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The motor protection gap in Latin America

Executive summary

We forecast that motor insurance premiums will grow by more than 3% CAGR in LatAm over the next five years.

We expect the economic recovery currently ongoing in Latin America (LatAm) will boost vehicle ownership and demand for motor insurance. Motor remains the largest line of business in Property & Casualty (P&C) in the region. Motor premiums were an estimated USD 32 billion in 2017, slightly more than 40% of P&C premiums. Motor premiums will likely grow faster that gross domestic product (GDP) in the coming years as car ownership and insurance penetration are still far below the point of saturation. Our baseline scenario is that motor premiums will grow by around 3% to 5% (CAGR) in real terms across countries in the region in 2019–2023, with the strongest growth in Colombia and Mexico. Another consideration for the future is disruptive technology which, in changing the mobility landscape, will impact car sales and demand for associated covers.

Uninsured vehicles are a significant economic burden in Latin America.

Alongside the positive outlook, a reality in LatAm is also that many vehicles are uninsured. About 58% of the aggregate fleet in the five largest markets have some kind of coverage. This represents a significant economic burden for society by exposing individuals to financial distress resulting from (1) third-party liability payments; (2) loss of income from permanent/temporary disability or death; and (3) out-of-pocket expenses to cover medical expenses and property damage.

We estimate an USD 76 billion protection gap in terms of premium volume in the five largest markets in LatAm.

From an insurance opportunity perspective, we estimate a motor protection gap of USD 76 billion in our five-country sample for this study,[1] approximately 2.8 times the combined premium volume in those markets. The motor insurance penetration for our country sample is currently 0.6% of GDP, and the estimated protection gap 1.7%. The gap is biggest in Brazil (USD 51 billion). In terms of insured car penetration, this is lowest in Mexico (30%). Key reasons for the motor protection gap include:

- affordability;
- unawareness of insurance products and risk perception;
- difficulty of buying insurance products;
- mistrust of insurance companies;
- high frequency/severity and costs of claims;
- regulatory and legislative constraints; and
- inconsistent enforcement of current laws.

The minimum mandatory policy covers less than 10% of income replacement needs in case of fatal accidents.

With a relatively high number of deaths from motor accidents in LatAm, the adequacy of third-party liability motor coverage is an important consideration. As part of our research we found that in the case of traffic fatalities, on average the minimum mandatory sums insured for third-party liability is less than 10% of income replacement needs.[2] This puts heavy economic strain on individuals and households, undermining their resilience in times of financial hardship.

More use of microinsurance, new distributions channels, product innovation and technology can help close the motor protection gap.

To tackle these challenges we recommend that insurers make more use of microinsurance and new distribution channels, foster product innovation and adopt new technologies. In addition, the public sector can play an important role by creating an up-to-date legal and regulatory framework to support adequate development of the motor market, and by enforcing mandatory insurance schemes. Governments need to make sure that level of mandatory cover is adequate to replace a household's income needs in cases of bodily injury and/or death, in addition to a proper annual adjustment as volatile and high inflation can erode its value over time. These measures will help close the motor protection gap and improve economic and social resilience.

[1] Argentina, Brazil, Chile, Colombia and Mexico.
[2] We do not include medical expenses from treatment for people injured and/or disabled by road accidents and their loss of income.

The motor insurance market in Latin America

Market size and penetration trends

Motor accounts for 20% of the total insurance premiums across the whole of LatAm.

We estimate that total motor insurance premiums in the whole of Latin America (LatAm) were USD 32 billion in 2017. That makes motor the largest line of business, counting for around 40% of P&C and 20% of all insurance industry premiums. The five biggest (and our sample) markets, Argentina, Brazil, Chile, Colombia and Mexico, account for more than 80%. Brazil is the largest market, with premiums of more than USD 12 billion, followed by Argentina and Mexico (see Table 1).

Table 1
Direct premiums written and GDP in 2017, USD billion

Country	Motor premiums	P&C premiums	GDP	Motor premiums as a share of P&C	Motor premiums as a share of GDP
Argentina	6.1	13.9	637.3	43.6%	0.95%
Brazil	12.2	24.1	2 053.3	50.8%	0.60%
Chile	1.2	4.1	277.1	30.2%	0.45%
Colombia	1.9	5.4	314.5	35.8%	0.61%
Mexico	5.3	10.5	1 160.1	50.8%	0.46%
Latin America	32.0	78.7	5 456.2	40.6%	0.59%

Source: National insurance regulators, national statistics agencies, Swiss Re Institute

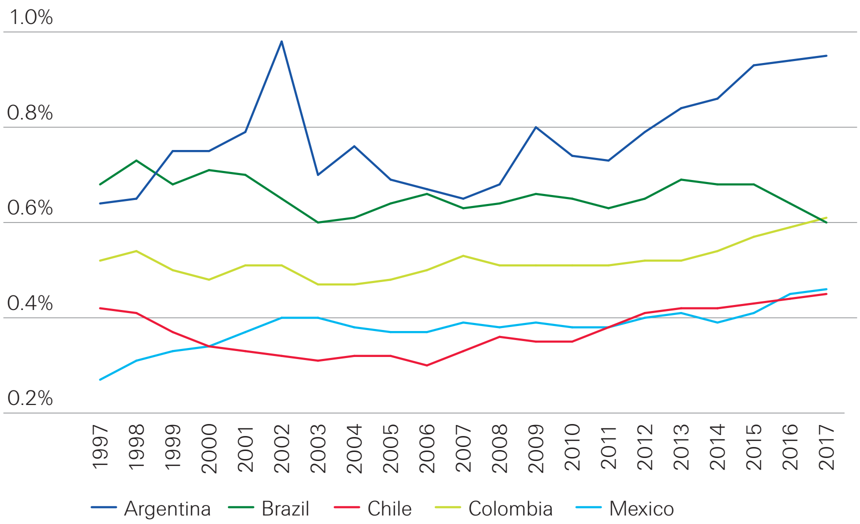
The overall motor insurance penetration rate in LatAm is 0.59%, but differs largely across countries.

The motor insurance penetration rate (the ratio of motor premiums to GDP) in LatAm overall was 0.59% in 2017, lower than the emerging markets aggregate (0.67%). However, penetration rates differ considerably across countries. Argentina has the highest penetration rate (0.95%) due to higher third-party liability sums insured required by law. Of our sample markets, penetration was lowest in Chile (0.45%). This may be a case of lower premium rates given fewer traffic accidents, and therefore lower claims frequency.

Motor insurance penetration trends vary in our sample countries, but have mostly gone up over the last decade.

Historical data shows that while motor insurance penetration trends have varied in our sample of countries, they have mostly gone up (except in Brazil) over the last decade, with premium growth outpacing GDP growth. The increase was largest in Argentina and Chile, up by 0.30 and 0.13 percentage points, respectively, between 2007 and 2017. The recent drop in the penetration rate in Brazil is due to a cut in the cap of premium rates for mandatory motor cover and economic recession, which has led to a drop in insurance demand.

Figure 1
Motor insurance penetration rate



Source: National insurance regulators, national statistics agencies, Swiss Re Institute

Structural growth potential for motor insurance

Motor insurance is usually the entry point for consumers to the insurance industry.

Motor insurance remains a key line of business in LatAm and the emerging markets generally. Not only is it the largest non-life line of business, it also represents the point of entry for first-time buyers. Since vehicles often are peoples' first insurable asset, motor insurance is usually the reason why the penetration rate of non-life is considerably higher than that of life insurance in countries in early stages of economic development.

GDP per capita is the main determinant of insurance buying.

Empirical research has found economic development, as measured by GDP per capita, to be the main determinant of insurance buying.[3] This relationship translates into the GDP elasticity of premium growth, which varies with different levels of development of countries. For low-income developing economies, GDP and premiums tend to grow at a similar pace, making the penetration rate constant over time. However, as the middle class grows, the rate of premium growth begins to outpace that of GDP, and penetration increases. In later phases of development, the income elasticity of insurance demand begins to wane, and the penetration rate plateaus as the market approaches saturation point. The differences in motor insurance penetration across countries with similar levels of GDP per capita reflect other economic, socio-demographic and institutional variables such as financial development and inclusion, income inequality, level of urbanization and education.

Studies have shown that as income rises, vehicle ownership grows until reaching the saturation point.

Previous studies have shown a similar relationship between car ownership and income levels.[4] As income rises, vehicle ownership grows — at a faster rate for middle-income countries — until it reaches saturation (when everyone who wants a car owns one). Countries with higher incomes tend to have higher vehicle ownership rates. Among countries with similar income levels, the impact of economic development depends on the degree of urbanization, population density, extensiveness of road network and the existence of reliable public transportation.

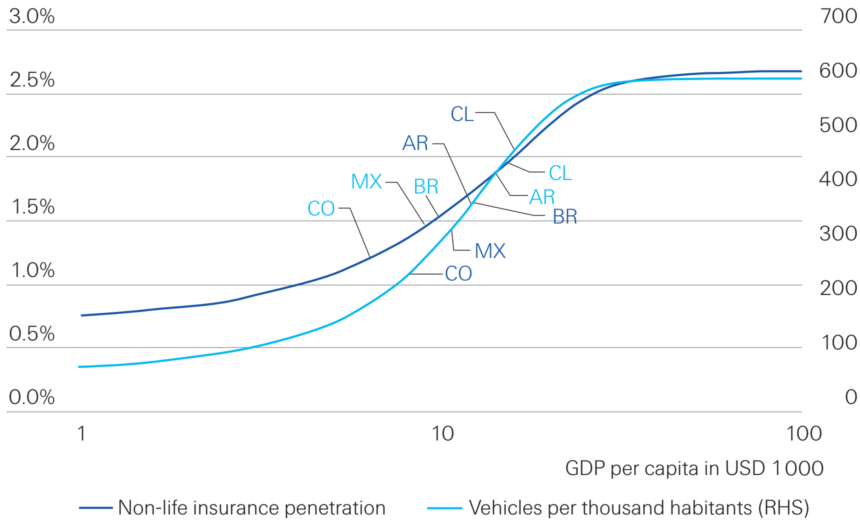
Vehicle ownership and motor premiums can grow faster than overall economic activity for the next years in LatAm.

Figure 2 shows how insurance penetration and vehicle ownership relate to income per capita, using an S-shaped logistic function. Our estimation finds the point of highest income impact on insurance penetration to be around USD 12 000 per capita. This generalized observation suggests that the non-life sector in LatAm is expected to grow faster than overall economic activity for the next years, since income per capita in most countries lies within the middle-income range (where the slope of the curve is steeper). The same can be said about car ownership in the region, which has plenty of room for growth. This in turn suggests strong growth potential for motor insurance.

[3] R. Enz, "The S-Curve Relation Between Per-Capita Income and Insurance Penetration," *The Geneva Papers on Risk and Insurance – Issues and Practice* vol 25 no 3, July 2000, https://www.genevaassociation.org/media/236194/ga2000_gp25(3)_enz.pdf

[4] L. Ecola, C Rohr, J. Zmud, T. Kuhnimhof and P. Phelps, *The Future Of Driving in Developing Countries*, RAND Corporation, 2014; J. Dargay, D. Gately and M. Sommer, *Vehicle Ownership and Income Growth, Worldwide:* 1960-2030, New York University, 2007.

Figure 2
S-curve estimations for non-life insurance penetration and vehicle ownership



Source: Swiss Re Institute

Outlook

We forecast that motor premiums in LatAm will grow by around 3-5% CAGR over the next five years.

Economic recovery to support demand for motor insurance
Over the next five years, we expect non-life real premium growth in LatAm to continue to recover (see Table 2). Cycle-sensitive lines of business such as motor are likely to be more responsive to economic recovery. In our sample countries, we expect motor premium growth to be highest in Colombia and Mexico, with robust economic growth in Colombia being the main driver there. In Brazil, total volume growth will likely be impacted by the average 63.3% cut to mandatory motor premium rates in 2019, while in Argentina car ownership is likely to be held back by high inflation and tight credit conditions. As inflation trends lower, higher purchasing power will support insurance demand in the region.

Table 2
Real CAGR projections, 2019–2023

Country	GDP	Non-life premiums	Motor premiums	Vehicle ownership*
Argentina	1.9%	2.5%	2.5%	3.5%
Brazil	2.4%	3.7%	3.1%	3.6%
Chile	2.9%	3.9%	3.2%	3.1%
Colombia	3.4%	5.3%	5.3%	5.1%
Mexico	2.2%	4.0%	3.8%	2.1%

*Vehicle ownership indicates potential growth based on GDP elasticities, not an actual forecast.
Source: Swiss Re Institute

New forces will play a large role in the future of both car sales and motor insurance demand.

In the longer term, we expect disruptive technologies will play a large role in car sales and motor insurance demand. In the past, the prediction of demand for vehicle ownership was based on a relatively stable relationship with income levels, but the emergence of the car-sharing market and other modes of mobility (eg, ride-hailing, use of bicycles and scooters) may have implications for this relationship. Similarly, the rise of self-driving cars, driver assistance technologies and connected services are putting motor insurance premiums under pressure, as they increase vehicle safety and reduce both loss frequency and severity.[5] The future could be one of lower rates of vehicle ownership and thus less need for private motor insurance, but increased demand from mobility service providers.

[5] *The Future of Motor Insurance*, Swiss Re, 2016.

New technologies and social trends are changing the mobility landscape.

The evolving mobility landscape

New technologies – including autonomous and electric vehicles, those with internet connectivity, and smart mobility (eg, ride hailing, carpooling and bike sharing) – are changing the mobility landscape. These changes have emerged at a different pace around the world and have been most evident in advanced economies and in China. In LatAm, which is still highly reliant on traditional forms of transportation and personal car ownership, smart mobility options like these are growing in popularity.

Ride-hailing is growing rapidly in LatAm, but development of associated regulation (including requirements for insurance) is lagging.

The transition to smart mobility in LatAm has not been particularly smooth, as governments are still figuring out how to regulate the new players, especially ride-hailing companies. Although ride-hailing is growing rapidly in the region (eg, LatAm is Uber's fastest-growing region) and is likely to continue to do so,[6] the sector is only regulated at a national level in Brazil and Mexico. This means that for much of the region, the legality of ride-hailing services is opaque, and the rules under which they should operate (eg, what type of insurance they should carry) are unresolved. In Brazil, drivers for ride-hailing services must purchase the mandatory motor insurance as well as insurance for passengers (the same as for other transportation services). In Mexico, meanwhile, insurance requirements are left to be decided by local governments or service operators.

These changes can present new risk pools and a potential shift from personal to commercial auto insurance.

As the mobility landscape changes, insurance companies need to understand their roles in the new reality in order to continue to access new risk pools. Shared mobility may reduce the growth of vehicles per capita in LatAm and challenge the traditional auto underwriting and insurance business model, but at the same time new opportunities and revenue streams will arise from new sources of risk and liability. Furthermore, we could see a shift in product mix from personal to commercial insurance, as liability moves from the individual to service providers.

[6] According to Research and Markets, ride-hailing market in South America is expected to grow at a CAGR of 11.5% by 2023.

The motor protection gap

Introduction

Motor insurance typically includes coverage for loss or damage to own vehicle and third-party liability.

Motor insurance can include coverage for loss or damage to the insured party's vehicle and medical expenses, as well as third-party liability. The first-party component usually protects against collision, theft, burglary, riot, fire, explosion, lightning, flood and other natural catastrophes. The third-party liability component covers legal liabilities that stem from an at-fault crash that results in property damage, and also from medical expenses and loss of income as a consequence of bodily injury, disability or death. Customers may add other types of coverage, such as roadside assistance, mechanical breakdown and rental reimbursement.

Mandatory cover is meant to protect the financial interests of not-at-fault parties.

In many countries, a minimum motor third-party liability insurance is mandatory when driving on public roads. This is to protect the financial interests of not-at-fault parties. Mandatory motor insurance schemes make some covers more affordable by increasing the pool of insureds and diminishing the risk of anti-selection increasing the claims potential. In Brazil, Chile and Colombia, mandatory motor insurance is limited to bodily injury for all victims (including the at-fault driver), and is separate from coverage provided by voluntary products. In Argentina and Mexico, on the other hand, minimum coverage for third-party bodily injury as well as property damage is required with the purchase of any motor insurance policy.

Calculating the protection gap

We differentiate between uninsured and underinsured vehicles.

As the basis for our research in this report, we consider the motor insurance protection gap to be the difference between the amount of insurance that is economically beneficial and the amount of coverage actually purchased. We differentiate between uninsured (when a driver has no insurance protection at all) and underinsurance (when an insurance policy is in place, but is insufficient to cover all potential claims).

We define the motor protection gap as the total amount of premiums currently not collected from uninsured vehicles.

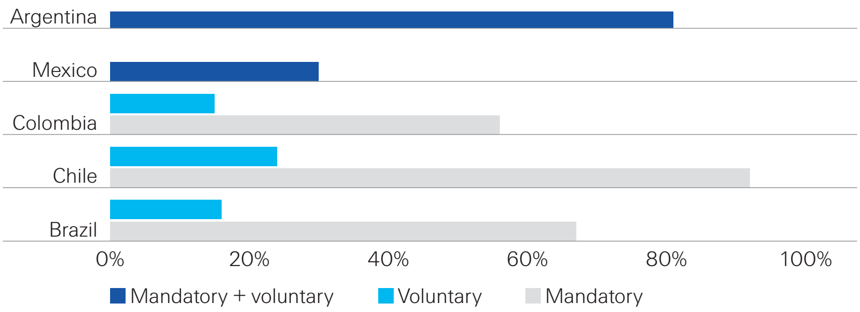
Quantifying the protection gap from the underinsurance perspective is challenging, because calculating uncovered exposures depends on a wide range of risk variables not measured by comprehensive statistical sources. There is a large variance among motor policyholders in terms of their risk exposure and potential for damages. Available data is patchy and does not allow for broad estimations that are comparable across countries. For this reason, we look at the protection gap from uninsured perspective, and define the metric as the total amount of premiums currently not collected from uninsured vehicles.

In our sample markets, 58% of the aggregate fleet have some kind of insurance.

Insured car penetration[7] — defined as the number of insured vehicles as a percentage of the total fleet — varies significantly in our country sample. Using 2017 figures, we find that 58% of the aggregate fleet in the five markets have some kind of insurance (see Figure 3). Mexico has the lowest insured car penetration (30%), and Chile the highest (92%). The disparity is mainly due to differences in income, regulatory schemes and law enforceability.

[7] Insured car penetration is different from insurance penetration, which is the ratio of nominal premiums to nominal GDP.

Figure 3
Insured car penetration, 2017



Source: National insurance regulators, national statistics agencies, Swiss Re Institute

We estimate a combined motor protection gap of USD 76 billion in the five largest markets in LatAm.

Using average premium rates for each market (including mandatory and voluntary insurance), we estimate an aggregate motor protection gap of USD 76 billion in 2017, about 2.8 times the current motor premium volume of our sample markets combined (see Table 3). Brazil has the largest gap (USD 51 billion), and also the largest car fleet. The gap is lowest in Argentina (USD 1.5 billion), given a much smaller fleet and higher insured-car penetration.

Table 3
Motor protection gap in 2017, USD billion

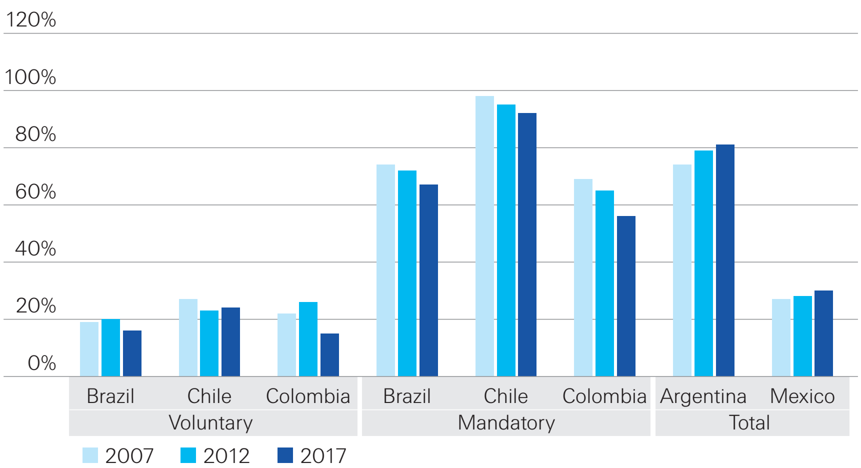
Country	Fleet (million)	Insured vehicles (million) Mandatory	Insured vehicles (million) Voluntary	Motor protection gap (billion)
Argentina	14.1	11.4		1.5
Brazil	94.6	63.3	15.4	51.0
Chile	5.1	4.7	1.2	3.7
Colombia	13.6	7.6	2.0	7.1
Mexico	45.5	13.6		12.5

Source: National insurance regulators, national statistics agencies, Swiss Re Institute

The region displays mixed trends in terms of insured car penetration.

Insured car penetration has trended down in recent years. Historical data indicates that in 2017, the uninsured share of the car fleet (both mandatory and voluntary cover) in Brazil, Chile and Colombia had increased relative to 2007. In Mexico and Argentina, the share decreased slightly (see Figure 4). For a cross-time analysis, this metric is preferable over the protection gap estimate because it is not subject to fluctuations in foreign exchange or insurance premium rates. For the countries with separate mandatory schemes, the share of uninsured vehicles varied more over time than in the voluntary scheme. Colombia has seen the sharpest drop in uninsured car penetration over the past decade.

Figure 4
Insured car penetration



Source: National insurance regulators, national statistics agencies, Swiss Re Institute

The level of cover provide by mandatory third-party liability is usually too low...

The shortcomings of mandatory third-party liability cover

One of the key aspects of buying motor insurance is the policy limit of the third-party liability coverage. Ultimately, the at-fault driver is legally responsible for the uncovered portion of property damage and bodily injury resulting from an accident. Customers purchase supplemental liability protection in addition to mandatory cover because the minimum protection required by law is often too low.

... covering well below 10% of household income replacement needs in our sample countries.

To assess the adequacy of the mandatory minimum coverage for bodily injury third-party liability, we compare the minimum sums insured required by law against average net income replacement needs per household from our estimates of mortality protection gaps.[8] Table 4 shows that the mandatory limits only cover a small fraction of the average income replacement needs in case of death of the main breadwinner of a household. Chile has the highest income replacement ratio, close to 8%, while Brazil has the lowest, at less than 4%.

Table 4
Comparison of death coverage required by law for motor insurance and net income replacement needs (USD), 2016

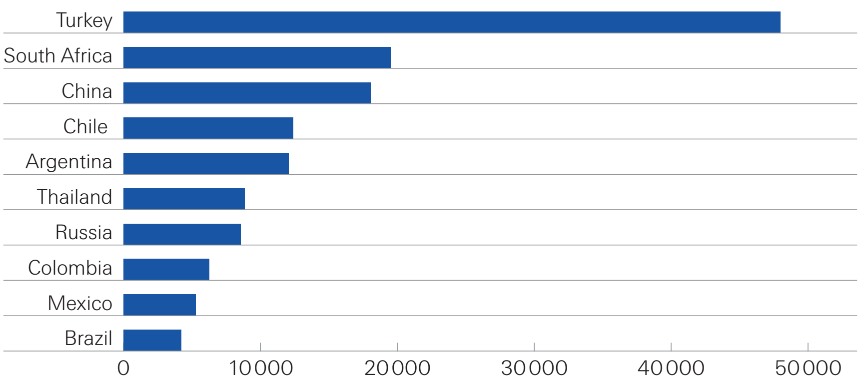
	Sum insured by mandatory scheme		Net income replacement	
Country	Death (A)	Permanent disability (B)	needs* (C)	(A)/(C)
Argentina	13 543.77	13 543.77	188 061.62	7.2%
Brazil	3 874.16	3 874.16	106 395.89	3.6%
Chile	11 532.45	11 532.45	147 878.25	7.8%
Colombia	5 646.24	1 355.10	80 626.09	7.0%
Mexico	5 350.84	5 350.84	92 550.56	5.8%

*Estimates using our mortality protection gap methodologies.
Source: National insurance regulators, Swiss Re Institute

Compared to other countries, Colombia, Mexico and Brazil have some of the lowest mandatory sums insured in the case of death.

In addition, we compare the mandatory minimum sums insured for accidental death in our five sample countries with other middle-income countries: China, Russia, South Africa, Thailand and Turkey (Figure 5). Colombia, Mexico and Brazil have the lowest mandatory sums insured. The disparities among these and the other countries are large. In Brazil, the sum insured for mandatory schemes has not changed since 2007, partly explaining this very low level. The lack of adequate income replacement in LatAm countries has a negative economic impact on households – undermining their resilience in times of financial hardship.

Figure 5
Mandatory minimum sums assured (USD) in the case of accidental death in select countries



Source: National insurance regulators

[8] Net of social security benefits and assets and liabilities.

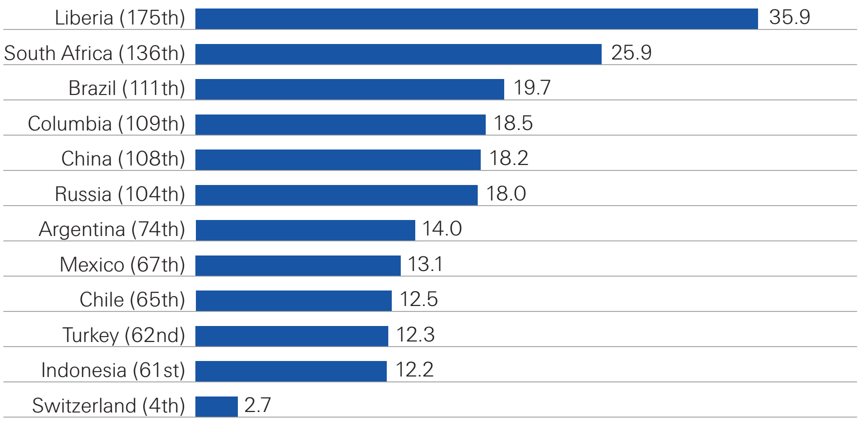
Traffic death rates in LatAm are quite high.

High traffic death rates exacerbate the problem of low coverage

The adequacy of motor third-party liability coverage is an important consideration since the number of deaths caused by traffic crashes in LatAm is quite high. Estimates for the traffic death rate per 100 000 population (in 2016) in a sample of 175 countries from the World Health Organization (WHO) show that the highest-ranked country in our study is Chile (65) with a death rate of 12.5, while the lowest ranked is Brazil (111) with 19.7 deaths per 100 000 population (see Figure 6). In Brazil, the penetration of insured cars with voluntary motor third-party bodily injury liability cover is only about 16%, meaning the probability of being hit by an uninsured driver is very high. In the case of death of a main breadwinner, if the responsible driver is not legally bound to pay compensation, the impacted household may be left with only the payment from the mandatory scheme and social security benefits.

Figure 6

Traffic death rates per 100 000 population, 2016



Source: *Global Status Report on Road Safety*, World Health Organization, 2018.

The aggregate gap in household income replacement for road traffic deaths is significant but hard to estimate.

The contrast in death rates across countries can be explained by differences in the quality of infrastructure (roads), average vehicle age and safety features, and driver behavior (in particular the use of seatbelts and drunk driving). The WHO estimates the economic costs of road traffic accidents in most countries to be equivalent to about 3% of their GDP.[9] However, the World Bank argues that estimates of economic impact at the national level are uncertain because causalties are not completely understood, data is scarce, and the number of unreported cases can be very large.[10]

Why the gap exists, and how to close it

The reasons for the motor protection gap are a mix of demand, supply and regulatory factors.

Reasons for uninsured and underinsured drivers

The motor insurance protection gap is not only the result of a lack in demand. Supply and regulatory imperfections also contribute to low take-up rates. These can result in any of the following: drivers who are entirely uninsured; insured but with some uncovered risks (third-party liability only, no cover for first-party risks); and insured but with restrictions (insufficient limits, high deductibles, sub-limits, exclusions).

[9] *Road Traffic Injuries*, World Health Organization, 7 December 2018, https://www.who.int/news-room/fact-sheets/detail/road-traffic-injuries

[10] *The High Toll of Traffic Injuries: Unacceptable and Preventable*, The World Bank, 2017.

Affordability remains a critical factor in motor insurance demand.

Affordability

Affordability of motor insurance remains the critical factor in buying decisions, particularly for low-income households. Global consumer surveys suggest that about half of insurance buyers make their final purchasing decision based on price.[11] Policies are selected based on cost rather than cover, so high premium payments could be an important factor for underinsurance. The weight of affordability is more pronounced in developing countries, where many consumers are not used to buying insurance and have severe budget constraints: paying insurance premiums would mean cutting back on other basic needs.

In LatAm, motor insurance is quite expensive because of elevated loss ratios.

High frequency/severity and costs of claims

Motor insurance in LatAm is expensive in a global context because of elevated risk factors such as higher road accident rates and costly servicing of claims. Premium rates are determined by individual risk factors such as the profile of the driver and vehicle, but also socio-demographic factors (eg, the frequency of theft/robbery and traffic accidents). In Brazil, where theft/robbery rates are very high,[12] the average premium for first-party hull is about five times more than for third-party property damage liability. The frequency of road accidents is also elevated in LatAm; the fatality rate from traffic accidents is twice the average of high-income countries, and is on the rise.[13]

Macroeconomic variables can also increase claims costs and, ultimately, premiums.

Macroeconomic dynamics such as increased inflation and exchange rate depreciation can also put pressure on the costs of repairs, spare parts and medical services and supplies. This translates into higher cost of claims that are ultimately passed on to consumers in the form of higher premiums.[14] According to the insurers association in Colombia (Fasecolda), if the peso depreciates by 10%, motor claim costs increase by 6%, and about 70% of the additional cost is passed on to consumers.[15] In recent years, higher inflation and currency depreciation have resulted in higher motor insurance rates in Mexico and Argentina, for example.

Financial illiteracy is a key obstacle for insurance awareness.

Lack of awareness of insurance products and risk perception

Low awareness of insurance products because of poor financial literacy or lack of education,[16] is another driver of uninsured and under-insured vehicles. In emerging economies many consumers do not have any kind of insurance either because they are not familiar with the concept of insurance or do not believe it provides enough value. In LatAm, financial literacy rates are between 25–34% of all adults, considerably lower than the 55% in advanced economies.[17]

Many uninsured drivers are unaware of their potential risk exposures.

At the same time, people who do not have insurance are often unaware of the risks they face, and how to assess their potential liabilities. Even when offered affordable premiums for insurance against low-probability, high-loss events, some still do not change their buying behavior. Many drivers are not aware of their risk exposure until they are involved in a car crash and are left with high debt due to bodily injury and/or property damage suffered by third-parties, for which they are legally liable. Mandatory motor third-party liability is often seen as form of tax rather than protection against personal liability, a concept not properly understood by the broader public.

[11] *Global Insurance Survey*, Ernst & Y oung, 2014.
[12] According to Brazilian Forum on Public Security, for every minute in 2017 there was a theft or robbery of a vehicle in Brazil.
[13] See for example *Road safety: Challenges and opportunities in Latin America and the Caribbean*, IBD 2018.
[14] For more information on exchange depreciation impacts on insurers, see: *Economic Insights: FX pass through effects: consumers and insurers beware*, Swiss Re Institute, 2019.
[15] *Impacto de la Devaluación en el Ramo de Automóviles*. Fasecolda, 2015.
[16] S. Cole, X. Giné, J. Tobacman, P. Topalova, R. Townsend and J. Vickery, "Barriers to Household Risk Management: Evidence from India", *American Economic Journal: Applied Economics*, 2013.
[17] S&P Global Finlit Survey.

Lack of trust in insurers is a critical driver of consumer buying behavior.

Mistrust of insurance institutions

A Swiss Re customer survey report suggests that trust in insurance companies is another critical driver of consumer buying behavior in LatAm markets.[18] When respondents were asked the reasons for lack of coverage, "I don't trust companies that sell insurance" was the fourth most popular answer.[19] A recent global survey shows that insurance had the second lowest levels of trust (53%) compared to other financial services areas (only behind financial advisory/asset management with 50%).[20] The large amount of protocol surrounding the purchase of insurance products and the payment of claims historically has made buying insurance a complicated and suspect experience for many consumers.

The abstract nature of insurance holds back consumer uptake.

Ease of buying insurance products

Survey evidence suggests that ease of purchase is also an important driver in insurance buying behavior. According to a global survey, having a product that is clearly explained, easy to understand and easy to deal with is as relevant to purchase decisions as price and extent of coverage.[21] As an abstract and intangible product, insurance often requires customized explanation: consumers are not confident buying something they do not understand. Furthermore, many are still not aware of aggregator websites which allow them to compare, customize and buy a motor insurance policy more quickly.

Limited legal requirement contributes to the high number of uninsured vehicles.

Regulatory and legislative framework

Regulatory and legislative institutions shape the motor protection gap to some extent. In Mexico for example, minimum third-party liability coverage started to be required by law as recently as 2014 (initially for newer cars only, and then for all cars from 2019 on), yet is only required for vehicles driving on federal roads (not local and state roads). This limited legal requirement helps to explain the highest rate of uninsured vehicles in our sample. Some developing countries find it difficult to impose a mandatory motor insurance scheme due to strong political opposition. The same applies to raising insufficient cover limits. This trade-off is directly linked to the magnitude of the affordability challenge.

Inadequate regulation makes it hard for insurers to offer sustainable coverage.

In addition, an inadequate regulatory framework can negatively impact the ability of insurers to offer sustainable insurance coverage. The World Bank found problems with the regulatory set up of the motor third-party liability market in several countries, such as inappropriate statutory maximum prices, risk segmentation and claims reserving.[22] In Colombia, all motor insurers are required to write mandatory policies. However, some have refused to do so, arguing that the system is unsustainable given inflexible pricing due to regulated rates, which fall behind claims trends. Regulated rates set below profitable levels jeopardizes insurer solvency.

Low enforceability of the mandatory motor insurance contributes to a larger number of uninsured drivers.

Rule of law and enforceability

In many emerging markets, the legal environment is weak and rules are often not properly enforced. Low enforcement of mandatory motor insurance coverage contributes to a larger protection gap as drivers do not feel compelled to comply with the law. In addition, it limits the ability of insurers to market insurance policies as a needed product. Mexico is a prime example of a lack of supervision from law enforcement officers and high number of uninsured vehicles.

[18] *Latin America Customer Survey Report 2013: Capturing future opportunities*. 2013. Swiss Re. "I can't afford it/ it is too expensive", "I just haven't got around to it yet" and "I haven't thought about it" topped the list.
[19] *Affordability concerns and answers related to a lack of urgency topped the list.*
[20] *Edelman Trust Barometer*, Edelman, 2017.
[21] *Global Consumer Insurance Survey*, Ernst & Young, 2014.
[22] *Motor Third-Party Liability Insurance in Developing Countries*, The World Bank, 2009.

Fraudulent policies and claims bring along higher costs that are eventually passed on to consumers.

Fraudulent policies and claims are a common challenge in LatAm motor insurance markets, in turn resulting in higher losses and administrative expenses for insurers. According to the Brazilian insurers association, 58% of the total incurred claims under mandatory covers in 2017 were questionable, and 27% were identified as fraudulent.[23] The costs associated with higher legal and personnel expenses arising from fraudulent claims are passed onto consumers, exacerbating the problem of affordability.

Solutions to close the protection gap

Some insurers have taken initial measures that should help close the motor protection gap in LatAm.

There are many ways to help close the motor protection gap: microinsurance, product innovation, and use of new technology and distribution channels. A few motor insurers in LatAm have introduced some measures to increase insurance uptake, but the aggregate impact is still small and will take some time to mature. The government and regulators also play an important role in closing the protection gap.

Table 5
Measures to address the root causes of motor un/underinsurance

	Solutions				
Challenges	Microinsurance	Product innovation	Use of new technologies	Distribution channels	Role of government and public institutions
Affordability	✓	✓	✓	✓	✓
Unawareness of insurance products and risk perception			✓	✓	
Mistrust of insurance institutions		✓		✓	
Ease of buying insurance products	✓	✓	✓	✓	✓
High frequency/severity and costs of claims		✓	✓		✓
Regulatory and legislative constraints					✓
Rule of law and enforceability					✓

Source: Swiss Re Institute

Microinsurance

Microinsurance makes coverage more affordable.

Microinsurance can make efficient insurance products affordable and available to low-income individuals through product design, distribution and claims management processes that differ considerably from traditional insurance. By offering small amounts of cover and per-person premiums, microinsurance allows for insurance that is affordable for consumers and financially viable for suppliers. The use of microinsurance has increased in LatAm in recent years, particularly for life, property and agricultural products, but overall remains low (about 0.3% of the total insurance premiums).[24] In motor, microinsurance can also be used to target uninsured drivers, especially those with limited or no access to financial services.

Partnering with mobile providers is one way that microinsurance providers can reach low-income households.

One way to reduce administrative costs is to partner with mobile network operators to bundle microinsurance with mobile products. The high mobile technology penetration (68%) in LatAm, and the fact that it is one the fastest-growing markets for mobile services,[25] offers insurers an opportunity to target low-income households which never had insurance before. However, in terms of use of mobile technology for insurance purposes, LatAm has lagged other regions. According to a study, of all insurance products distributed via mobile in emerging markets, only 4% are in LatAm (54% in Sub-Saharan Africa, 23% in South Asia and 20% in East Asia).[26] A survey conducted in South Africa and five other African countries found that 97% of the mobile microinsurance consumers sampled live below USD 10 per person per day.[27]

[23] *Quantificação da fraude no mercado de seguros brasileiro, CNSeg*, 2018.
[24] *The landscape of microinsurance in Latin America and the Caribbean* 2017, Microinsurance Network and Munich Re Foundation, 2018.
[25] GSMA Intelligence data February 2019
[26] *Digital Innovation Survey, Accenture*, 2014.
[27] *Bima customer survey*, Leapfrog labs, 2014.

Product innovation

Product innovation can help insurers to reach underserved markets and new areas of insurability.

Providers can design new products to reach previously underserved segments of the population or new areas of insurability. In Brazil, where more than 80% of vehicles older than seven years are uninsured against first-party hull risks, a new product called "popular insurance" with less restrictive rules was introduced in 2017. It provides cheaper cover than traditional polices for vehicles older than five years.

PAYD and PHYD could mean lower costs for insurers and consumers.

Pay-how-you-drive (PHYD) and pay-as-you-drive (PAYD) are other innovative products that can lower costs and reduce purchase barriers for customers. By breaking down traditional cover into much smaller sums insured, PAYD allows drivers to pay only for insurance that they actually need, benefiting those that drive fewer miles. This solution has been implemented by a few insurers in Argentina, Chile and Mexico in the last two years. According to a PAYD provider in Mexico, a client who only drives up to 8000 km a year could save about USD 270 annually in motor premiums. Similar to PAYD, PHYD takes into account a driver's safe driving behavior. Both allow insurers to move from a fixed annual price model to a policy that is priced based on how often, when and how the individual drives. These solutions allow for better client segmentation by facilitating a more accurate risk assessment of each customer, and thus also potentially improving profitability.

Simplifying policy language can help earn consumers' trust.

The wording of policies is also important. Simplifying language in legal contracts, while maintaining product integrity and policy accuracy, is a key way for insurers to earn the trust of consumers.

Taking on new technologies

Technology can help improve affordability, levels of awareness and customer experience.

Technological change — in particular, digital and mobile technology — can help address the motor protection gap. The positive impacts of technology include improved affordability of motor insurance as the costs of providing cover falls; increasing levels of awareness through social media and mobile communication tools; and enhancing customer experience through hassle-free, individualized products and more-regular communication.

Tech transformations such as IoT, AI and blockchain have the potential to accelerate motor insurance growth.

New technologies can facilitate new products and distribution channels, and also promote entirely new business models. Digitization and Internet of Things (IoT) can enable advanced, customized and more efficient products and underwriting methods (eg, PAYD and PHYD), as well as distribution channels (online sales) and claims settlement (eg, self-claim video and photos). Some insurers have started using Big Data and data analytics tools to obtain deeper insight into the risks covered. By establishing digital trust between policyholder and insurer, blockchain can be used to increase transparency and speed up the submission and verification processes. Artificial intelligence and machine learning algorithms can help make submission and claim processes more efficient and allow insurers to offer individualized quotes for customers, integrate robo-advisors and reduce fraudulent claims. Using these technologies, a US insurance start-up, Lemonade, claims that policies can be underwritten in just 90 seconds and for a cheaper price than traditional insurers.

Developing new distribution channels

Alternative distribution channels are instrumental in providing efficient customer service.

Distribution channels also play a crucial role in providing individuals and businesses the insurance protection they require as efficiently as possible. Insurers are introducing market-specific products with greater use of alternative channels such as utility and remittance companies, cellphone networks, cooperatives, financial institutions and insurance aggregators. These distribution channels can target potential customers that have not had insurance before.

New technologies and changing customer preferences are shifting the distribution landscape.

New technologies and changing customer preferences on how they select insurance companies and products are shifting the distribution landscape. Channels that adapt to the new reality of customers, such as digital distribution, are for the most part currently untapped in LatAm, and represent potential new business. As traditional channels become saturated and the emergence of digital technologies becomes the norm, those who embrace change will have competitive advantage. According to participants in the Insurance Governance Leadership Network, the need for insurance to be sold via more direct channels and at a lower cost is greater today than ever: historically, 15–40 cents of every dollar of premiums collected in a policy went to distribution.[28]

Digital distribution can make insurance accessible to those in remote areas.

The robust upsurge of mobile technology penetration in emerging markets is also increasing access to insurance products. Digital distribution will make insurance accessible to those who live in remote areas and will improve the purchasing process for both the consumer and the insurer. For example, in Chile customers in remote areas are able to purchase mandatory motor cover online.

The role of governments and public institutions

Governments and regulators have the political and legal power to set rules to support a stable insurance market.

Governments and regulators set rules that enable the insurance market to function, and help expand the availability of risk transfer solutions to individuals and businesses by introducing mandatory insurance schemes. They also share responsibility for establishing a transparent and reliable legal structure, including efficient tort liability laws, a functioning court system, effective traffic law enforcement and adequate minimum motor insurance cover. In addition to an effective legal framework, a sound regulatory framework regarding premiums, reserving standards, information systems and reinsurance techniques is vital to support a stable insurance market and protect consumers.

They must ensure that mandatory insurance is enough to cover damage caused to third parties.

All five of the LatAm countries in our sample have established some sort of mandatory motor insurance. However, governments need to make sure that level of cover is adequate so that in extreme-case scenarios of injury, permanent disability or death, a household's income replacement needs are met. In addition, in some of these markets inflation is volatile and sometimes very high, meaning that an annual adjustment mechanism is necessary. For example in Brazil, like in Chile and Colombia the minimum required coverage could follow an inflation index, similar to other social security benefits. Statutory maximum rates should be based on objective data rather than political pressure, while remaining affordable. Regulatory bodies should maintain a reliable claims database — in particular, of frequency and severity of claims — to help insurers and supervisors compute accurate rates for products.

Governments can subsidize motor insurance premiums or offer tax benefits for low-income people.

Governments can also subsidize motor insurance premiums or offer tax benefits for low-income individuals. Another way to reduce insurance costs to consumers and losses to insurers is to make safer roads. Public institutions can cooperate with the insurance industry to establish joint efforts to prevent road accidents. For example, the Insurance Institute for Highway Safety in the US has provided objective information about safety issues such as the crash performance of new cars.

The solutions require a joint effort by the public and private sectors.

Overall, the solutions to the motor protection gap require a joint effort from the public and private sectors. The public sector plays an important role in setting a legal and regulatory framework that supports the adequate development of the insurance market, and in introducing (and enforcing) mandatory motor insurance schemes. Meanwhile the insurance sector should develop attractive products and create incentives for risk mitigation through risk-based pricing. Both sides share the responsibility of communicating effectively the benefits of motor insurance, the consequences of causing an accident, and the financial costs involved, which in itself could lead to both improved driving behavior, and greater uptake of insurance.

[28] *The future of distribution: insurers grapple with a rapidly changing landscape*, Ernst & Young, 2017.

Conclusion

We estimate a USD 76 billion protection gap in terms of motor premiums for the biggest markets in LatAm.

We estimate a motor insurance protection gap in the five largest markets in LatAm of USD 76 billion, based on the number of uninsured vehicles. About 58% of the aggregate fleet in the five largest markets have some kind of insurance coverage. The current sums insured under mandatory insurance schemes replace, on average, less than 10% of income needs. This highlights the vulnerability that households face in the event of a car accident that results in third-party liability expenses, loss of income, first-party damages and/or medical expenses.

The public and private sectors can close the motor protection gap by addressing its root causes and communicating the benefits of motor insurance.

We call on the public and private sectors in LatAm to close the motor protection gap by addressing the root causes of uninsured and underinsured, such as affordability, under-estimation of risks by drivers, lack of trust in insurers and weak enforcement of regulations. Developing innovative products, and implementing and expanding the use of new distribution channels are powerful ways insurers can increase uptake of motor insurance. Solutions like PAYD and PHYD are good first steps, but these products are still in early stages of adoption in the region. Governments need to ensure level of cover is adequate so that in cases of bodily injury and/or death, a household's income replacement needs are met, as well as an annual adjustment mechanism, given volatile and high inflation in the region. Regulators need to ensure that legislation keeps up with the evolution of market conditions, and allow for the adoption of new technologies (eg, autonomous and electric vehicles, new underwriting solutions, vehicle connectivity, and smart mobility) and adaptation to new social trends (eg, ride-hailing). Governments and insurance companies share the responsibility of communicating effectively the perils of not having motor insurance and the costs associated with uninsured driving.

We project motor premium real growth to exceed real GDP given economic recovery and growing car ownership.

Demand potential for motor insurance remains strong in LatAm given the current levels of income per capita. With broader economic recovery, car ownership levels look set to rise, and this should boost insurance demand. Our baseline scenario is that motor premiums will grow by more than 3% (CAGR) in real terms across the region in 2019–2023. We expect premium growth in Colombia will outperform its regional peers, with robust economic growth being the main driver there.

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