Risk financing a key priority

There are many reasons why there is still a serious insurance protection gap in Asia for Nat CAT risks. These include perceived high cost of insurance, mistrust of the industry, cultural challenges and data paucity. **Mr Amer Ahmed** of **Allianz Reinsurance** stresses that despite these challenges, the (re)insurance industry and governments in this region must work together to make disaster risk financing a "key policy priority".

It seems everything is on the increase in Asia. Its booming population is predicted to double by 2050 and several of the world's largest and fastest-growing economies are in the region.

Simultaneously, a sharp increase in prosperity is being recorded, with estimates indicating that 1.75 billion people in Asia will be defined as "middle-class" by 2020. This represents a 100% increase from 2009. Deloitte reported that by 2050 Asia will account for over half the world's financial assets.

The growth of megacities is also largely an Asian phenomenon, with all six of the most populous located in the region. Many of these are coastal megacities exposed to an increasing risk of natural catastrophes (Nat CATs). Globally, over one billion people live in low-lying coastal areas at risk of flooding.

Rate of Nat CAT insurance penetration low

The incidence of Nat CATs is increasing in the region with the Asian Development Bank (ADB) reporting that Asia has borne half the annual global economic cost of natural disasters over the last two decades – amounting to around $53 billion each year. Losses from disaster over the past 40 years have far outpaced GDP growth in the region and seven of the 10 countries with the highest expected GDP losses per annum from Nat CATs are also in Asia.

Nat CATs also tend to take a higher toll on human life in developing or emerging countries with studies revealing the most fatalities from natural catastrophes between 1980 and 2012 took place in Asia and Africa.

Worryingly, what has not kept pace in the region is the rate of insurance penetration. Last year, Munich Re reported that "for every euro of destruction caused by a natural catastrophe in Asia, on average only eight cents was covered by insurance during this period [1980-2012], while the average for the same period was 40 cents on the American continent."

Of the $168 billion global insurance shortfall, the majority rests in Asia. China, poised to become the world's largest economy, has one of the biggest insurance shortfalls in the region with 90% of the total loss per Nat CAT event between 2004 and 2011 recorded as uninsured.

Perceived high cost of insurance one reason for low take-up rate

So what more can the (re)insurance industries do as it becomes clear the economies most affected by increasingly frequent and economically destructive Nat CATs are the least protected?

A recent ADB report suggests several reasons for the low take-up rate of insurance in Asia. Among other factors the expense of insurance is cited along with widespread mis-

trust of the industry. The report goes on to warn that the lag in insurance take-up is of particular concern as "the gap between economic and insured losses can be so severe that it may outstrip the government's ability to act as an insurer of last resort."

A Marsh study found the telecommunications, energy and petrochemicals industries in Asia are typically underinsuring by between 30% and 60% and pointed to inaccurate loss potential valuations and the perceived high cost of insurance against risk exposure as factors.

Reliance on savings and cultural challenges are other reasons

The ADB also notes that in Asia there is "an inclination toward...self-insurance – viewing savings as a form of contingent capital and assuming balance sheets are sufficiently robust to cover their own risks."

This cultural challenge facing insurers is not new. In her book Marketing Death, University of Hong Kong sociologist Cheris S C Chan writes about the difficulties faced by life insurers early to the Chinese market. In a country where discussing premature death is taboo, those agents using the familiar sales rhetoric of "love" and "responsibility" proven in Western markets were faced with anything from rejection to outright hostility. Local insurers such as Ping An had more success presenting products that were "designed according to the locals' habits of saving, their concerns about life during retirement, and their child-centred way of life," said Ms Chan.

Ex-ante disaster risk financing approach

As markets open up and trade barriers are liberalised, it is critical for insurers to position products that meet these new consumer needs. Initiative must also come from governments, with the ADB encouraging those regions to make disaster risk financing a "key policy priority".

It favours an ex-ante disaster risk financing approach which would see capacity to pay for Nat CATs secured before they occur. This involves a blend of insurance and reinsurance measures as well as capital market risk transfer tools, such as catastrophe bonds.

Swiss Re's latest *sigma* agreed: "Risk transfer can protect livelihoods from catastrophic events and increase the willingness of decision-makers to invest in economic development. Additionally, risk transfer puts a price tag on risk and thereby incentivises investments in prevention measures."

Data paucity

The question of insurance pricing in many ways comes back to the availability of reliable data. Asia poses a particular problem in relation to data paucity – something that has been widely discussed. The ADB believes a high priority for the region is to "develop and promote a regional platform for collecting and disseminating data on assessing and modelling risks."

Recently, NASA and the University of Bristol issued a call through the journal Nature for international cooperation on "a high resolution and accuracy global Digital Elevation Model (DEM) in order to strengthen protection against damaging floods." Such a DEM, they claim, would have "an enormous impact on finance (such as flood re-insurance), humanitarian services (such as disaster relief) and scientific research."

Data paucity also impacts the ability to quantify the ways in which climate change and future weather patterns will affect the region. Even with the best scientific estimates there are many uncertainties. This difficulty was highlighted in a report by the Economics of Climate Adaptation (ECA): Shaping Climate-Resilient Development.

In one case study, scientists arrived at two equally plausible but contradictory scenarios for rainfall patterns in a region – one showed a decrease of 5%, the other, a 10% increase.

(Re)insurance is a powerful tool

Crucially, the ECA report said adaptation measures can avert between 40% and 100% percent of the expected losses in a 2030 high climate change scenario. In many cases the measures also have a negative cost, generating cost savings. Initiatives such as these provide real opportunities for government, industry bodies and the (re)insurance industries to collaborate.

Swiss Re's latest *sigma* made this observation: "In continuing to further push the boundaries of insurability, the (re)insurance industry can make an effective contribution by developing the numerous business opportunities that climate change has and will create in the future. In this way, (re)insurance is a powerful tool to strengthen the resilience of local and national economies, and humanity at large."

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