

THE INSURANCE INDUSTRY IN MEXICO

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INTRODUCTION:

It is an honor for me to have the opportunity of addressing such a distinguished audience at this AEAI/RIMS Conference.

Today I will speak to you about the Insurance Industry in my country, MEXICO, and I will try to give you a panoramic and objective view of what the prevailing insurance and reinsurance climate is.

I will be glad to answer any questions that you may have at the end of my talk, so I would be grateful if you could jot down your queries for that time.

1. KEY FACTS ABOUT MEXICO

- Population: 81 million inhabitants
- Workforce: 34 million
- Surface area: 1.96 million square kilometers
- USA border: 3,300 kilometers
- 1990 GDP: \$ 227 billion USDLLS
- 1990 growth: 3.8% Estimated for 1991: 3.9 % - 4 %
- 1990 exports: \$ 27 billion USDLLS. Manufactures 52%,
Oil 38%, Primary products 10%
- Accumulated foreign investment up to 1990: \$ 30.0 Billion

USDLLS.

- 1990 New foreign investment: \$ 3.7 billion USDLLS.
- 1991 Estimated new foreign Investment: \$ 8.5 billion USDLLS.
- 1991 projected annual inflation: 18 %

2. SOCIAL, POLITICAL, ECONOMIC AND INVESTMENT ASPECTS:

Mexico has started to reap the benefits of the stabilization policies and the other structural reforms that began in response to the Debt Crisis nine years ago. Moreover, in the past two years, the dynamic Administration of President Salinas has continued to make further progress with the stabilization programme, whilst broadening and deepening the process of modernization, deregulation, privatization and trade liberalization.

With top-level Mexico-US governmental relations at a new all-time-high, the prospect of a North American Free Trade Agreement (NAFTA) with the US and Canada is boosting business confidence, encouraging investment locally and from abroad and will extend the reform process throughout the economy. Thus, the government has rectified the economic policies that contributed to the Debt Crisis in 1982 and, in less than a decade, has transformed Mexico into an open, market and export-oriented

economy that is actively seeking to encourage foreign investment. In doing so, the Government has rebuilt the foundations for steady economic growth and the containment of inflation.

The risk of a sudden change in the political scene impacting adversely on the economy and the investment environment seems minimal in the short-run and reassuringly small in the medium term. In the longer run, beyond the 1994 presidential elections, it is reasonable to presume that Mexico can continue to move forwards towards a more pluralist multi-party democracy in a relatively stable political and socio-economic environment.

The mid-term elections held last August confirmed the social stability prevailing in the country and reaffirmed the strong hold the ruling Revolutionary Institutional Party (PRI) has both in Congress and in the Senate.

Further ahead, the PRI is likely to remain in a very strong position to win the 1994 elections. If the Salinas Administration has already joined the NAFTA by 1993, as proposed, and if the economy continues to perform well, the next President will probably be reluctant to reverse or substantially alter the principal aspects of the economic policy that are succeeding at that time.

In the economic front, the principal objectives of the Salinas Administration economic strategy are to defeat inflation, to complete the process of opening the economy and to build up the market mechanisms that can restore financial confidence and ensure consistent economic growth. The instruments for achieving this strategy are a blend of prudent fiscal and monetary policies, privatization, deregulation, modernization, trade liberalization and a tripartite pact (PECE) with business men and trade unions to suppress price and wage inflation through a process of " Concertation " (i.e. co-ordination and mutual agreement).

As a result inflation has been reduced from a historic high of 160 % in 1987 to an estimated 18 % for 1991 and the country's economy has begun to grow again. Accumulated inflation as of July of 1991 has was 8.5 % which encourages the possibility of reaching this goal and a 4 to 5 % annual growth rate is expected to be reached by 1994.

In summary the socio-political and economic outlook for the future is optimistic. Faster economic growth is expected. Lower inflation and a minimal near term currency risk are feasible. Political and social stability are likely to continue. All of which should allow the country to grow and successfully compete in the evermore present Global scenario.

3. AN OVERVIEW OF THE INDUSTRY.

Insurance activity in Mexico started during the middle part of the 19th century as a result of the country's industrial development. Business was written outside Mexico but service and client attention was offered locally through agencies of foreign companies and brokers.

In 1935, the first Insurance and Mutual Institutions law was passed. It provided the legal framework for the establishment and operation of insurance companies in Mexico. This legislation allowed only Mexican corporations to underwrite coverages and regulated local reinsurance operations. Foreign equity holdings in existing companies were permitted to continue but were reduced to a minority position.

Additional legislation regulating property, casualty and marine, policy issuing and coverages, group life operations and agent activities was later put into practice and, in general terms, continues to be valid.

The National Banking and Insurance Commission (CNBS) was created as a government entity in charge of overseeing and regulating the sector's operations. Tariffs were published for all lines of business, in essence, following a combination of the Spanish, American, British and French systems of the time.

The Mexican Association of Insurance Institutions (AMIS) was formed to coordinate the companies activities and to act as a rating bureau for the industry. AMIS encompasses all insurance companies operating in Mexico.

During the '50s, '60s and '70s, the industry developed at a fast pace, as a result of the country's industrial growth, foreign investment and the expansion of a more economically powerful middle class. Individual life, commercial and industrial non-life markets together with personal lines, provided a solid base for business.

During the early and middle '80s, insurance activities were adversely affected as a result of recession and the country's economic problems. Reduction of the population's purchasing power and a diminishing flow of foreign investment, together with high inflation levels took a severe toll on the market. The 1985 earthquake in Mexico City, Hurricane Gilbert, the lowering of interest rates and poor automobile results also contributed to the sector's problems during this period.

In November 1987, the beginning of a much freer and more internationally oriented market was heralded by allowing the underwriting of "jumbo" accounts following international terms. In May 1989, as a result of the new foreign investment law,

another important change took place in the area of insurance and reinsurance intermediary activities, permitting ~~up to 100%~~ foreign ownership of direct and wholesale broker firms.

In December 1989, the government published new legislation concerning foreign participation in the country's insurance and reinsurance activities. By opening up the industry to international capital, a strong incentive for investment and development was provided. The government is aware of the need to strengthen the insurance sector's infrastructure and prepare it for the opening of the Mexican economy currently taking place.

The insurance sector, together with stock brokerage houses, have become the main resource attraction of the private parallel financial system that originated in 1982. In 1990, the industry generated a total premium volume of \$ 2.70 billion USDLLS., and held assets in excess of \$ 4.94 billion USDLLS. These figures represent an increase of 24.6 % and 26 % respectively over 1989 results.

The National Insurance and Bonds Commission (CNSF) was created in early 1990, in substitution of the existing CNBS, as the governing agency in charge of insurance, reinsurance and bond activities in Mexico. It was provided with supervisory and sanctioning authority to support its functions.

Reflecting the positive international reaction to these measures, by January 1991 a total of eight European and American based insurance companies had either increased their existing participation in local companies or had acquired an important equity holding in Mexican firms. These investments have given them access to 44 % of the total market.

4. MARKET

The insurance sectors activities are regulated by Federal Laws, which are applicable throughout Mexico. This facilitates operating procedures and reduces administrative red tape.

The domestic market is comprised of 35 insurance companies, 24 of which operate in all lines, 8 in property and casualty only and one in life lines. Credit insurance is provided by a Mexican market pool-owned separate company. Agricultural coverages are provided by 6 all line companies.

The private sector controls 75 % of all assets and 82 % of all premiums written. The government controlled Aseguradora Mexicana / Hidalgo group, which insures the majority of state resources, has been recently put up for sale, reinforcing the government's privatization policy.

The industry is highly concentrated. Seven companies including the state-owned group control 81.6 % of underwriting. However, as a result of foreign investment, competition and the formation of new financial groups, this situation is expected to change allowing smaller firms to increase their market share and forcing others to disappear.

Major underwriting companies are:

<u>COMPANY</u>	<u>1990 MARKET SHARE</u>
Aseguradora Mexicana / Hidalgo Group	17.81 %
Seguros America	17.42 %
Nacional / Provincial Group	16.48 %
Seguros Monterrey	11.66 %
Seguros de Mexico	10.07 %
Seguros La Comercial	<u>8.16 %</u>
Total Market Share	81.60 %

The market operates in all lines of life and non-life insurance. In 1990 life, accident and health premiums represented 44% of the total market. Property, casualty, credit, agricultural and marine represented 56 %. Total written premiums in 1990 were \$ 2.70 billion USDLLS.

The market's combined loss ratio for 1990 was 111 %. Losses amounted to \$ 1.34 billion USDLLS. and represented 56.27 % of earned premiums in 1990.

The industry is tariff oriented and although each company can write business at their own rates, these have to be registered by each company before the National Insurance and Bond Commission (CNSF). Insurance and bonding operations have to be performed by separate companies, although reinsurance between both sectors is permitted, thus strengthening each others operations.

Workmen Compensation, Individual Pension Plans and National Health are provided by the National Social Security Institute (IMSS) and the Institute of Social and Security Services for State Employees (ISSSTE). Plans for allowing the insurance sector to participate in pension schemes are currently being studied by the government.

5. DISTRIBUTION CHANNELS

The Insurance Agents regulation allows two legal figures, the Incorporated Agent and the Individual Agent. The differences reside mainly in fiscal and operating obligations that each have to comply with.

Current regulation "De Facto" nullifies the possibility of each company having captive agents that could sell only its products and services, since the CNSF issues an Agents Certificate which is valid for all insurance companies operating in the country. To gain agent's loyalty, each company signs commission agreements with the agent and seeks to create a preference on the basis of service, products and incentive programmes.

The market is clearly divided into two major distribution channels. The commercial and industrial business is mainly controlled by large Incorporated Agent broker houses, some of which either represent an international broker firm or have foreign equity participation. Approximately 80 firms operate in this way.

The portfolio is more concentrated on non-life products (66 %), with a marked emphasis on automobile and fire lines. Their revenue was severely affected by competition last year, which forced premiums to go down, as a result of rate reductions.

All major world-wide brokers are present in Mexico, in one way or another. Although there are no official statistics, it is estimated that this sector represents approximately 28 % of the market's written premiums.

The largest broker houses present in Mexico are:

LOCAL BROKER FIRM

Asesores Sedgwick James

Asesores Kenndy

Brockmann & Schuh

Consultores BMZ

Codisa

~~International Broker Group~~

Ramos, Rosado y Asoc.

Vertex

INTERNATIONAL AFFILIATE

Sedgwick James

Alexander & Alexander

Willis Corroon

Rollins, Burdick, Hunter

Arthur J. Gallagher

Johnson & Higgins

Marsh & McLennan

Frank B. Hall

Although low prices and competition in this segment are presumed to remain for the near future, the broker market is expected to grow as a result of an increase in national and foreign industrial and commercial investment, originated by the NAFTA and the overall improvement of Mexico's economic climate.

The personal lines market is attended by a force of approximately 28,000 active Individual Agents and general agents, dedicated to offer mainly life, health and automobile coverages. Unofficial figures estimate a 72 % market share for this distribution channel.

This market segment is presumed to have a large growth potential as the purchasing power of the population increases as a result of the NAFTA and the issuing of individual pension regulation currently under study.

Both incorporated and individual agents are subject to maximum commissions scales, authorized by the CNSF and are applicable to the lines in which a company operates. In addition, each company formulates sales incentive programmes which increase the agents income.

The agents average commissions for a given portfolio are around 13 %. Although this percentage may vary in relation to the type of product sold by each agent and portfolio composition.

Typical incentive programme allow for bonuses of between 3 and 5 % of premium for life and accident products. Health coverages are normally excluded as a result of poor underwriting figures. Property and casualty lines focus mainly on fire products, allowing between 5 and 8 % of the premiums and provide experience based incentives of approximately 1 % for the rest of the lines.

6. REINSURANCE

Compared with international insurance operations, Mexican companies tend to be small with limited capital bases and reserves, and many simply reinsure almost all their business, except for traditionally retained life, auto and health lines. This practice had proved to be highly profitable, but it limited the local retention capacity of the industry and made it vulnerable to international market fluctuations and conditions.

The industry is heavily dependent on foreign reinsurance for its operations. Local coverage can be provided by two private Mexican companies, by market reinsurance pools. Access to the international markets is gained through subsidiaries or affiliates of foreign reinsurers.

There are close to 120 reinsurance underwriters registered with the CNSF that have the authorization to reinsure Mexican risks. Principal reinsurers operating through local offices in Mexico are:

Reaseguradora Patria S.A.

Reaseguros Alianza S.A.

Gerling Konzern Globale

Kölnische Rückversicherungs-Gesellschaft

Münchener Rückversicherungs-Gesellschaft

Stockholm Reinsurance Co.

Swiss Re

Skandia International Insurance Corp.

TELA Verischerung A.G.

The Mercantile and General Reinsurance Co.

The Tokyo Fire and Marine Insurance Co. Ltd.

Reinsurance intermediaries play an important roll in placing large facultative business and excess of loss programmes for cedents, specially in the American and European markets. There are some 20 intermediaries involved in brokerage operations, some of which represent major foreign firms, although all have an international connection in one way or an other. The market's major players are:

LOCAL BROKER FIRM	INTERNATIONAL AFFILIATE
Agencia Interoceanica	Heath - Fildings
Alexander Howden	Alexander and Alexander
Crisa	Bain Clarkson
Guy Carpenter	Guy Carpenter
International Reinsurance Group	R. Mears
Reinmex	Johnson and Higgins

Over the past two years, some of the major International Brokers have entered the market offering Wholesale services directly to the end client, by-passing their local representative and therefore, acting directly as reinsurance intermediaries. These practices have had a negative reception in some cases as a result of inadequate claims service, faulty placements and delays

in collecting loss from underwriters. The market tendency is to limit such practices in the future since foreign brokers are acquiring equity holdings in their local affiliates.

7. PRODUCTS

As I mentioned previously, the Mexican insurance industry provides all traditional lines of life and non-life products. Life, accident and health represent 44 % of the total premiums written. Property, Casualty Credit, Agriculture and Marine account for the remaining 56 %.

Life and automobile covers amount to 83 % of the market. Fire follows with an 11 % share. The rest of the lines contribute with 26 %. (graphs 1 and 2).

Prior to 1989, the market had remained relatively stable and only a few new products had been developed, mostly in response to grant protection against inflation and currency devaluation. In this area sophisticated endorsements were devised, particularly in property, life and health insurance covers by which, automatic increases in the insured amount and up dated indemnity clauses were offered.

From 1989 onwards and as a result of the possibility of insuring " JUMBO " risks following international terms and the improvement of the country's economy, the market has gone through

a rapid evolution. First Loss and All Risk covers are now available for almost all property lines and a new impulse on creativity has taken over what had in the past been a more conservative and traditional market.

This tendency is likely to continue in the future allowing the market to become much more dynamic and flexible in the products and services it can provide.

8. NATIONAL AND INTERNATIONAL ASPECTS THAT ARE IMPACTING THE LOCAL MARKET

In order to stimulate the development of the Insurance sector and contribute to raise its level of competitiveness to international standards, the government recently implemented (December 1989) a number of important policy directives and actions that are already having a positive impact on the industry's growth.

Some of the most significant actions taken have been :

1. A complete restructuring of the General Insurance and Mutual Institutions Law, allowing companies to operate more autonomously and underwrite risks at rates and conditions that each may see fit, subject to prior individual tariff approval by the CNSF.

2. The setting of parameters to determine each company's solvency margin and guarantee capital.

3. A simplification of administrative procedures and processes that eliminates unnecessary paperwork and reduces legal requirements.

4. Opening foreign investment in existing or new insurance companies of up to 15 % of the capital. This percentage can increase up to 49 % at the discretion of the Ministry of the Treasury.

5. Allowing ~~up to 100%~~ foreign ownership of insurance and reinsurance broker houses.

6. Permitting the formation of Financial Intermediary Groups, integrated by Insurance, Bonding, Financial Leasing and Warehousing, Factoring, Stock Broker, Currency Exchange and, in the immediate future, Banks. These Groups will be allowed to use the synergy of their operations to promote their individual company activities.

The international scene is also impacting upon the industry. As a result of the opening of the Mexican economy, the market has become more involved with foreign legislation and

exposures that in the past were considered a luxury to cover, have now taken a relevant stand, specially those related to the export and import of goods and services.

A soft reinsurance market has also taken its toll on the sector. The impact has been twofold. On one hand the rates have been slashed considerably, forcing profit margins to contract. In addition, coverages that in the past were issued and charged separately, have now been pooled under All Risk coverages, further reducing companies and agents income and operating margins.

Risk Management has also been an important factor. As a discipline, it began to be practiced the late 60's and from then on has turned into a driving force for the industry. Many Mexican corporations have sophisticated Risk Management programmes which involve full time executives, risk prevention and control, retention schemes and captive operations. Risk Managers have greatly contributed to making insurance and corporate protection a much more professional and efficient activity in the country.

These points, together with the recent participation of multinational insurance companies in the industry, are modifying traditional marketing and underwriting views and will demand a more flexible and dynamic outlook.

8. OUTLOOK FOR THE FUTURE

A strong growth potential exists for the insurance industry in Mexico. For years it has been highly protected and effectively closed to outside competition and investment, allowing it to become undercapitalized, inefficient and technologically weak.

New legislation has been passed aimed at revitalizing the market via privatization, foreign investment and increased competition. Notwithstanding current regulations, the market remains underdeveloped, both in premiums per capita and percentage of GDP. In 1990 the industry represented 1.2 % of GDP, down 0.1 % from the previous year. Annual premiums per capita represented \$ 32.00 USDLLS. and \$ 76.00 USDLLS. per workforce capita.

In order to prepare itself for the NAFTA and the opening to international competition of service providers, the Mexican Insurance Industry will be required to :

1. Broaden it's capital base and increase the risk retention capacity of the companies, specially for the medium and small size segment of firms.

2. Greatly improve administrative procedures, in order to simplify operations by taking advantage of available new business processes and computer technology that not just "mechanize" existing work flows, but fundamentally simplify them and increase operating efficiency.

3. Gain access to new underwriting expertise and technology that will enable it to develop innovative products and services designed to satisfy, with rapid and responsive service, their clients' changing coverage and savings needs.

4. Develop new products and services that will satisfy exposures originating from the country's entrance to the Global scenario, particularly in the areas of Pollution Liability; Technical, Contractors and Builders Risks; Personal Lines and Individual Pension schemes.

5. Review current distribution channels and devise simplified and more efficient ways of getting their products and services to clients.

6. Modify the industry's operating "culture", reorchestrating it's work flows and organizational structures to adapt and function in a rapidly changing, deregulated and competitive market.

7. Seek higher levels of productivity from their human and financial resources.

Dedicated measures taken to solve these aspects will create successful companies that will separate them from the pack and insure their presence for the coming years.

Private pension programmes and personal lines business will become one of the most active and growth oriented markets of the Mexican insurance industry. The government is currently studying the possibility of allowing the private sector to participate in the establishment of individual pension schemes, in parallel to the existing coverage provided by the National Social Security Institute. Specific proposals have been presented to the authorities by AMIS and legislation is expected to be passed soon.

In order to prepare itself for growth, Mexico will require to develop the country's infrastructure in all fronts. Everything from ports, highways, telecommunications, energy supplies, etc. will have to be either built or improved in order to face the economic needs of the country. This infrastructure projects will demand specialized risk and insurance management services to help them cope with their exposures.

Commercial and Industrial business should also be boosted as a result of new investment in the country. These lines will require specialized and professional service providers to ensure client satisfaction and success.

CONCLUSIONS

The Mexican insurance industry is going through rapid changes that require companies to move simultaneously on strategic, organizational and technological fronts.

The imminent start of the NAFTA negotiations and an increasingly open economy demand an ability to change and a willingness to accomplish work in new ways. Foreign investment is a viable means to accomplishing the technology required to face the future.

These areas, together with the access to a rapidly growing consumer market underline the business opportunities present in the Mexican insurance sector. The legislation changes, designed to reactivate operations and allow foreign participation and increased competition, are an additional incentive to establish strategic alliances with Mexican partners in this sector.

Many of the country's insurance companies have a solid financial position and are interested in joining forces with multinational partners. This will allow them to improve their

competitive position and increase their scope of operations. Companies of international renown such as Cigna, American International Underwriters, Commercial Union, Allianz and others have already formed joint ventures.

Mexican industrial and commercial activities are expanding to accommodate the needs of more than 81 million potential consumers, 32 % of whom are economically active. This makes the Mexican internal market specially significant. Complementing domestic demand, Mexico's booming "maquiladora" (in bond) industry represents a vigorous market for insurance products and services.

I trust that my talk has proved useful to you and that it's content will assist you in having a clearer view of how the Mexican insurance market operates and as a result facilitate the control of your Mexican interests.