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Life Reinsurance In The Mexican Market

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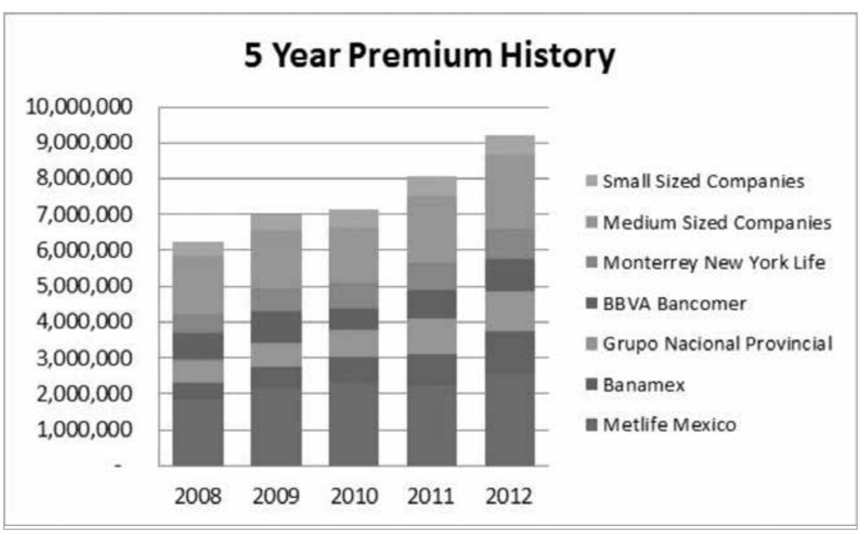
Mexico, the second most populous country in Latin America,[1] has long been a hub of Latin America's Insurance markets, due to its size, business-friendly environment and regulatory sophistication.[2]

Approximately 100 insurance companies currently operate in Mexico, more than half of which are subsidiaries of foreign entities. The insurance market has experienced significant growth over the last 20 years.[3]

Notwithstanding the recent growth, the market continues to have tremendous potential.[4] One indication of this is that the Mexican insurance market contributes less than 2 percent to the country's adjusted[5] gross domestic product, whereas the U.S. insurance market contributes around 12 percent to adjusted gross domestic product. The OECD average is a little less than 9 percent annually.[6] The Mexican Insurance Commissioner estimates that the country's insurance penetration will double by 2030.[7]

LIFE INSURANCE MARKET

Mexico's life insurance market contained 21 life insurers and 33 multiline insurers. The overall market has been growing strongly since 2005, primarily due to the growth of life insurance products with both protection and savings components.[8]



The life insurance market is dominated by five companies: Metlife, Banamex, Grupo Nacional Provincial, BBVA Bancomer and Monterrey New York Life—four of which are multinationals. This can be seen in the following graphic depicting the history of Mexico's most recent five-year life insurance premium.[9]

If we look closer at these top multinationals and domestic insurers, we can see how concentrated the life business is: out of US$9.2 billion of life premium written in 2012, 64 percent was written by the top five multinationals and 18 percent by the top five domestic insurers.

Interestingly, two of Mexico's five largest life insurers, BBVA Bancomer and Banamex, are bancassurers. Although agents are the largest distribution channel for insurance products, bancassurance, especially in life insurance market, has been gaining ground over the last several years.[10]

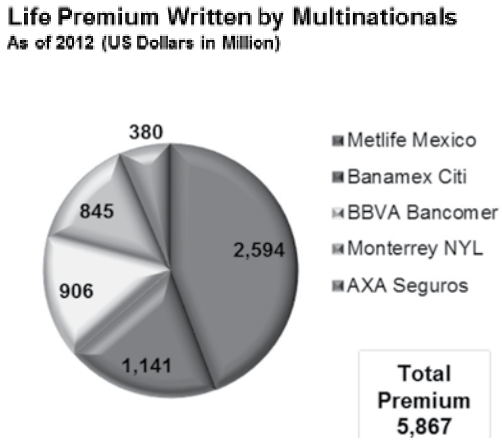
Pure mortality protection is the dominant product in the Mexican life insurance sector.[11] The main additional benefits include accidental death & dismemberment, total & permanent disability (lump sum), waiver of premium and critical illness. There is not a strong penetration of disability income or long-term care products.

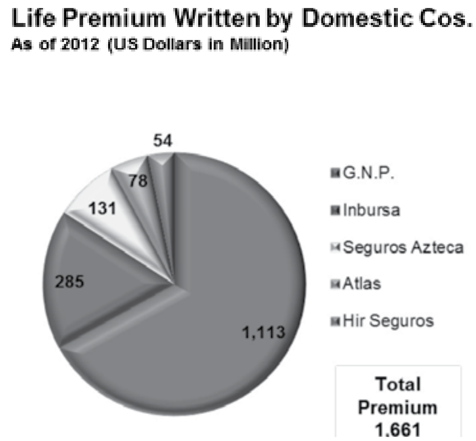
Microinsurance is another area seeing increases: by 2010, according to a March 2012 report on Mexico from the International Monetary Fund, 3.3 million Mexican citizens were reached by microinsurance with an insured amount of 65 billion pesos.[12] However, there is still a great need for a greater variety of life and health products for middle- to low-income buyers.

Another area of recent growth is the annuity market. Mexico's pension system for private sector employees, expanded in 2007 to incorporate state workers, which is driving significant growth.[13]

LIFE REINSURANCE MARKET

The Mexican reinsurance market is the largest by premium in Latin America[14] with the majority of reinsurance premium being ceded to foreign reinsurance companies. Currently, there is only one domestic reinsurer





in Mexico providing life reinsurance[15] and given that many of the multinational reinsurers have offices in Mexico, life reinsurance brokers are not as common as in some other countries in the region; e.g., Colombia.

To operate as a reinsurer in Mexico, a company must be licensed by the SHCP (Mexico's finance ministry) and the CNSF (Mexico's insurance regulator). Foreign reinsurers must show sufficient solvency and stability to assume reinsurance via a minimum financial strength rating from a recognized rating agency and by being authorized by their country's regulations to practice reinsurance.

The proportion of life premium ceded is currently quite small: of the $9.2 billion of direct insurance premium in 2012, only $592 million was ceded life premium.[16] One explanation is that, unlike the United States and Canada, Mexico's current valuation laws do not grant reserve credit for ceded reinsurance. Hence, coinsurance and other capital-efficient reinsurance transactions are not common. Often, life reinsurance contracts are structured as excess of retention deals on a risk premium basis. It is common to see four to five reinsurers providing protection under the same terms in a treaty; usually, with experience refunds.

The majority of life reinsurance treaties have automatic recapture at the end of the annual term. For the cedant, it has two advantages: one, administration is simplified, as all in-force business is reinsured under the same terms; and two, rates can be negotiated every year. However, the cedant has no guarantee that the risks will be reinsured in the future, or if so at what terms. This increases the cedent's exposure in the case of a risk such as a pandemic event.

NEW PRINCIPLES-BASED SOLVENCY REQUIREMENTS

In April 2013, Mexico passed a federal law—the first in Latin America—mandating industry-wide implementation of principles-based solvency requirements. The law does not detail the specific actuarial model(s) to be used, but instead, grants Mexico's insurance commissioner the authority to approve the specific model(s).[17]

In June, the commissioner published a draft guidance note loosely based on European Solvency II guidelines. The guidance note is currently under industry review. The intent is to consider and/or incorporate industry feedback, build a standard model and have everything ready for market-wide implementation by April 2015.

FUTURE IMPACT OF PRINCIPLES-BASED FRAMEWORK

In a recent survey of LATAMIR (Latin American Insurance Review) readers, 81.9 percent said they believe Solvency II-type standards would impact the Latin American insurance industry in a moderate to significant way.[18]

How significant that impact, and in what manner, will be determined by the final solvency model adopted. The availability and utilization of capital solutions could be one area to provide a significant positive impact on the market, including the potential financial solutions offered by reinsurance.

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If the new law were to include favorable treatment of reinsurance by including reserve credit for ceded risks, companies would be able to use reinsurance to reduce strain, release inefficient capital and ultimately bring innovation to the marketplace.[19] In the end, the ultimate beneficiary of these improvements would be the consumer, with more options and better products.

SUMMARY

The Mexican insurance market remains at the forefront of the region, with significant growth expected for the foreseeable future. The implementation of a principles-based solvency framework could allow for increased collaboration between direct writers and reinsurers to optimize capital and introduce innovations that will improve market penetration and ultimately provide better products for the policyholders.

In addition, investments in technology that will allow for improved analysis of proprietary data with the aim of understanding retained risks and their correlation could give insurers a competitive advantage with internal models, especially in a principles-based world. ■

References

[1] *http://ais.paho.org/chi/brochures/2012/BI_2012_ENG.pdf* and *https://www.cia.gov/library/publications/the-world-factbook/geos/mx.html*. Mexico's population of more than 116 million has a relatively low median age—27.7 years—and a life expectancy at birth of approximately 77 years. 40.7 percent of the population is between the ages of 25 and 54 years old. In 2010, 42.4 percent of households were estimated to be in the middle class and 55.1 percent were estimated to be in the lower class.

[2] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pg 10 and *http://www.ambest.com/bestweek/marketreports/BWUS_MexicoSpotlight.pdf.*

[3] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pg 14 Four-fold growth between 1990 and 2010.

[4] *http://www.towerswatson.com/en/Insights/Newsletters/Global/Emphasis/2012/brazil-mexico-and-argentina-what-will-new-insurance-market-entrants-see.*

[5] Adjusted GDP: "The import penetration rate shows to what degree domestic demand D is satisfied by imports M. It is calculated as M/D, where the domestic demand is the GDP minus exports plus imports i.e. [D = GDP-X+M)]" *http://stats.oecd.org/oecdstat_metadata/ShowMetadata.ashx?Dataset=CSP6&Coords=[SUB].[IMPPENET]&Lang=en.*

[6] *http://stats.oecd.org/Index.aspx?QueryId=25437* Under Insurance Indicators and Penetration.

[7] *http://www.lloyds.com/~/media/Files/The%20Market/Tools%20and%20resources/New%20Market%20Intelligence/Country%20Profiles/Latin%20America/mx_mi_2013_05_31_Country%20Profile.pdf.*

[8] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pgs. 14-15

[9] *http://www.cnsf.gob.mx/InformacionEstadistica/Paginas/SectorAsegurador.aspx.*

[10] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pgs 25-26.

[11] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pg 8.

[12] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pg 9.

[13] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pg 21.

[14] *http://www.fundacionmapfre.org/fundacion/es_es/images/El-mercado-asegurador-latinoamericano-2010-2011_tcm164-3766.pdf* pg 103, it is also true that the Mexican life reinsurance market cedes more premium than any other Latin American Country (see pgs. 109-122).

[15] *http://www.imf.org/external/pubs/ft/scr/2012/cr1267.pdf* pg 24.

[16] *http://www.fundacionmapfre.org/fundacion/es_es/images/El-mercado-asegurador-latinoamericano-2010-2011_tcm164-3766.pdf* pg 103.

[17] *http://www.cnsf.gob.mx/Normativa/Leyes%20y%20Reglamentos/DECRETO%20Ley%20de%20Instituciones%20de%20Seguros%20y%20de%20Fianzas_04abr2013.pdf*. The current plan is for the commissioner to propose a standard model. The option also exists that a company can request approval to use an internal model.

[18] *LATAMIR Insurance Review*, May 2013, page 5. Also see *www.insurancelatam.com*. Although this article pursues the idea that changes can come in the form of capital motivated transactions that benefit the market, these changes also have other significant impacts on the insurance companies (e.g. financial reporting, systems, internal controls, etc.).

[19] *http://www.iisonline.org/forum/market-trends/reinsurance-as-a-capital-management-tool/* and "Reinsurance and Financial Stability", International Association of Insurance Supervisors (IAIS), July 19, 2012.