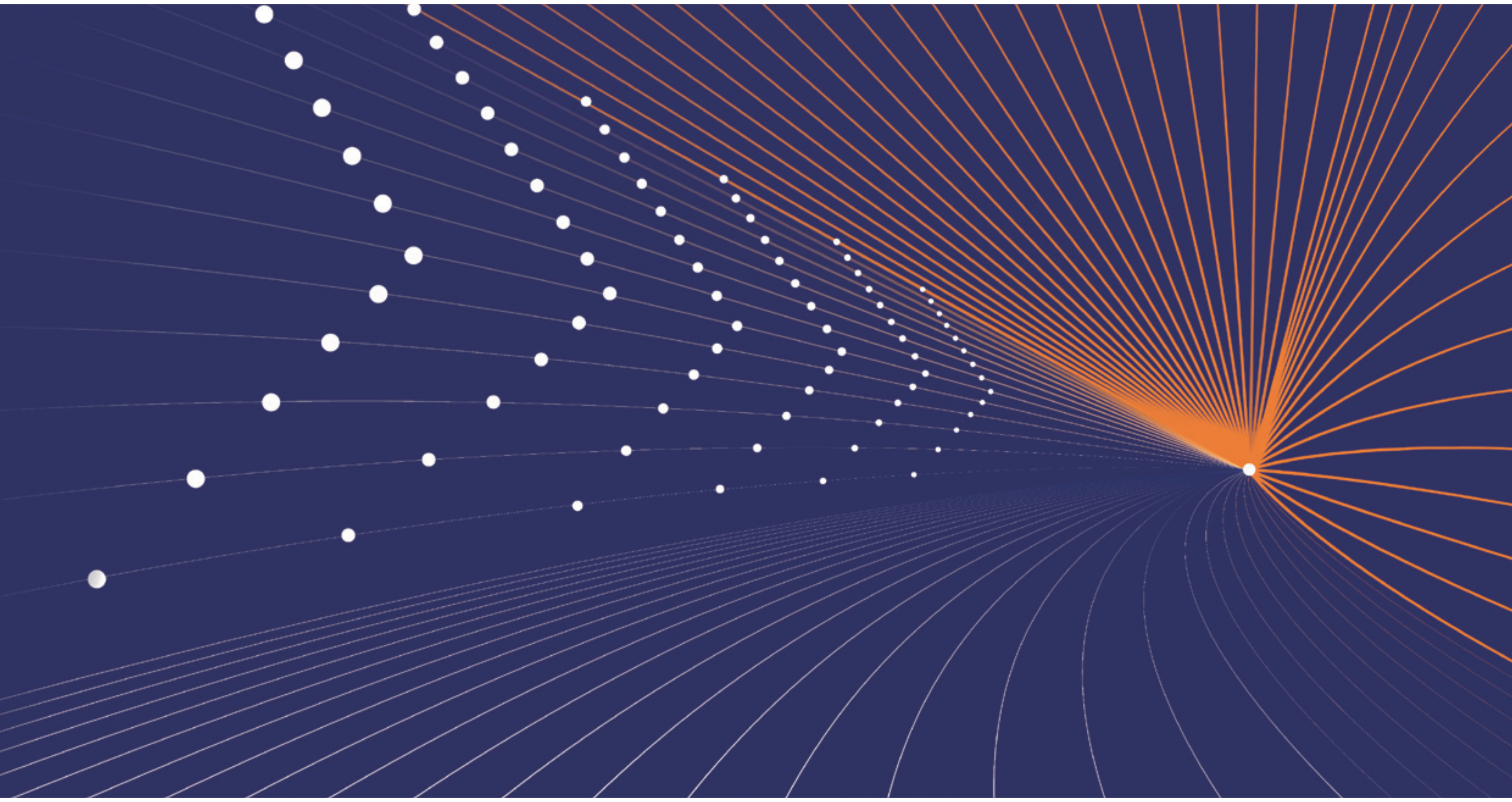
PEAK INSIGHTS 2019

Access challenges to financial services in emerging Asia: An opportunity for now



Peak Re

www.peak-re.com

Foreword from the CEO

This fourth edition of Peak Insights offers an insurance perspective on one of the world's most exciting and important socio-demographic trends: the rapid rise of Asia's middle class. The publication analyses the financial aspirations of this group of more than 1.4 billion people – as well as the many vulnerabilities that could thwart those families' plans. On that basis, our study suggests a few "quick-win" types of insurance and risk management responses and provides more general food for thought about new products and solutions. In order to make the report more inclusive, we are also exploring the needs of those who have not yet fully made the transition to the middle class but aspire and have the potential to do so.

Assisting families in cementing their emergence from poverty is a major commercial opportunity for the insurance industry. It is also an essential contribution to making Asia's emerging economies more resilient – and a great testament to insurers' significant and frequently underestimated relevance to societal development and economic growth.

For Peak Re, these considerations are particularly pertinent. Our company was established with the aim of supporting the needs of communities and the emerging middle-class society through meeting reinsurance needs covering life, health and non-life risks, especially in Asia.

With this core mission in mind, we have chosen the topic for this edition of Peak Insights, which underlines our unabated commitment to investing in research and sharing its findings with our business partners and the public at large. This research is designed to enable dialogue and facilitate the collective search for innovative solutions to today's risk management challenges. Therefore, we are keen to receive any comments you may have or specific views on how we could jointly harness/use this research for the greater good.

Franz Josef Hahn
Chief Executive Officer of Peak Reinsurance Company Limited

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Executive summary

Emerging Asia offers a growing opportunity to insurers with its lower insurance penetration (premiums as a share of GDP) of 3.2% on average compared to developed Asia's average rate of 9.0%, calculated based on numbers from OECD Insurance Indicators. Asia-Pacific also has the fastest growing middle class. The Brookings Institution defines middle class as households earning between USD 11 and USD 110 per person per day in 2011 Purchasing Power Parity terms. According to the Institution, 46% of the global middle class (or 1.4 billion people) was living in Asia-Pacific in 2015. This number is expected to grow by 8% per annum to represent 54% of the global middle class (or 2 billion people) in 2020. The middle class in other regions is expected to increase by less than 3.5% per annum between 2015 and 2020.

The emerging middle class comprises low-income and lower-middle income households. Peak Re defined the emerging middle class on the basis of their spending aspirations, since earning and saving capacities and purchasing power are different across economies. Largely underserved by both the social welfare system and insurers, these households rely primarily on emergency funds (own savings and income, borrowings and disposal of assets) to finance sudden large expenses, medical costs and retirement. Their financial safety nets can be severely compromised by sudden large expenses (such as rebuilding a house or paying for a medical operation), or long-term care costs.

To reach these households with products and services meeting their expectations, insurance companies need to understand these households' priorities and the risks they face, as well as their access to financial services, and saving and risk mitigation tools. Accumulating wealth is the key priority for the emerging middle class looking to move up in social class. Due to barriers to opening a bank account, these households are likely to keep their wealth in illiquid assets such as livestock, jewellery and property that take a long time to convert into cash.

This leads to the emerging middle class facing higher cash-flow and liquidity issues when compared to higher-income households that are more able to save and in greater liquid assets. Fast claims reporting and settlement are, therefore, key elements contributing to trust and insurance purchase. Insurers need to be flexible and customer-focused in finding ways to collect premiums and pay claims to the claimants in a short time, given that not all households have an account with a financial institution or a mobile-money service provider.

Based on an analysis of the aspirations of Asia's emerging middle class and these households' massive vulnerability to financial distress, this report suggests some specific contributions that insurers can make to narrow the region's massive protection gaps, such as faster claims payments and improving the professionalism of the distribution channels.

1. Building financial protection based on customers' wealth

Insurance was developed to address specific individual and organisational needs. Developing products based on such needs requires an understanding of the households' priorities and lifestyles as well as their goals. Priorities can vary with the financial situation of the household, as well as the age and health of the breadwinner(s). In this section, we will identify the priorities of households living in some countries in emerging Asia, their saving methods and the adequacy of their financial protection.

Exhibit 1: Top 10 perceived economic and social development priorities

Priorities	Lower middle income					Upper middle income	
	India	Indonesia	Pakistan	Philippines	Vietnam	China	Malaysia
1	Education	Education	Education	Poverty reduction	Government effectiveness / reform	Government effectiveness / reform	Education
2	Employment	Anti corruption	Government effectiveness / reform	Government effectiveness / reform	Anti corruption	Environment	Government effectiveness / reform
3	Agriculture and rural development	Economic growth	Health	Employment	Private sector development	Economic growth	Anti corruption
4	Poverty reduction	Employment	Employment	Environment	Education	Anti corruption	Economic growth
5	Health and sanitation	Government effectiveness / reform	Economic growth	Food security	Food security	Reducing inequality	Cost of living
6	Economic growth	Transport infrastructure	Energy	Education	Transport infrastructure	Law and justice system	Social protection
7	Natural resource management	Poverty reduction	Anti corruption	Agriculture and rural development	Environment	Completing the transition to a market economy	Reducing inequality
8	Government effectiveness / reform	Agriculture and rural development	Water and sanitation	Anti corruption	Agriculture and rural development	Social stability	Social stability
9	Transport infrastructure	Social protection	Poverty reduction	Transport infrastructure	Poverty reduction	Innovation	Transport infrastructure
10	Reducing inequality	Trade and exports	Agriculture and rural development	Social protection	Pollution	Quality of growth	Law and justice system

Color legends	Counts
Reducing poverty or inequality, and improving education	19
Social stability, justice and government effectiveness	17
Economic growth	15
Transport, health, sanitation and food safety	10
Environment and resources management	6
Social protection	3

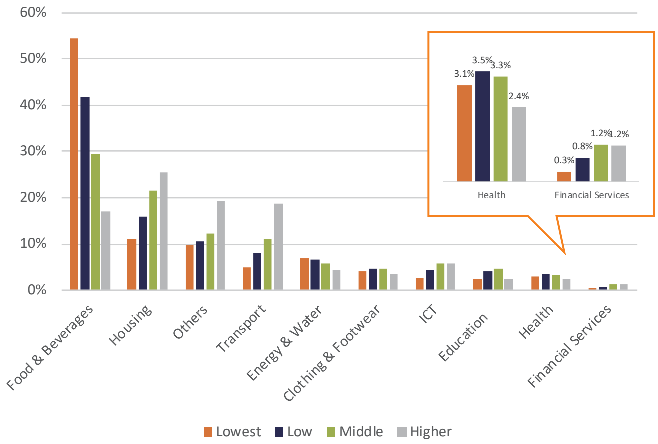
Sources:
The World Bank Group (2018), FY2018 India country opinion survey report
The World Bank Group (2018), FY2018 Indonesia country opinion survey report
The World Bank Group (2018), FY2018 Pakistan country opinion survey report
The World Bank Group (2016), FY2016 the Philippines country opinion survey report
The World Bank Group (2017), FY2017 Vietnam country opinion survey report
The World Bank Group (2015), FY2015 China country opinion survey report
The World Bank Group (2016), FY2016 Malaysia country opinion survey report

1.1 The priorities of the households living in emerging Asia

Exhibit 1 lists the top 10 social and economic development priorities arising from surveys conducted by the World Bank Group. Among the top 10 priorities, the most frequent ones are related to reducing poverty (including using education as a means to grow future wealth) and increasing economic growth. Other priorities include a better living environment, which includes improving infrastructure for transportation, health and sanitation, as well as environmental solutions, energy and natural resources management.

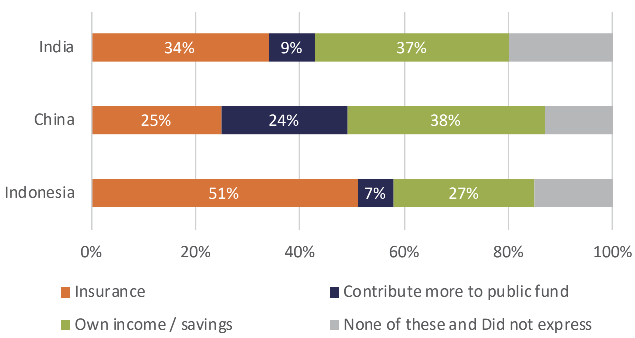
Education, economic growth and reducing poverty determine peoples' willingness to create and accumulate wealth. If wealth provides access to better housing and greater purchasing power, a household's spending patterns reflect its current priorities and the type of lifestyle it would look for if it were to become wealthier (exhibit 2). It is not a surprise that as the household moves to a higher income class, it tends to allocate more budget to education and health – two of the top 10 priorities.

Exhibit 2: Spending by income class and by consumption segment (2010)



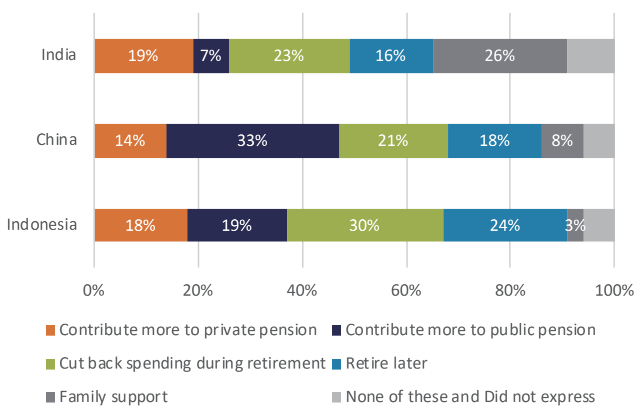
Source: *World Bank database, Global Consumption Database*
Note 1: *ICT stands for Information and Communication Technology*
Note 2: *figures are the average of spending by class and by consumption segment for China, India, Indonesia, Philippines and Thailand*
Definitions: *Lowest – below $2.97 per capita per day*
Low – between $2.97 and $8.44 per capita per day
Middle – between $8.44 and $23.03 per capita per day
Higher – above $23.03 per capita per day

Exhibit 3: Plans to finance long-term care



Source: *The Gallup Organisation – Europe (2013), Risk perception survey: summary of findings*

Exhibit 4: Plans to finance retirement (adults aged 45 years and older)



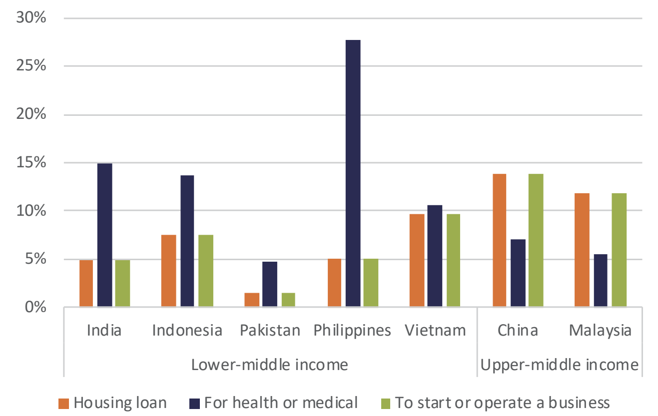
Source: *The Gallup Organisation – Europe (2013), Risk perception survey: summary of findings*

1.2. Lives without sufficient protection

Households may contribute to social security systems to fund future protection needs. However, public funds are not necessarily the largest financing method when an unfortunate event (like a health issue) or retirement occurs. Depending on the social protection system in the country, use of public funds to finance long-term care and retirement varies from 7% to 33% (exhibits 3 and 4). Individual savings and dependence on family support form the largest planned source of funding for long-term care and retirement. If the planned funding is insufficient, the breadwinners or the households know they will have to cut back spending (exhibit 4).

In addition, according to the World Bank's survey, among adults who have borrowed in the past, financing health or medical costs is the single most important borrowing reason in lower-middle income economies. In upper-middle income countries, the main borrowing reasons are housing and the start of a business operation (exhibit 5). This again stresses the lack of adequate financial protection for health, particularly in lower-middle income economies. Similarly, in situations where there is an immediate need for money, like after a natural catastrophe (exhibit 6), households rely on savings and borrowings, particularly from family, friends and their local community. Interestingly, the expected reliance on insurance (about 20–30%) exceeds the amount of natural disaster losses generally insured in the three markets surveyed. This may point to a greater willingness to buy insurance compared to the actual level of protection currently afforded by insurers, who may be able to close this apparent gap through improved services and products.

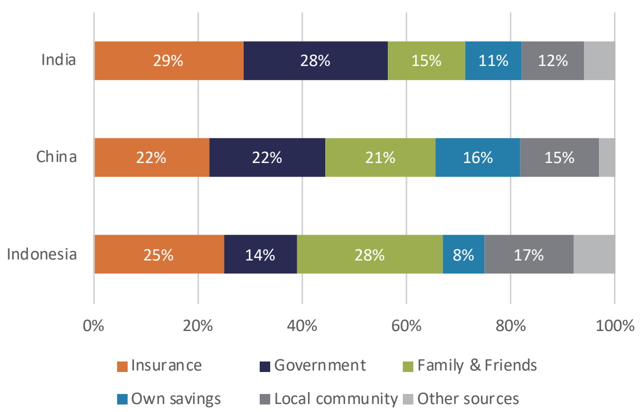
Exhibit 5: Borrowing and purposes (adults aged 25 years and older)



	India	Indonesia	Pakistan	Philippines	Vietnam	China	Malaysia
% of adults interviewed who have borrowed in the past	45%	57%	41%	60%	50%	46%	39%

Source: *World Bank (2017), the Global Findex database 2017: Measuring financial inclusion and Fintech*

Exhibit 6: Means of recovery from natural catastrophe



Source: *The Gallup Organisation – Europe (2013), Risk perception survey: summary of findings*

2. The financial resilience of households in emerging Asia

Without adequate financial protection, households rely on their own savings and borrowings to finance any sudden need for cash, potentially nullifying their past efforts and forcing them to accumulate wealth again. The ability to save determines the speed of wealth accumulation, and households that are not able to build wealth and manage liquidity at the same time have weaker financial resilience.

2.1. The ability to save and savings methods

The ability to save and saving methods determine the financial resilience of households in immediate need of cash. Not all households are able to save (exhibit 7). Indian and Pakistani households have more difficulty saving compared to households in other emerging Asian economies with larger households and dependants.

Saving methods include deposit and investment (bond, equity, mutual fund) with financial institutions, although these are not always the preferred options across Asian countries (exhibit 8). Other common types of saving are recurring deposits with credit associations or a person outside the family, and building assets (livestock, jewellery, and housing). The key problem with savings outside of financial institutions is the time lag when converting the assets into cash. Another problem is that saving in the form of livestock may not be the best option, since disease can put the entire investment at risk.

Exhibit 7: Ability to save (adults aged 25 and older)

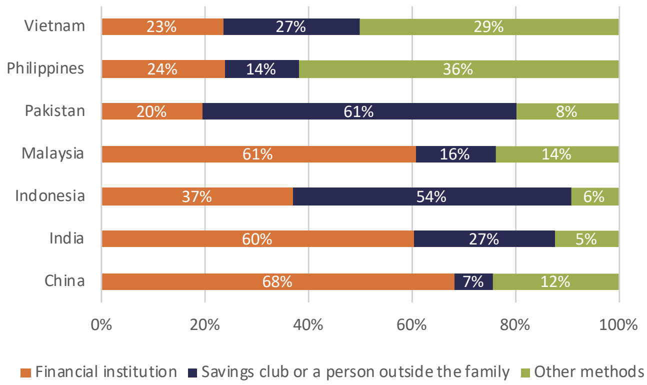
	% of adults interviewed who did not save over the past 12 months	Average household size	% of households interviewed with at least two dependants
India	63%	4.6	16%
Pakistan	60%	6.8	20%
China	49%	3.4	10%
Vietnam	41%	3.8	10%
Philippines	42%	4.7	11%
Indonesia	41%	4.0	11%
Malaysia	40%	4.6	8%

Sources: *World Bank (2017), the Global Findex database 2017: Measuring financial inclusion and Fintech revolution*

United Nations (2018), Department of Economic and Social Affairs, Population Division

Note: *Dependant is defined as a household member under 20 years old or over 65 years old.*

Exhibit 8: Savings methods (adults aged 25 years and older)



Source: *World Bank (2017), the Global Findex database 2017: Measuring financial inclusion and Fintech revolution*

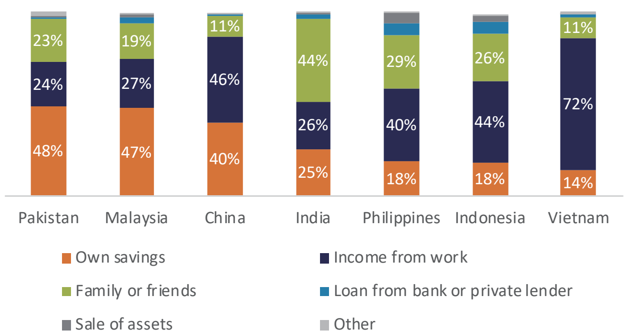
Notes: *Savings club means rotating savings and credit association. Other methods are cash at home, livestock, jewellery, real estate*

2.2. The role of emergency funds

Since the safety nets of households in emerging Asia greatly rely on own savings, income, and family or friends (exhibit 9), the ability to raise emergency funds is key to meeting immediate cash requirements (exhibit 10). Households with lower incomes may find it difficult to access emergency funds, especially when their family and friends are in a similar financial situation, with very little savings or liquid assets.

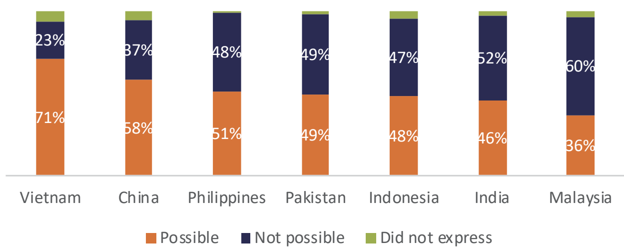
In addition, the reliance on own savings and income slows down the savings pattern, while financial support from family, friends or the local community could put households into poverty for a longer period of time while they repay loans. Also, if the supported households are unable to repay loans, the support providers themselves can be exposed to the risk of poverty. Therefore, self-insurance and other informal forms of risk management are not considered fully efficient.

Exhibit 9: Sources of emergency funds (% of adults aged 25 years and older who are able to raise funds)



Source: *World Bank (2017), the Global Findex database 2017: Measuring financial inclusion and Fintech revolution*

Exhibit 10: Ability to raise emergency funds (adults aged 25 years and older)



Source: *World Bank (2017), the Global Findex database 2017: Measuring financial inclusion and Fintech revolution*

3. Facilitating access to financial protection

Being underprepared for sudden large expenses or retirement can make households financially vulnerable and even expose them to the risk of falling back into poverty. While public schemes play a substantial role in protecting the lowest-income households, the emerging middle class seems to be left behind, with some households even no longer eligible to benefit from free public schemes. Therefore, the private sector can and must cater to the growing and more complex protection needs of the emerging middle class. To attract more households to purchase insurance, intermediaries and risk carriers need to promote risk prevention and mitigation tools, facilitate access to financial protection tools and increase these households' trust in financial services.

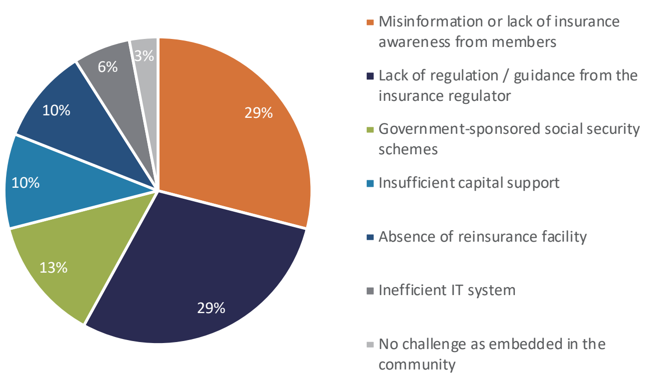
The following section focuses on what insurers and their intermediaries can do to facilitate access to financial protection. It deliberately does not dwell on public sector initiatives to increase insurance penetration of the lowest-income households.

3.1. Promoting risk prevention and mitigation methods

Insurance companies may want to identify intermediaries with existing product distribution and risk prevention advisory capabilities. According to the Access to Insurance Initiative (a2ii), over the last decade, community-based organisations (MCCOs) have established a strong foothold in the communities they serve. They also play a role in financial protection. In fact, at least in emerging Asia, they act as important intermediaries for licensed insurers. In Asia, 70% of life and property policies issued to low-income households are from licensed insurers. Out of 507 products in the market, licensed insurers actually underwrite 304 of them.

However, not all MCCOs in emerging Asia have the necessary tools, such as the ability to explain insurance products and manage claims, to serve the communities well when it comes to insurance. For example, according to the International Cooperative and Mutual Insurance Federation (ICMIF) and the Insurance Institute of India, the first threat to growth for MCCOs in India is the lack of knowledge about insurance from individual members and agents' conduct in selling a risk product (exhibit 11). Therefore, insurers and intermediaries may consider improving the professionalism of their representatives to enhance customers' experience and trust.

Exhibit 11: Operational and growth challenges viewed by Indian MCCOs



Source: ICMIF & the Insurance Institute of India (2017), The missing chapter of microinsurance in India: a diagnostic of mutuals

Improving claims process and accelerate claims settlement are part of the strategy of the Center for Agriculture and Rural Development Mutual Benefit Association (CARD MBA) in the Philippines. CARD MBA provides death benefits, medical subsidy, pension and loan redemption assistance. Its continuous effort to improve claims process has resulted into more than doubling the number of insureds within six years from 7.2 million in 2011 to

15.3 million in 2017. To further develop trust and support the resilience of the community, CARD MBA has adopted a policy in 2017 aiming to shorten the claims payment within 24 hours with technology. In 2017, 94.5% and 92.9% of the claims were settled between 8 and 24 hours to the members and legal dependents respectively. These are large improvement compared to 2011 where the payment speed was 89.3% and 62.8% for the members and legal dependents respectively.

Intermediaries and risk carriers may need to think about their roles in risk prevention, in advising households on risk mitigation tools and in identifying insurance needs.

> ***CARD MBA have reached scale in 20 years through a unique model that builds trust and resilience in communities and responding to ten of the Sustainable Development Goals, imagine if we could take that model and get to 20% of the population of emerging Asia in 10 years utilising what we have learnt through CARD MBAs success.***
>
> *Shaun Tarbuck,*
> *Chief Executive of ICMIF*

3.2. Facilitating access to financial services

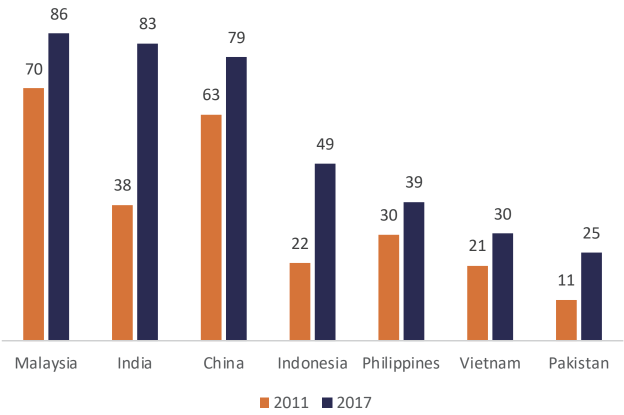
Lower and lower-middle income households have limited access to financial services. Account ownership at financial institutions or with mobile-money-service providers is lower in countries considered to be lower-income economies (exhibit 12). This limitation is due to barriers to opening accounts set by the banking industry such as minimum balance requirements, cost and necessary documentation (exhibit 13). Without a financial account, it is difficult to pay insurance premiums and receive claims.

In some countries in emerging Asia, due to greater wealth, more households can afford to obtain a mobile phone number and one person can even hold more than one SIM card (exhibit 14). However, having multiple mobile phones does not necessarily translate into regular use of the internet to make purchases online or even to pay bills online (exhibit 15). For example, Indonesians may have one to two SIM cards, but only 4% of those interviewed have paid bills online and only 10% have shopped online. These numbers are four to ten times lower than in China, where each person has one mobile cellular subscription on average.

Due to the differences in habits of mobile phone users in emerging Asia and developed countries, the digital strategy for insurance companies must differ across emerging Asia. In countries where subscribers tend to use their mobile phone to search for information rather than for paying bills, an informative platform about risk prevention and a reporting platform for claims would make more sense than a payment platform.

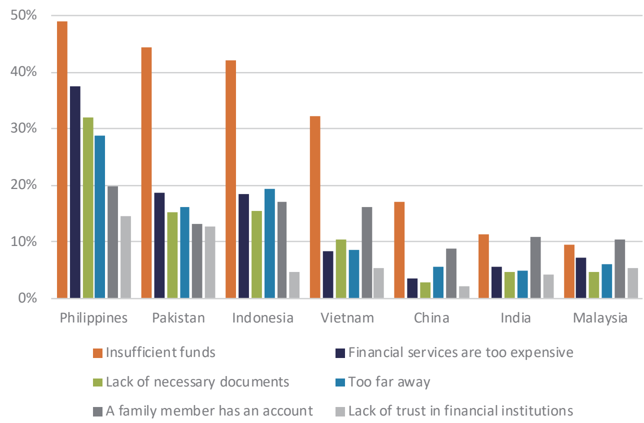
Also, in countries where account ownership at a financial institution or with a mobile-money-service provider is not common, cash becomes the preferred option of payment for premiums or for receiving claims. For this to be feasible, there must be at least one physical agency close to the community served.

Exhibit 12: Account ownership at a financial institution or with a mobile-money-service provider (% of population aged 25+)



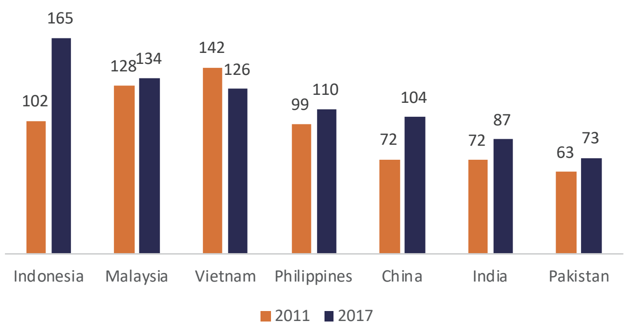
Source: World Bank (2018), World Development Indicators

Exhibit 13: Key reasons for not having a bank account (adults aged 15 years and older)



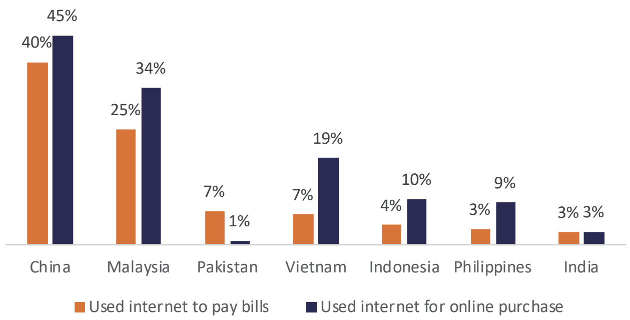
Source: World Bank (2017), the Global Findex database 2017: Measuring financial inclusion and Fintech revolution

Exhibit 14: Mobile cellular subscriptions (per 100 people)



Source: World Bank (2018), World Development Indicators

Exhibit 15: Internet usage (adults aged 15 years and older)



Source: World Bank (2017), the Global Findex database 2017: Measuring financial inclusion and Fintech revolution

3.3. Shortening claims settlement period

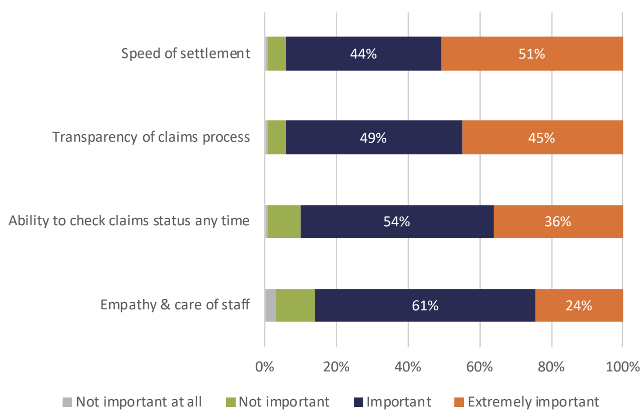
Speed of claims payment, transparency of processes and ability to check the claims status are highly valued by all income classes (exhibit 16) in evaluating satisfaction with the overall claims experience. This is even more true for lower and lower-middle income households, which are more likely to be exposed to liquidity and cash-flow risks in comparison to higher-middle- and high-income households. Shortening the claims settlement period means shortening the time for households to report claims, for risk carriers to manage claims, and for intermediaries to transfer the payment to claimants.

While claims reporting and processing can be improved, the ability of a risk carrier to settle claims is subject to their cash-flow management. Risk carriers without accurate reinsurance protection and proper selection of reinsurers can encounter cash-flow issues, for example, in a situation where a large cash out is needed to pay claims to victims following a significant natural disaster.

Reinsurance can provide greater capacity for business growth and can facilitate cash-flow management for risk carriers, thereby accelerating claims settlement. This is assuming reinsurers process claims in a short period of time, allowing the risk carriers to indemnify the claimants quickly.

The absence of legal recognition (through regulation and guidance) and reinsurance facilities are cited as some of the operational and growth challenges for Indian MCCOs (exhibit 11). Consequently, they have expanded extremely conservatively. Due to the lack of legal recognition and scale, Indian MCCOs have had difficulty in purchasing reinsurance. In response to the lack of scale, some risk carriers in developed markets manage to find reinsurance by joining forces to establish a legal umbrella structure.

Exhibit 16: Key contributors to customer satisfaction with claims experience



Source: *Accenture (2014), the Digital Insurer: Claims customer survey – Why claims service matters*

Conclusion

The insurance protection gap in emerging Asia is exacerbated by insufficient protection through social security. It is also driven by a lack of understanding of households' priorities, saving methods and ability to save. Without adequate protection, a sudden need for cash to pay medical fees or to rebuild a property would rely on households' access to emergency funds. These emergency funds include their own savings and income, borrowings (mainly from family and friends), and sales of assets. However, the ability to raise emergency funds tends to be lower for households with the least ability to save, especially in liquid assets.

Therefore, without sufficient financial protection, households can easily lose financial security and have to accumulate wealth again. Simultaneously, not all households have a bank account due to high service charges, complicated processes to open one or the distance to a bank branch. Without a bank account, it is difficult for these households to pay premiums and receive claims, restricting their access to insurance protection. This is indicative not only of a weaker financial safety net for the emerging middle class compared to middle- and higher-income households, but also of the difficulty these lower-income households face in managing and building wealth compared to more financially resilient households.

Insurance companies may want to rethink their approach to emerging middle-class households. Improper sales and advisory practices, as well as slow claims settlements, erode the image of and trust in insurance, creating unwillingness to purchase financial products even if the households can afford to do so. Since households may not have an account for conducting financial transactions, cash is the only transaction method. Also, as lower-income households tend to invest in illiquid assets, fast claims settlement would protect these households from the deterioration of their financial safety net. The ability to settle claims fast is subject to clear claims reporting and settlement processes, and the selection of reinsurance partners who pay claims fast. It is up to insurers to make this happen. This does not require any intervention from the public sector.

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