

LATINOS ARE WORTH THE RISK

PETER HEAP



MY favourite story is that of the British shoe manufacturer which sent a representative to an African country and received a report that there was no possibility of sales since nobody wore shoes. Then a Japanese shoe manufacturer sent its representative who reported that there was tremendous sales potential since nobody yet wore shoes. The British part of this story is reminiscent of many reinsurers' attitude who present eight reasons why they should not do business in Latin America rather than one reason why they should.

I have been involved in Latin America for about 20 years and in that time have often been accused of masochism, false optimism or just being there for the *pisco* (a potent cocktail in Peru and elsewhere), but the only vice that I will confess to is an unshaken faith in the region's growth potential. People make wisecracks about Latin America always being the area of the future, but the successful entrepreneurs are those who spot tomorrow's opportunity today.

So why the enthusiasm when the whole of Latin America only accounts for less than 2% of world premium income? Precisely for the same reason why the Japanese shoemaker is more likely to succeed. Take the premium income in the major Latin American countries as a percentage of gross domestic product (GDP) compared to the United States. In most of the countries the volume is just a fraction of that of the USA, but the corollary is that the growth potential is enormous. Take Brazil which is one of the largest economies in the world, yet insurance is only 0.86% of GDP. Of Latin America's largest 500 corporations, over 300 are based in Brazil and the potential is obvious. Mexico is fast developing as an economic power and the probability of a common market with America and Canada holds out a very exciting future for the giant of the Hispanic world.

A further factor, which is vital when looking at the region, is the impact of improved economic performance on levels of personal

spending. Traditionally, the bulk of the insurance premiums in Latin America has come from commercial and industrial business, but with increased personal wealth we are now starting to see an increase in personal lines and I firmly believe that this is where we will see the major growth in premium volume. I again cite the cases of Chile and Mexico where financial services and personal lines business have really taken off in the past two or three years.

As regards the annual growth rates in Latin America compared to other parts of the world between 1970 and 1986, in most classes of businesses the expansion has been much higher than in the USA or Europe. Whilst life business has been lower, the past two years have seen the start of a boom in this class also.

The next question is why should the growth potential be any greater now when it has been largely unrealised for the past ten years? To answer this we need to look at what has happened over this period. The economic boom of the early seventies was brought to an abrupt halt by the banking crisis when rocketing interest rates wiped out surpluses and reserves. This produced a further closing of already overprotected economies and this, coupled with mainly inefficient statal control and massive budgetary deficits, caused a drop in foreign investment and high inflation.

But look at what has happened in the past five years. Chile was the first to break out of this downward spiral in the early eighties with a bold change to a free market, privatisation of statal industries, de-regulation and de-monopolisation. After a difficult start, the success of this change has been amazing, as anyone who is familiar with Chile knows; the same model is being followed by many other Latin American countries. From an insurance viewpoint, de-regulation has now been introduced in Chile, Mexico, Colombia and Argentina and is coming for Venezuela and Peru. National monopoly for reinsurance is now limited to Brazil, Peru, Uruguay, Costa Rica and Nicaragua, and even in Peru there is

legislation before Congress to de-monopolise Reaseguradora Peruana and allow the domestic market free negotiation of its reinsurance programmes.

The clear result of these major economic changes has been to attract new foreign industrial and commercial investment, which is beneficial to the insurance markets, by stimulating demand for new products and increased premium volume. Equally the privatising projects have created new opportunities on risks previously uninsured. Traditionally, governments have insured very few of their assets in Latin America, but under private or part-private ownership there is new emphasis on financial and risk management and consequent new opportunities for the insurance markets. The premium volumes involved are substantial.

These opportunities are both in retail insurance and in reinsurance. The growing domestic demand cannot in the main be satisfied by local capacity and the ever-present catastrophe risks in many countries mean a perpetual demand for international reinsurance. Regrettably, there was a lack of capital investment in the insurance sector which has meant local companies in the main being under-capitalised with small retentions. This has also meant that many companies were able to make a very adequate living on the reinsurance commission earned and with very little motivation to ensure that loss-ratios were kept low.

Fortunately, this situation is now changing fast with a recognition that local companies must be carriers of risk with an adequate capital base. This is helped by the fact that many new foreign insurance companies (mainly European) have made investments into the domestic insurance and reinsurance markets. Companies

such as UAP, Mutuelle du Mans, Mapfre and Commercial Union have all made acquisitions in different parts of Latin America, joining companies like Assicurazioni Generali, Cigna and Allianz (among others) which have been in the region for many years. This is a trend that will continue and it is healthy that it should do so, bringing technology and capital to these markets.

Against that, and hopefully only in the short term, the scrapping of tariffs and market deregulation have meant little growth of premium volume in real terms, so reducing reinsurance margins and increasing buyers concern for price. So if both opportunity and demand are there, why do many reinsurers take such a cynical view of Latin America? I believe that there are several reasons. For the sake of simplicity, I have invented four categories into which many international reinsurers seem to fall: the ignorant, the indifferent, the burnt and the die-hards.

The Ignorant are unaware of the opportunities of the region and regard all offers of business with deep suspicion. They can usually be identified by comments such as: "Don't they all wear large hats and sleep in the sun?" However they can often be convinced by proper information about the area and the business. It should not be forgotten that Latin America comprises some 17 countries stretching more than 5000 miles from Mexico to southern Chile and covering some 7.5 million square miles. Britain would fit into Brazil 35 times! The total population is some 400 million of which 250 million speak Spanish and 150 million speak Portuguese. But there is no more similarity between Mexico and Argentina than there is between the UK and USA. The culture, the history, the ways of conducting business and even the language show huge

PREMIUMS AS PERCENTAGE OF GROSS DOMESTIC PRODUCT — 1987

Country:	World Bank:	Total:	Non-life:	Life:
America	3	9.07%	5.38%	3.69%
Britain	6	8.35%	3.10%	5.25%
Spain	25	3.31%	2.04%	1.27%
Portugal	30	2.69%	2.34%	0.35%
Panama	22	3.76%	2.01%	1.75%
Venezuela	34	2.26%	2.04%	0.22%
Chile	35	2.20%	1.07%	1.13%
Argentina	38	1.80%	1.66%	0.14%
Uruguay	41	1.78%	1.44%	0.34%
Colombia	44	1.53%	1.25%	0.28%
Peru	53	1.08%	1.04%	0.04%
Mexico	55	1.02%	0.69%	0.33%
Brazil	58	0.86%	0.73%	0.13%

Source: Sigma/Swiss Re

AVERAGE ANNUAL GROWTH RATES 1970-1986

	General Liability:	Fire:	Life:	Motor:	Marine:	Accident:	Gross Domestic Product:	Personal Consumption:	Gross Investment:	Public Spending:
EC	4.9%	2.8%	5.9%	3.3%	1.8%	5.0%	2.7%	2.9%	1.5%	3.0%
USA	8.7%	-1.8%	4.7%	4.1%	-0.4%	-3.7%	2.7%	3.2%	3.3%	1.8%
Japan	12.8%	3.8%	8.8%	3.6%	-0.2%	26.6%	4.3%	4.1%	3.4%	4.3%
North Africa		9.0%	7.7%	6.8%	6.0%		5.9%	5.6%	7.4%	5.7%
Latin America	9.0%	6.0%	4.6%	6.5%	6.8%	11.5%	3.7%	4.2%	2.5%	5.0%

Source: Sigma/Swiss Re

variations. Any reinsurer interested in doing business in any part of the region must take the trouble to understand these differences and adjust his philosophy accordingly.

The Indifferent are fully aware of what the region has to offer and are well informed about, say, the differences between Guatemala and Bolivia or why Uruguay is not subject to earthquakes. However, their commercial judgement is that the catastrophe exposures and often unbalanced nature of the portfolio make the area unattractive when compared to the United States or Europe. Whilst this has been true in the past, I believe that increasing premium volumes and a more pragmatic attitude by many local companies will make for better margins in the future.

The Burnt are those who tried and gave up in disgust. Whilst I have been (and continue to be) a lifelong advocate for Latin America, nevertheless it is true that the activities of the few have done much damage to the image of the many and are the cause of the jaundiced view held by some reinsurers. There is no doubt that in some cases corruption, a lack of *uberrima fides* or just a plain lack of premium payment have created their unfair share of problems. However times are changing and my hope is that those types of problem will diminish (and indeed it is in the interests of the Latin Americans that they do diminish).

The Diehards form the backbone of international reinsurance capacity for the region. They understand the area well and are not put off by short-term setbacks. They have been successful in adapting their own business philosophy to suit individual local conditions on the basis of when in Rio, do as the Brazilians.

Yet despite fairly high levels of international cynicism about Latin America, I have been amazed by the fierceness of reinsurance competition in the past three years or so; this has enabled many Latin American companies to obtain reinsurance at bargain basement prices. Unfortunately, this competition has also produced a lamentable drop in standards with

low cost overriding prudent practice. Both sides are guilty — some clients find that they can obtain cheap capacity from good security without the troublesome need to produce information and some reinsurers are in such a hurry to accept the risk that they only remember to ask questions when a loss occurs. More often than not, it is the broker in between who has to sort out the mess!

Whilst the whole world has been affected by the soft market, nevertheless I believe that the impact has been especially felt in Latin America. I attribute this to the fact that in the past, the controlled markets have meant higher than average rates and lower loss-ratios, hence wider margins for both insurer and reinsurer. Additionally, the huge catastrophe exposures create a continual demand for both proportional and excess of loss reinsurance at a time when larger retentions and mergers, particularly in Europe, have meant a stagnant reinsurance demand. But as I said earlier, liberalisation of Latin American markets means greater competition and falling rates and a consequent narrowing of margins. The demand is still there, but the price may be different.

I am convinced that the positive economic changes of the last few years and a more stable political environment are creating new opportunities in Latin America in both insurance and reinsurance and I exhort the sceptics to look afresh at the region, country by country. My thanks to the Diehards for their support in difficult times. ■

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