September 12, 2006 • 10:15 a.m. – 12:15 p.m.**

This “one-of-a-kind” seminar will examine the past and current state of the market in China and India. It will discuss market practices; the development of brokers and consultants as client advocates; and the role of foreign insurers and brokers. This is a valuable seminar for risk managers/insurance buyers who have exposures, and brokers and carriers who have clients, in China and India.

#### Speakers

Brian Murray, Ph.D.  
AIG Corporate R&D

Additional speakers to be announced.

*The Gaylord Opryland Resort & Convention Center, 2006 Annual Meeting headquarter hotel, is known for its indoor gardens, world-class spa, and first-class entertainment.*



Photo courtesy of the Nashville CVB and Barry M. Winiker.

**Registration will begin in early spring.**



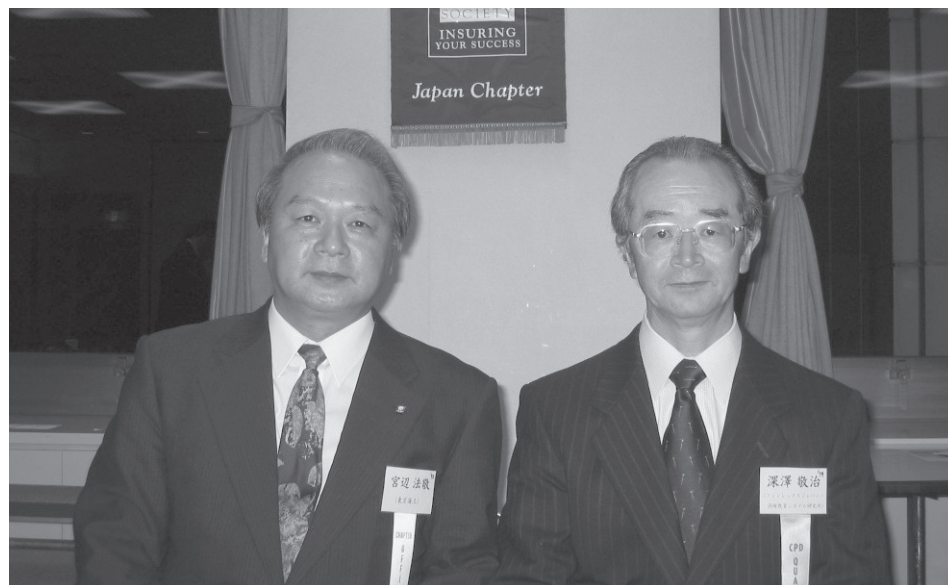
# Japan Chapter—New Officers Selected at Third Annual Meeting on November 11, 2005

by Keiji Fukasawa, CPCU, CLU, ChFC

It was an enjoyable experience for me to have served as the first president of the CPCU Society's Japan Chapter since October 2003. My role ended on November 11, 2005, when new officers were selected at our third annual general meeting with a conferment ceremony.

As the immediate past president of the Japan Chapter, I would like to briefly review the chapter activities for the past two years, by listing the focused areas. The Japan Chapter's most important goal has been and still is the market recognition of the CPCU professional designation. In Japan, the CPCU designation is regarded as a U.S. insurance designation and not of the Japanese insurance market. We needed to increase its recognition by spreading the word about the CPCU designation as the global insurance designation that can be an alternative insurance professional designation in the Japanese market where there is no domestic equivalent professional designation. The most effective tool to spread the word for recognition of the CPCU designation has been the local insurance newspapers such as *Insurance Daily News*, *Insurance and Banking Daily News*, and *Weekly Insurance*. We invited the news reporters to attend our annual meetings, conferment ceremonies, and Ethics Awareness Month activities. We occasionally provided them with the CPCU exam news and the *CPCU News*, and fortunately they cooperatively wrote about us. This has been the greatest tool for us to show what CPCU means in Japan because of its circulation in the insurance market.

We also held special press meetings whenever the CPCU Society officers and AICPCU executives visited Japan. Also arranged were visits to the leading Japanese insurance companies, General Insurance Association of Japan, and the Non-Life Insurance Institute. These visits were related to our second chapter goal of



■ Current Japan Chapter president Noriyuki Miyabe, CPCU, on the left, and immediate past president Keiji Fukasawa, CPCU, CLU, ChFC, on the right, attended the chapter's third annual meeting and conferment ceremony in November 2005.

increasing the number of candidates for CPCU exams. Unlike the U.S. market, Japanese domestic insurance companies provide no financial support to CPCU students for exam fees and textbook costs. We explained the broad recognition the CPCU designation has in the U.S. market with employers' good financial support, and we have requested the Japanese insurers and agencies to provide the same level of financial support to their employees when they study the CPCU program. Only one domestic insurer gives its employees president's award to the CPCU completer, and another insurer has just introduced a small award to CPCU completers, but the majority of Japanese insurance companies show no interest in completion of the CPCU exams. For candidate development, we have held introduction seminars at a few insurance companies. We hope to see the increasing number of CPCU students in Japan.

The third area we stressed was ethics in insurance. All Japanese insurers have completed their organizations'

compliance requirements, but none have talked about ethics yet. The CPCU Society's Japan Chapter is a unique existence in the Japanese financial services market because it is only one group raising ethics as its basis for conduct, in addition to another uniqueness of an insurance professional group passing the rigorous CPCU examinations.

The new officers will carry on these three areas of chapter activities.

I am pleased to introduce our new Japan Chapter officers for 2006. **Noriyuki Miyabe, CPCU**, who has been chapter vice president for the past two years, was elected as chapter president on November 11, 2005. Miyabe is general manager, International Department, Tokio Marine Nichido Fire Insurance Company, and he is a 1993 designee. He joined the insurance market in 1978, after graduating from Sophia University in Tokyo. He studied his M.B.A. degree at Geneva University in 1983, being sent

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# Japan Chapter—New Officers Selected at Third Annual Meeting on November 11, 2005

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■ New Japan Chapter officers for 2006: from left to right, Satoru Shiono, CPCU, ARM, Secretary; Noriyuki Miyabe, CPCU, Chapter President; Hiroshi Kinoshita, CPCU, Vice President; Rie Hidaka, CPCU, Treasurer

from his company. He experienced two overseas assignments from Tokio Marine: Honolulu office in Hawaii, and Sao Paulo office in Brazil. He completed his CPCU designation during his Honolulu period. In his inaugural speech as the new Japan Chapter president, he mentioned that his main goals are increasing recognition of the CPCU designation in the Japanese market, and increasing the number of CPCU members. He believes CPCU activities would contribute to globalization of Japanese insurance companies, expanding into worldwide markets.

The new vice president of the Japan Chapter is **Hiroshi Kinoshita, CPCU**, a 1995 designee. He works as chief consultant in the environmental department for InterRisk Research Institute & Consulting, Inc., which is a subsidiary company of Mitsui Sumitomo Marine and Fire Insurance Company Limited. He graduated from Tokyo

University in 1980 and from law school at George Washington University in 1987.

The new secretary of the chapter is **Satoru Shiono, CPCU, ARM**. He is manager, commercial production department of Mitsui Sumitomo Marine and Fire Insurance Company, and he is a 2003 designee.

Shiono joined Sumitomo Marine and Fire Insurance Company in 1988 after graduating from Sophia University in Tokyo. He obtained his CPCU designation in 2003.

The new treasurer of the chapter is **Rie Hidaka, CPCU**, a 1997 designee, the first female CPCU in Japan, and one of three women in the Japan Chapter. Hidaka was secretary of the chapter in the past two years. She is financial information manager of GE ERC Services Japan Co., Ltd. She was a graduate from Sophia University in

Tokyo in 1983. She is married and has a son in junior high school.

Following the new officers' installation ceremony, the chapter's conferment ceremony was held on the same day. The new designee this year was **Ichiro Tozawa, CPCU, CLU**, who works for Tokio Marine Nichido Fire Insurance Company, Ltd. He was assigned to its Guam Office in July 2005 and had to fly back to Tokyo from Guam to attend the conferment ceremony in November.

We also invited to our general meeting and conferment ceremony some of the recent IIA program completers in Japan such as ARM and ARE. We held a buffet party after the ceremony. ■



## SAVE THE DATE!

### Attend the **CPCU Society's 62nd Annual Meeting and Seminars** **September 9-12, 2006 • Nashville, TN**

*Featuring exciting celebrations, timely seminars,  
and a riveting Keynote Speaker!*

- Celebrate with your colleagues and new designees at the Opening Session and national Conferment Ceremony on Saturday afternoon, followed by the Congratulatory Reception.
- Enjoy a memorable evening at the Grand Ole Opry.
- Be inspired at Sunday's Keynote Address by retired New York City Fire Department Battalion Commander Richard Picciotto, the highest ranking firefighter to survive the World Trade Center collapse and author of *Last Man Down*.
- Attend two new exciting panel discussions conducted by industry leaders, focusing on critical industry issues and environmental catastrophes.
- Choose from 30-plus technical education and professional career development seminars.



*Retired FDNY Battalion Commander Richard Picciotto will speak at the CPCU Society's Annual Meeting on September 10, one day before the fifth anniversary of 9/11.*

*Online registration will begin in early spring.*



*Photo courtesy of Nashville CVB and Heavenly Perspectives.*



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- Choose from nine courses developed and taught by top insurance professionals.
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**Register online by April 14** at [www.cpcusociety.org](http://www.cpcusociety.org). For more information, call (800) 932-CPCU (2728), option 5. NLI courses are open to nonmembers, so encourage your associates and colleagues to attend as well!



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