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# NORTH AMERICAN FREE TRADE AGREEMENTS: MEXICO, CANADA AND THE UNITED STATES

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Panelists: W. PAUL MCCROSSAN
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Recorder: HARRY R. MILLER

- What should we expect?
- Status
- Opportunities
- What are the implications for cross-border membership in the professional actuarial organizations?

MR. ROBERT L. COLLETT: This is an exciting time for the three large countries of North America. The Free Trade Agreement between Canada and the U.S. has been in place for a couple of years now. It is to be augmented and replaced by the North American Free Trade Agreement (NAFTA) among Mexico, Canada, and the U.S., if it is ratified in all three of those countries. NAFTA's passage is by no means certain in the U.S. President Bush's administration is committed to the agreement in its present form. Candidate Clinton is also in favor but with a commitment to an additional review of its elements. Mexico, I believe, is clearly on board and Paul McCrossan will speak of the prospects in Canada. The treaty contains important provisions which impact actuaries and our employers. There are major specific elements impacting insurance employee benefits, and the actuarial profession. You will hear about some of these specific elements. Our panel consists of four actuaries, all with important international experience and ties. Our first panelist is Paul McCrossan. Paul is a consulting actuary in Canada, a partner at Eckler Partners Ltd., the Canadian member of the Woodrow Milliman international network. Not only is Paul a Fellow of the Canadian Institute of Actuaries, but he also has served at all senior levels culminating with his service as president during the last year.

Paul is the only actuary ever to have been elected a member of the Canadian Parliament. He served from 1978 through most of the 1980s. In Parliament, he worked on and was responsible for a number of important reforms and changes relating to insurance and pensions. These included unemployment insurance reform and regulation of the financial services industry. From 1985-88, he coordinated federal pension reform including changing the Canada Pension Act, the Pension Benefits Standards Act, and the Pensions Reporting Act. Later, after going into consulting, he served as an actuarial consultant to the all-party House of Commons Finance Committee, which completely overhauled the tax basis for tax-assisted retirement plans in

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Canada. Paul has been an active international speaker, having presented papers and remarks in New Zealand, Taipei and Singapore within the last 18 months.

Our second presenter will be Camilo Salazar. Camilo is chief actuary for the American and Caribbean regions for the American Life Insurance Company, a member of the American International Group (AIG). AIG is active throughout the world, including both Canada and Mexico. In Mexico, their company is Seguros Interamericana and is one of the few foreign-controlled companies that has had a presence in the Mexican insurance market for several years. Because of that presence, AIG is well-positioned to take advantage of the benefits that they see NAFTA as providing.

Camilo's exposure to Latin America goes back more than 15 years. He has worked in Latin America and had a prior position at Lincoln National Life in international reinsurance for Latin America. In his current position, he is quite active in Latin America and Mexico in particular, (even though based in Wilmington, Delaware).

Our third speaker will be Segundo Tascon. Segundo is a consulting actuary in Mexico. He is manager of Wyatt Mexico and serves international clients in the field of employee benefits. He has been with the Wyatt Company for 10 years and had prior experience in the employee benefits and actuarial consulting areas. Segundo has a Bachelor of Science from the Universidad Anáhuac in Mexico and a Master of Business Administration in Actuarial Science from the University of Texas. He is a member of the Colegio Nacional de Actuarios in Mexico, the International Association of Consulting Actuaries, and the Actuarial Practice Committee of the Wyatt Company. Segundo has also been very active professionally and has published articles in both local and international journals on actuarial topics.

Our fourth speaker is Oliva Sanchez-Garcia. Oliva is director of the Actuarial School at Universidad Anáhuac in Mexico City and has been there since 1988. She has a Bachelor of Science in Actuarial Sciences from Universidad Anáhuac and a Master of Science in Statistics from the University of Wisconsin, Madison. She has worked in the academic field since 1981 teaching courses such as probability, statistics and life contingencies. She is also an academic member of the Advisor Board of the Colegio Nacional de Actuarios.

We will talk about the history of NAFTA and its predecessor, the Canada/U.S. Free Trade Agreement. With Mr. Tascon's help, we will look at employee benefits in Mexico and trends and opportunities in that area. Mr. Salazar will talk to us about insurance implications and issues from both the Mexican and U.S. perspectives and about the likelihood that NAFTA will be expanded elsewhere in Latin America. He will also give us a brief education on the insurance industry in Mexico. Mr. Tascon and Ms. Sanchez-Garcia will discuss professional issues and opportunities, particularly as they relate to the Mexican actuarial profession. Finally, Paul McCrossan will discuss his views on the professional issues from the Canadian and U.S. perspectives. Now let's begin with Mr. McCrossan on the background, developments, and current status of the North American Free Trade Agreement.

MR. W. PAUL MCCROSSAN: The Canada/U.S. Free Trade Agreement has been in place for just under four years now. NAFTA is scheduled to be effective

January 1, 1994. There are four potential areas in both the current Canada/U.S. Free Trade Agreement and NAFTA which could impact actuaries.

1. Professional mobility, i.e., the ability to work in other countries.
2. Financial institution reform.
3. The possible impact on social security plans in each of the countries.
4. The possible impact on employee benefit plans.

I will concentrate on the first two areas in my remarks. Let me start with the conclusion and then develop my rationale as to how I arrived at that conclusion. Changes resulting from NAFTA will be slow to emerge in terms of the impact on your day-to-day lives, but the changes, when they do arrive, will be fundamental and far-reaching.

**IMPACT OF NAFTA ON PROFESSIONAL MOBILITY**

Under the Canada/U.S. Free Trade Agreement, professions have the opportunity, but not the responsibility, to allow cross-border employment opportunities. That opportunity is created by a decision to list a profession in a schedule to the Canada/U.S. Free Trade Agreement. This agreement provides that if there is reciprocal recognition with respect to professional standards, codes of conduct, and disciplinary procedures, the professional will be recognized in both countries. Actuaries are not yet on the schedule of recognized professions for the Canada/U.S. Free Trade Agreement. We are in the process of trying to add our profession to the list and I hope sometime before the end of the year or early next year we will make application for inclusion on the list.

The primary question that has to be decided is, of course, who is an actuary? The Council of Presidents, which consists of the presidents and presidents-elect of the six Canadian and U.S. actuarial organizations, has been working on this question. They have tentatively concluded that a Fellow of the Canadian Institute of Actuaries (FCIA) is an actuary in Canada. That's not too terribly controversial. They have also tentatively concluded that a Member of the American Academy of Actuaries (MAAA) represents an actuary in the U.S. who can practice in Canada. This may, of course, prove to be more controversial.

The Canadian actuarial profession was sidetracked in our decision to apply for registration because we faced a constitutional challenge to the actuarial profession's organizations in Canada last year. The actuarial profession is the only federally organized profession and one of the Provinces challenged the right of any profession to organize federally. So before we could set about registering under the Canada/U.S. Free Trade Agreement, we had to defend our professional organizations in Canada. It was decided by the Canadian Supreme Court that we are organized constitutionally.

In Canada, FCIAs are recognized by the federal government in the territories -- nine provinces for insurance and eight provinces for pensions. Thus, one cannot sign required legal certifications in Canada unless one is an FCIA. The situation in the U.S., of course, is much different. You have the Enrolled Actuary (EA) designation for pensions. The NAIC model insurance legislation refers to MAAAs or other qualified people; so in the U.S., it's been much less clear what an actuary is in terms of legal accreditation and licensing. What has been agreed to in principle between the

Canadian and American actuarial organizations is that actuaries who are recognized under the Canada/U.S. Free Trade Agreement should be able to consult in each other's jurisdictions. That is, a Canadian FCIA would be able to offer consulting advice in the U.S. and a MAAA would be able to offer consulting advice in Canada. However, neither would be able to sign legal certifications without some additional accreditation that has to yet be defined. The tentative agreement does not mean, for example, that a Canadian FCIA would be able to come down and sign an actuarial opinion statement for a U.S. life insurance company. To sign the opinion statement, he would need to meet any continuing education or other requirements specified by the American Academy of Actuaries.

The Council of Presidents found that in order to list ourself as a profession, we had to complete a whole series of steps. One step was developing a common code of conduct. Luckily, the actuarial profession is well underway in the development of a common code of conduct. Most of the organizations have passed what started out to be a common code of conduct, but has ended up to be a very uncommon one in the sense that just about every organization changed something in the code. Another step was to agree on standards and disciplinary procedures, including who was going to develop them and who was going to apply them. For example, I assume any practice that takes place in the U.S. is covered by the AAA's disciplinary procedures even if it is performed by a Canadian practicing in the U.S. Any Americans practicing in Canada are subject to the CIA's disciplinary procedures and standards even though they are American residents. These are but two of the basic steps that have to be taken.

**IMPACT OF NAFTA ON FINANCIAL INSTITUTIONS**

The second area I will comment on is the impact on financial institutions of NAFTA. The Canada/U.S. Free Trade Agreement provides for national treatment, not reciprocity. This is an important concept to understand. Basically, what this means is that we will treat the other companies as well as we treat our own domestic companies, but that no company will be able to do in the other country what they can do in their own country just because they can do it in their own country. For example, we have a national banking system in Canada. That does not mean that a Canadian bank can come down and set up a national bank in the U.S. Conversely, Canada does not permit branches of foreign banks to operate. They must set up a subsidiary. This will apply to U.S. banks operating in Canada also.

In the insurance arena, we have effectively had free trade between Canada and the U.S. since the turn of the century. Almost all Canadian insurers are treated as domestic Michigan insurers. That is an historical fluke arising from the fact that most Canadian companies had entered from Windsor, Ontario into Detroit, Michigan before there was an NAIC and so they have been treated historically as Michigan domestics. However, there were still foreign ownership restrictions on purchasing a Canadian financial institution prior to the passage of the Canada/U.S. Free Trade Agreement. These were completely eliminated with respect to American financial institutions. Even though these restrictions have been eliminated for over three years, nobody has made a major purchase. It could be that American financial institutions are concentrating on problems at home.

Capital standards are country specific at this stage of the game. Risk-based capital standards are further advanced in Canada than in the U.S., but that obviously is changing very quickly. The Canadians arrived at somewhat different standards than those being discussed in the U.S.

**PROSPECTS FOR NAFTA'S PASSAGE**

So what are the prospects for NAFTA? First of all, you have to understand that NAFTA is being adopted on a fast-track approach. The fast-track approach was chosen by both Mexico and Canada because it means that the treaty cannot be amended in Congress. We have a long history in Canada and I'm sure Mexico does, too, of negotiating treaties and then submitting them through Congress, and watching things keep getting added on, the Christmas tree ornament effect. The fast-track approach basically means it cannot be amended. It can only be voted up or down, yes or no, and I would expect that both Mexico and Canada will wait to see what happens in the U.S. Congress before they take any ratification steps themselves.

**NAFTA PROVISIONS RELATING TO PROFESSIONAL MOBILITY**

In the area of professional mobility, there have been major changes between the Canada/U.S. Free Trade Agreement and NAFTA. First of all, there's a new category for business visitors. Business visitors can move across borders to transact their business provided that their business is international in scope and that they do not intend to change their residence. They must, in order to be qualified as a temporary business visitor, give assurance that their residence will remain outside the country and that their primary renumeration will be received outside the country as well. That means, in effect, that a Canadian can come down to the U.S. and consult to a Canadian company operating in the U.S. and be paid from Canada. One of the benefits to business visitors is that they can bring in their equipment duty-free. Up until now, if you tried to bring computers or publications across the border, it was difficult.

There has also been a fairly extensive expansion of the opportunities for professional mobility. There is a list of covered professions provided in the agreement but actuaries are not on the list. It's surprising who is on the list. For example, landscape architects, land surveyors and interior designers are on the list.

There is an obligation under NAFTA for professions to develop mutually acceptable professional standards and criteria. Also, the professions must develop licensing, which is objective and transparent and cannot include, after the first two years, any requirement for citizenship. Furthermore, there's an immediate provision that professionals conducting business seminars or training seminars can basically pass freely across borders. Another new provision is that professionals who are allowed temporary entry to another country have the possibility of having their spouses come with them.

Part of the difficulty under NAFTA is the same issue that we faced between the Canadian and the U.S. professions, deciding with whom we negotiate in terms of the Mexican actuarial profession. Obviously, the Mexicans have the Colegio Nacional de Actuarios. They also have several other professional organizations. The answer, of course, is that the Mexicans themselves have to decide who represents the Mexican actuarial profession in terms of negotiating the standards. However, some steps have been taken already as a result of the initiation of NAFTA. The Mexican National Actuarial Organization has been invited to attend the Council of Presidents meetings as observers, and we've invited them to join the Work Agreement Task Force, which is essentially the coordinating bodies for the Presidents-Elect of the actuarial profession, as full representatives. Therefore, in terms of setting the agenda for the next year or two, we have decided that the Mexican actuarial organizations should be invited to be full participants with the Canadian and U.S. organizations. We hope that very shortly we will arrive at a methodology for building upon the Canada/U.S. reciprocal professional arrangements to incorporate the Mexicans.

**NAFTA PROVISIONS RELATING TO FINANCIAL INSTITUTIONS**

On the financial service institution side, there has once again been a substantial extension of the Canada/U.S. Free Trade Agreement. First of all, there's a commitment in the treaty for all financial service industries to have full access to each other's markets over time. However, it's recognized that the markets are less developed in Mexico; and while there is full access given immediately to Canada and the U.S., there is a phasing in of access to the Mexican market. Immediately upon signing the treaty, Canadian insurers and banks and American insurers and banks will be able to establish joint venture operations in Mexico and will have the opportunity to offer cross-border sales. That is, those companies located along the border will have some opportunity to sell across the border. One would expect, for example, that Mexican financial institutions might try to penetrate the Hispanic market in the southwest. However, foreign market shares in the banking and insurance industry in Mexico will be limited through the year 2000, at which time there is a commitment to have further negotiations on or before January 1, 2000 with respect to phasing out these market share limitations. At the very latest, the market share limitations in Mexico must be phased out by 2007. So, an American or Canadian financial institution can go in and establish joint venture operations in Mexico now, but the ability of these foreign companies to capture a large share of the Mexican market is going to be limited for the rest of the century.

NAFTA also provides for the establishment of a financial services committee which will have consultations with respect to standards and rules for financial institutions. This is a new provision. It provides for coordination of the regulatory authorities in the three countries. Also for the first time, there is a dispute settlement mechanism with respect to trade disputes including financial services. Unlike the previous dispute settlement mechanism, which basically only included lawyers and jurists, the financial sector dispute settlement mechanism will be drawn from a panel of 15 people from each country serving three years who are financial services experts. Furthermore, there is also a specific provision that in the case of disputes involving the financial services sector, each country cannot retaliate outside the financial services sector. That is, should there be a dispute between Canada and Mexico with respect to financial services, Canada cannot block the importation of tequila; it can only block something in the financial services sector. This limitation does not normally apply in NAFTA.

There are two other important concessions which actually were given by the U.S. that are important. The first is that, if and when the U.S. liberalizes its own financial services structure, for example to allow national banking, Canadian and Mexican financial institutions will automatically get the benefit of those liberalizations. No other countries in the world are guaranteed this treatment. This was very important from both the Canadian and Mexican perspective.

Second, there is also a provision that states that the financial services sector will receive "most favored nation" status. You might ask what that means and why it's important. Both Canada and the U.S. saw the impending possibility of a trade war between the European Economic Community (EEC) and the North Americans. The EEC has been trying to get specific concessions with respect to the financial services sector in the U.S. What the treaty says is all three countries must be treated as favorably as anyone else. So, any restrictions or any concessions that the French, the British or the EEC negotiates with the U.S. must automatically be extended to Canada and Mexico.

MR. CAMILO J. SALAZAR: My presentation will concentrate on two main areas:

1. the significance of NAFTA as it relates to new opportunities for U.S. insurance companies in Mexico, and
2. the significance of NAFTA for U.S. insurance companies beyond Mexico into the rest of Latin America.

**THE MARKET POTENTIAL IN MEXICO**

Before we talk about the significance of NAFTA, we should spend some time exploring why Mexico should be considered an important market with or without the benefits of a free trade agreement.

Let's take a look at some basic numbers to try to develop an overall definition of the life insurance market potential in Mexico. Mexico represents a market of 86 million potential consumers. Forty-nine percent of the Mexican population is under age 20, while only 6% is over age 60. That compares with 28% and 16%, respectively, for the U.S. Mexico's population is expected to grow to 120 million by the year 2010, with an annual growth rate of over 2%.

Approximately 40 million people in Mexico are 20-60 years old, the typical age range of life insurance buyers. This compares with 140 million people in this age range in the U.S. Of these 40 million potential buyers, approximately 50% live at or below the poverty level and cannot afford life insurance. Twenty percent (or about 8 million people) comprise the upper-income economic level. Therefore, the potential number of consumers in the Mexican marketplace for life insurance is somewhere between 8-20 million people.

In general, the Mexican insurance industry is underdeveloped by international standards. The ratio of total insurance premium to gross domestic product (GDP) stands around 1%, whereas this ratio is at least 4-5% in developed countries.

Only 1.5 million people in Mexico own individual life insurance, even though as we saw, the viable market is somewhere between 8-20 million people. Thus, the level of saturation of the market is about 10%. Altogether, it is estimated that only 7% of the Mexican working population has life insurance today.

The insurance industry is growing faster than the economy as a whole. Life insurance premiums have grown over 30% per year in the last three years. The 1991 total life premium stood at $1.3 billion; a 37% increase over 1990.

From these numbers, it is clear that the life insurance market in Mexico represents a significant opportunity for U.S. companies considering participating in this market. NAFTA will not only provide the channel for such an entry, but it is expected to generate significant economic growth that will, in turn, expand the life insurance market.

With the implementation of NAFTA, U.S. companies will gain greater access to 86 million Mexican consumers. The successful long-term growth of the life insurance market in Mexico will largely depend on the economic expansion of the manufacturing and industrial base of the country. As happened in Asian countries, as the national economy grows, the middle class grows and begins to have the monetary means to insure its newly acquired wealth.

The necessary ingredients for such an expansion are currently present in Mexico: low labor costs; a large, competent work force; an abundant energy supply; and the potential for the free flow of investment capital provided by NAFTA.

Such prospects for growth, within the context of the free trade agreement, represent opportunities for the U.S. life insurance industry that were previously closed to all but a few outside participants. NAFTA addresses issues directly related to Canadian and U.S. insurance companies including joint-ventures, branches, subsidiaries, mergers, reinsurance, and eventual 100% foreign ownership.

**NAFTA PROVISIONS RELATING TO INSURANCE IN MEXICO**
Specifically, the agreement signed in late August provides for Canadian and U.S. companies, which already have an ownership stake in Mexican insurance companies, to be able to obtain up to 100% ownership by January 1, 1996 – up from the 49% limitation currently in place.

Newcomers to the Mexican market via joint ventures will face ownership limitations, beginning with a 30% ceiling in 1994 and increasing gradually to a 51% limit by January 1, 1998 and 100% after January 1, 2000. Market share restrictions will not apply to joint ventures.

Alternatively, U.S. and Canadian insurers can establish wholly owned subsidiaries immediately, but these will be subject to an aggregate market share limit of 6% through January 1, 1994 and gradually rising to 12% by January 1, 1999. Individually, each subsidiary will be limited to a 1.5% market share. All limits are removed on January 1, 2000.

The agreement also allows intermediary and auxiliary insurance service companies to set up subsidiaries with no limits on ownership or market share, although approval from the Mexican government is required for any acquisition with a purchase price in excess of $25 million. This limit will gradually increase over 10 years to $150 million, at which time it will be eliminated altogether.

Mexico and the Mexican consumer will benefit from the increased market activity, the more contemporary products, marketing and distribution methods, and services that Canadian and U.S. life insurance companies will bring under NAFTA.

Entrance into the Mexican market, however, should be viewed as a long-term investment. The number of Mexicans entering the work force will almost certainly surpass the number of available jobs, even with the free trade agreement. For Mexico's general population, the economic benefits under the free trade agreement will come slowly and, because of the relatively high population growth, these benefits may not be reflected in per capita numbers until well into the 21st century.

The economic benefits of the free trade agreement will concentrate in the industrialized areas of Mexico City, Monterrey, Guadalajara and along the U.S. border, in the "maquiladora" zone. The activity generated in these areas will provide an effective environment for developing agency forces that can capitalize on the expansion of the manufacturing labor base, which is likely to broaden the marketplace for individual life insurance products, particularly for middle and upper income groups.

The U.S. Department of Commerce estimates that Mexico's individual life production will benefit the most from NAFTA. The Department predicts that individual life premiums are likely to double over 1991 levels by 1995; group life premiums are estimated to grow similarly. These increments will come primarily as a result of new products, more efficient distribution, and marketing and administration methods introduced by the new foreign players.

Future premium growth will be facilitated by Mexico's more flexible regulatory stand relating to new product approval and solvency requirements. The development of more sophisticated products, perhaps with tax advantages, will also accelerate this growth under NAFTA. Ultimately, sustained market growth will be provided by the general economic expansion expected under the free trade agreement.

**THE LIFE INSURANCE INDUSTRY IN MEXICO**

The life insurance industry in Mexico operates with two major distribution systems: agents and independent brokers. Agents work exclusively for one company, selling primarily individual life products. These agents are a cross between captive and independent agents. Approximately 65% of new premiums are concentrated in the 25-44 age group.

Independent brokers primarily sell commercial products. Distribution costs for individual life insurance are high, due to a low premium per policy of about $300, a high first year commission of about 60% and dismal persistency both for agency and policy retention.

Persistency is a serious problem in the ordinary life market in Mexico. For 1991, the five largest companies writing ordinary business in Mexico reported first year premiums of $198 million versus $310 million in renewal premiums. Seguros Monterrey, for example, with the largest volume of ordinary business, reported $86 million of first year premiums and $91 million in renewal premiums.

Although you would expect to find large and profitable portfolios of individual policies, for the large and established companies, the renewal block of business is about equal to the first year business. This is due to two problems: the devaluation years of the 1980s seriously eroded the renewal portfolios of the industry and as an indirect result of the inflationary pressures, a significant portion of the business has had a tendency to "rotate" from company-to-company from year-to-year. This generates first year commissions' every year and leaves the companies with significant sunk costs.

This situation has made it impossible for the carriers to achieve profitability in the ordinary line of business. These market problems will have to be addressed by newcomers with better training, products, and administrative controls of the distribution outlets.

**THE SITUATION IN OTHER LATIN AMERICAN COMPANIES**

The general perception in the U.S. is that Latin America is a vast and underdeveloped land that starts and ends with Mexico. In the business community this perception, although starting to change, is not much different. At the same time that NAFTA has helped focus attention on Latin America, it has tended to reinforce the perception that Latin America starts and ends in Mexico.

Latin America, as a whole, is in the midst of the most dramatic and economic restructuring of the last 50 years. With varying speed, governments are privatizing state-owned industries, lifting import tariffs, removing currency controls, and opening their economies to foreign investment. The capital infusion that these changes are producing, particularly the privatization of state-owned industries, has already contributed to end the decade-old debt crisis in much of the region.

NAFTA is seen by many as the first step to a hemispheric trade zone that would eventually run from the Yukon to Patagonia, the southern tip of Argentina. To that end, the agreement contains an accession clause that would allow for other countries, or groups of countries, to be admitted into the treaty with the unanimous consent of Canada, Mexico, and the U.S.

In that context, U.S. and Canadian companies should not ignore the added potential that the opening of the Mexican insurance market under the free trade agreement will provide further down the road in the rest of Latin America.

Argentina, Brazil, Chile, Colombia, and Venezuela alone represent an additional market of over 250 million people that, if integrated with the NAFTA members, could create a total market of over 600 million consumers.

Mexico and Argentina are at the forefront of economic change and opportunities in Latin America. As other countries in the region speed up their own pace of economic reform, the region as a whole will provide unmatched opportunities for growth.

President Bush has already promised Chile that it will be the first nation to accede to NAFTA and it is expected that these negotiations will begin even before the free trade agreement is voted on, sometime next year. Chile has already signed a trade agreement with Mexico that could provide the basis for joining NAFTA.

Brazil, Argentina, Paraguay, Uruguay, and Bolivia are in the process of implementing their own free trade agreement, referred to as MERCOSUR. This trading block of nations could eventually represent the group of countries that, by joining NAFTA, would create a truly hemispheric trading zone.

Brazil, the largest country in Latin America, cannot ignore the economic challenge that the North American Free Trade Agreement poses to its own economy. NAFTA countries currently import 25-30% of Brazil's total exports, usually goods to which relatively high tariffs apply. Under the free trade agreement, Brazil's Mexican competitors in a range of sectors will gain a significant advantage in the U.S. market.

Although the importance of the U.S. as a destination for Brazilian exports has declined in the last 20 years, it still remains the country's largest market. If Brazilian exports to the NAFTA countries are substantially reduced, Brazil would have great difficulty in trying to offset this situation with increased sales to MERCOSUR countries and Western Europe. Ultimately, Brazil will aim to accede to NAFTA.

In the rest of the hemisphere, and in particular the Caribbean region, the concern is that the free trade agreement might represent a conflict with their own trade arrangements with the U.S. under the Caribbean Basin Initiative. Caribbean nations fear loss of preferential market access to the U.S. for several categories of products established under this Initiative in 1984. They will try to determine now how the Caribbean Economic Community (CARICOM) will be able to join NAFTA and become part of this free trade zone under the accession conditions of the treaty.

It is too soon to attempt to determine how fast and to what extent NAFTA will evolve into a hemispheric free trade zone, but the initial reaction in the hemisphere points in that direction.

**OTHER BENEFITS WHICH MAY ARISE FROM NAFTA**

It is important to note that beyond the direct benefits that the free trade agreement will bring to U.S. companies that choose to enter the Mexican life insurance market, there are other indirect benefits that are worth mentioning.

By operating in Mexico, U.S. companies will develop valuable in-house expertise on how to manage an operation in a Latin American country. This expertise will be vital, not only to access and penetrate other markets in Latin America in the future, but to target the substantially large and fast growing Mexican-American and Hispanic community here in the U.S.

In particular, the large Mexican population resident in the U.S. has more discretionary income for purchases such as life insurance than does its counterpart in Mexico, and could be targeted by U.S. companies from their already established domestic base at a marginal cost. So the free trade agreement could not only bring potential growth and market opportunities to U.S. companies in Mexico, but could result in additional opportunities for growth right here at home in the U.S.

MR. SEGUNDO TASCON: In recent years I do not recall a more controversial subject in Mexico. You find either fervent proponents or opponents of the agreement; no one seems indifferent. It indicates that NAFTA has already had a definite impact within

Mexico. The marketplace in general has placed a lot of emphasis on becoming more competitive, moving ahead technologically, increasing our business, and making strategic alliances. People strongly believe that in order to get the most out of NAFTA, "equalization" seems to be the key issue, since in every field only those who attain technological sophistication will be able to cope with NAFTA.

As a pension actuary who has been deeply involved in actuarial education in Mexico, I will focus my presentation on two major issues on which NAFTA will have an impact:

1. The academic preparation of the pension actuary, and
2. The recent history of the pension and benefit plans environment in Mexico, including recent trends and the potential impact of NAFTA.

**EVOLUTION OF THE MEXICAN ACTUARIAL PROFESSION**

The actuarial profession in Mexico is in its infancy as compared with countries like Great Britain and the U.S. Like most countries, it had its origin in the insurance industry. The first actuarial work ever performed on a regular basis in Mexico occurred at the beginning of this century when an insurance company hired the British actuary Frederick Williams. Mr. Williams founded the first actuarial association, The Mexican Institute of Actuaries, in 1937. The Mexican Institute of Actuaries' basic goals were to promote actuarial investigation and to train new actuaries. The Mexican Institute of Actuaries to a very great extent defined the role of the profession in Mexico. Since its founding, the actuarial profession's reputation has grown. However, official recognition of the actuarial profession in Mexico began in 1946 with the enactment of the General Law of Professions in Practice. The first graduates occupied prominent positions in insurance companies and, as a result, the actuary was quickly considered a highly respectable professional.

Interestingly enough, the most important distinctive characteristic of Mexican actuaries, as compared to actuaries in other parts of the world, is their widespread field of activities. A number of factors led to such diversification. Different types of industries other than insurance realized their importance, given their strong mathematical background. Also, the small size of the insurance industry made it less rewarding for later graduates and motivated actuaries to seek other fields of activities.

In Mexico, the process for becoming a qualified actuary consists of university courses concentrated in advanced mathematical courses, statistics, probability, life contingencies, and theory of interest. Upon fulfillment of the academic requirements, the government grants a license that entitles the actuaries to sign official documents. This is in contrast to the actuarial examination process in the U.S. and Canada.

Currently, there are three actuarial organizations in Mexico. The Colegio Nacional de Actuarios is the official organization embodying all Mexican actuaries. The other two organizations embody insurance and benefit plans practitioners; both of these organizations are more like actuarial clubs rather than official organizations.

**BACKGROUND OF PENSION PLANS AND PENSION ACTUARIES**

Mexican pension plans began in the 1950s. The foundation of the pension plans was in the Labor Code since it prevents an employee from being dismissed without the payment of a termination indemnity equivalent to 3 months' salary plus 20 days salary per year of service. Importantly, old age is not regarded as a just cause of dismissal. Consequently, in Mexico, all companies have a retirement obligation regardless of whether or not they have implemented a formal pension plan. As a result, pension plan benefit formulas were designed to duplicate the termination indemnity requirements.

However, there have also been important tax advantages in implementing a pension plan. These include:

- Pensions are taxable only on the portion of the benefit that exceeds nine times the monthly minimum wage. Termination indemnities on the other hand are taxable in full with somewhat favored treatment.

- Employers may elect to receive a current tax deduction on contributions to the pension plan if the plan is financed through an irrevocable trust fund. Contributions to the fund must be actuarially determined using any of the generally accepted actuarial cost methods and using any set of reasonable actuarial assumptions. A point worth noting is that companies can decide the amount of the contribution from zero up to the maximum amount determined through the actuarial valuation. This means that currently in Mexico there are neither minimum nor maximum funding limits like those imposed by ERISA and the IRS. Moreover, it is not necessary for a pension plan to be funded for an employee to receive the tax deduction on his benefit payment.

The evolution of the pension market can be summarized as follows:

- Insurance brokers were operating for many years before the first pension plans were implemented. They perceived the pension plan business as an obvious extension of their activities, forgetting or possibly not understanding the conflict of interest of being advisors at the same time as drawing commissions. This situation has been generally viewed as an advantage rather than a conflict of interest. For many years, pension actuaries were directly linked to the insurance brokers and only a handful were independent or worked for consulting firms.

- Pension advisors quickly found the universal answer to the pension plan design question. The pension plan was established with a benefit formula which had a cash value equivalent to the termination indemnity at retirement. The remainder of the plan's design and actuarial assumptions were merely copied from the U.S.

- Surprisingly, actuarial assumptions have remained unchanged for many years, despite the tremendous changes in the economic environment in Mexico on the basis that the spread between the rate of interest and the rate of salary increases was really important. Some observers were concerned and confused about the actuary's work. Similarly, for many years pension plan design remained static with only slight changes, such as the practice of offering the pension in a lump sum due to the high inflation environment. Surveys conducted in the past indicated that the great majority of the companies (especially multinationals) offering a pension plan, perhaps due to the pressure of competitive practice, had a benefit formula equivalent to the termination indemnity.

- Companies with retirees realized that pension plans were not fulfilling their basic purpose of providing an adequate retirement benefit. Rather, they forced employees either to become entrepreneurs or look for a different job after retirement. There is a strong tendency among retirees to squander their lump sums because of their lack of financial education and, more importantly, because the rates of return available for individual investors are lower than those available for pension funds.

- The trend toward modifying or adapting retirement plans to meet the specific requirements of a company started when the leading companies decided to break with market practice. Never before have companies and employees been so concerned about their retirement program. Developments that have made pension plans an important priority include:

  1. the U.S. SFAS 87 GAAP Accounting Standard,
  2. the new Mexican mandatory defined-contribution plan,
  3. the new Mexican accounting standard which will become effective January 1, 1993,
  4. an unprecedented increase in retirements that have taken place and,
  5. all the publicity regarding the potential of NAFTA.

- The new mandatory defined-contribution plan named SAR, effective May 1, 1992, aims to provide retirement income to all employees affiliated with the Social Security plan in Mexico. This mandatory savings program will not replace the existing Social Security arrangement, but will be in addition to it. The system has as a major objective the generation of internal Mexican savings, which will create available financial resources to be invested in long-term projects.

## SUMMARY OF SAR'S KEY FEATURES

### Level of Contributions

The employer is obligated to make bimonthly contributions equivalent to 2% of the Social Security covered pay, but subject to a cap of 25 times the Federal District monthly minimum wage (approximately U.S. $130), instead of the 10 times cap for Social Security.

### Administration

Banks will receive the contributions and administer the funds through the establishment of individual accounts. Banks will also be required to provide acknowledgment of receipt of company contributions to each employee covered by the program. In addition, banks are mandated to issue annual statements to each covered employee showing a detailed description of contributions plus interest earned.

### Investment

Employees may elect to invest in either the Central Bank (Banco de Mexico) or with a financial institution. If invested with the Central Bank, there is a guaranteed annual rate of interest of at least 2% (net of inflation), payable monthly. When invested with a financial institution, guarantees will not be applicable.

**Implications for Company Sponsored Plans**
If the company provides a benefit equivalent to the termination indemnity, there may not be much impact. However, if the company plan is designed to provide a more generous benefit, then it should be integrated with this new SAR benefit. Furthermore, a funded plan with a surplus can use the surplus to provide the 2% contribution.

The new Mexican accounting standard will be quite similar to the U.S. SFAS 87. For all practical purposes, prior to this accounting standard, there was no obligation for companies to disclose pension plan liabilities.

**IMPACT OF NAFTA ON THE PENSION ACTUARY'S ACADEMIC PREPARATION**
Before the NAFTA negotiations started there was considerable concern over how to improve the academic preparation of the actuary in Mexico. The Universidad Anáhuac became an examination center three years ago and started preparing candidates to take exams from the Society of Actuaries. The results so far have been very impressive, with most of the candidates passing the exams with good grades.

NAFTA will place certain obligations on the actuarial profession in Mexico just as in the U.S. and Canada. In general terms we were speaking about equalization in every respect. The Colegio Nacional de Actuarios has worked intensively trying to develop an action plan that equates the actuarial profession within the three countries.

It is fair to say that relationships with American actuaries have always existed, as a matter of fact most American consulting firms have an affiliated operation in Mexico and many insurance companies have representatives. It is not uncommon for many American actuaries to have performed actuarial services in Mexico just as many Mexican actuaries have gone to the U.S. for assignments.

In speaking about equalization, too much attention has been paid to the actuarial certifications required in each country. I believe it is far more important to be able to say that the actuarial profession in the three countries is based on the same theoretical foundation. Certification of actuarial reports should be treated as a completely different issue. The key point is that the academic preparation should be the same and only the legal examinations and practice requirements should be different to be qualified as a certified actuary in each country. This situation would be quite different than the present situation. Now, if a Mexican actuary desires to work in the U.S., none of his current credentials are accepted. Therefore, he is required to write actuarial exams to gain his credentials. The same situation applies for an American actuary coming to Mexico.

I believe that in the education arena, NAFTA will seriously motivate a reconstruction of the Mexican academic preparation to include actuarial exams in addition to the university courses. Mexican actuarial students will continue writing actuarial examinations to the point that those exams will gain professional recognition. As an ideal goal, I would like to see an equalization of the education of actuaries among the three countries. There are two different goals: education of actuaries and professional conduct. Steps have already been taken on both due to NAFTA.

**IMPACT OF NAFTA ON BENEFIT AND PENSION PLANS**

In the Mexican business community, there is a general consensus that a key impact of NAFTA will be to lead us to become much more efficient. The major concern is how to improve efficiency and become competitive against U.S. and Canadian companies. The first step taken by many large Mexican companies has been to establish programs to reduce staffing levels. With such programs, they are hoping to attain a significant improvement in pricing competitiveness. However, they realize that the implementation of such programs will not be enough. To be in a competitive position, sophisticated technology as well as highly trained employees are essential ingredients. Pensions and benefit programs are seen as playing a key role in achieving this objective. Employers see their pension plans as an important tool to promote replacement of older employees and attract and retain skillful younger employees.

The new Mexican accounting standard to reflect and appropriately fund pension plan liabilities has raised a lot of interest and concern among companies. Since many large Mexican companies listed in the Mexican stock market have not appropriately recognized their pension liabilities, their stock price may be affected due to the application of the new accounting standard.

There has been a lot of activity relating to pensions, benefits, actuaries, and NAFTA in Mexico, and there will be much more in the years to come. The Mexican actuarial profession looks forward to working with actuaries in the U.S. and Canada in order to meet the obligations of the profession under NAFTA in a way that is best for all of us.

MS. OLIVA SANCHEZ-GARCIA: There are two main differences between actuaries in Mexico and in Canada or the U.S. The first relates to the education and certification system, and the second relates to the diversified practice that actuaries have developed in Mexico.

**ACTUARIAL EDUCATION IN MEXICO**

In order to become an actuary in Mexico, an individual must obtain a degree from an officially recognized Mexican university. This degree is then certified by the Ministry of Education who grants a professional certification which is required to sign any official document legally requiring the signature of an actuary.

There are seven undergraduate programs in actuarial science. Five within Mexico City, one in the city of Puebla, and the other one in Guadalajara. Since 1946 they have produced more than 1,800 certified actuaries and about 7,000 individuals who have fulfilled all their education requirements but have not yet been fully certified as actuaries.

To become an actuary, a student enrolled in one of the universities must undertake a four year program consisting of 38-49 courses, depending on the school. The academic programs in the seven universities are quite similar. They are intensive in pure and applied mathematics, statistics and actuarial science. In all cases, a student also takes courses in different areas, such as finance, economics, administration, accounting, demography and computer sciences. In some cases, there are also a number of general courses which cover areas such as philosophy, sociology, and professional ethics.

However, the program is focused on the education of specialists; therefore, it leaves little room for nonactuarial subjects. Besides taking these courses, a student must learn at least one foreign language and complete 480 hours of socially valuable work in a six-month period. After completing these requirements, a student has to write a dissertation, defend the dissertation in front of an examination committee and swear in public to uphold the code of ethics of the profession.

The quality of undergraduate programs in actuarial science in Mexico is high compared to other undergraduate majors; however, it is not uniform among the schools. For the last four years, the Colegio Nacional de Actuarios has been working closely with the seven universities to agree on common contents and standards for most of the subjects.

If we compare our programs with the educational curriculum of the SOA, we see that 50-60% of the courses account for about 175 of the 200 credits of the SOA requirements at the Associate level. The rest of the Mexican curriculum covers material which corresponds to requirements at the Fellowship level, such as legislation, theory of insurance and pensions, asset management, corporate finance and other general subjects such as economics, accounting, and ethics.

Starting last year, ITAM offers a one-year graduate program in insurance and Universidad Anáhuac offers a two-year Master's Degree in Actuarial Science. These programs cover some of the other topics included in the SOA requirements. In 1990, the Universidad Anáhuac began to encourage students to take the SOA exams and has been organizing workshops to prepare students to take them. The workshops are independent of the regular academic workload and thus require an additional time commitment from the students. Students submit to exams strictly on a voluntary basis; there are no rewards – academic or otherwise. The results have been very encouraging and give some indication of the level and contents of our courses.

## DIVERSITY OF PRACTICE OF ACTUARIES IN MEXICO

The diversity of interests among Mexican actuaries can be seen by the different professional areas they choose. While most enter the work force after college, some feel the need to pursue graduate education in different fields such as finance, demography, statistics, and actuarial science both in Mexico and abroad.

## PROFESSIONAL ISSUES ARISING FROM NAFTA

With the coming of NAFTA, we should start to learn how the profession operates in each country. It is important to realize that Mexico has a different professional tradition. For example, the Napoleonic tradition in Mexico requires an academic degree for the profession and supervision by a Civil Authority. Hence, final negotiations about our profession will have to recognize these differences and include all the various associations. In any case, there are many different issues that need to be addressed.

It would be convenient to have a common educational core between the university studies in Mexico and the Associate examinations, while still recognizing the unique practices and codes of conduct of the professions in each of the different countries.

We realize that an actuary in Mexico should be as qualified as an actuary in the U.S. and Canada; hence, we are very interested in learning and in establishing joint mechanisms for training and continuing education. A task force or committee with members from each of the three countries should be formed to deal with the professional practice issues as they arise.

We are entering a new phase, a very challenging one and we Mexican actuaries hope it will be very productive for all of us.

MR. MCCROSSAN: I will wrap up the discussion of the outstanding professional issues, with comments on three main issues.

**RECOGNITION OF THE ACTUARIAL PROFESSION**

The first issue relates to what has to be done to get actuaries recognized as a profession to the mutual satisfaction of the practicing professionals in each country. To accomplish this, we will need to go through a process similar to, but not necessarily the same, as was done for the Canada/U.S. Free Trade Agreement. I think most people believe we should have a code of common conduct, but not necessarily the code of common conduct that we have developed so far.

These conclusions suggest two items need to be done. First, we need to review what has been done so far in developing a common code of conduct between Canada and the U.S., and then look at its applicability in Mexico. Indeed, the Mexican actuaries themselves have a code of conduct and we need to look at what it has to offer us.

The second item to be examined relates to education. Mexico has a university-based education system with a requirement for a dissertation and an oral defense of the dissertation. That is quite a different basis of education than actuaries have had in Canada and the U.S. We are going to have to decide how to reconcile these two systems. There is no doubt in my mind that the Mexican actuaries are actuaries in every sense of the word and meet the tests that we would use to describe ourselves. But they have a different educational system and we have to make sure that the end result of our work is satisfactory to everyone.

Accreditation for full licensing is an interesting issue. We are well on the way to submitting the profession for addition to the Canada/U.S. Free Trade Agreement. My feeling is, and this may come as a bit of a shock, that it may be easier to negotiate reciprocal accreditation between Canada and Mexico than between the U.S. and either Canada or Mexico. This is because there is currently a strong licensing and accreditation system present for actuaries in both Canada and Mexico. The U.S. profession has not succeeded in unifying itself and in getting the accreditation in the life insurance and the property/casualty insurance arena to the same extent. This may create difficulties in terms of actually including the U.S. as part of the reciprocal package.

**EXPANDING NAFTA TO INCLUDE OTHER COUNTRIES**

The second main issue relates to the expendability of NAFTA. As was mentioned, NAFTA is an open-ended treaty. The three original countries have a veto on new entrants, but essentially any new entrants that apply can join if they accept the terms of the treaty. That means that whatever we decide not only has to work among Canada, Mexico, and the U.S., but it has to be capable of expansion into Chile, Argentina, Brazil, and the common market that's developing down in South America. Also, Australia and New Zealand have indicated some interest in joining NAFTA. So we not only have to set up a model that covers our three specific situations, we have to design a model which covers a much broader universe of possibilities.

**DEALING WITH THE PROBLEM OF THE AGING POPULATION**

The third main issue is that actuaries in all three countries are going to have to decide to what extent they, as professionals, will try to lead governments through the most difficult sociological problems that they face -- that is the problem of an aging population. Knowing the raging debates in the U.S. over the financing and benefit levels of Social Security and in Canada over whether we can afford Medicare, it's interesting how the debate over the shift in the population is assuming alarming proportions in Mexico. A social infrastructure based upon the existing demographics has developed in Mexico and, as young as the Mexican society is, its population ratios are shifting just as rapidly as ours -- just not to the same level. I think the professions in the three countries have a lot to offer and can learn from each other in this area, because this is a worldwide problem and one where NAFTA and the professional cooperation it will generate can offer something to each country.

MR. COLLETT: Ms. Sanchez-Garcia, maybe I can ask you two questions. You indicated that there were about 7,000 university graduates in actuarial science and about 1,800 certified actuaries. Why the big difference in these numbers? Are those people just in the pipeline or do many people have an actuarial education and no intention of becoming certified?

MS. SANCHEZ-GARCIA: In addition to their course work, the students must prepare a thesis and then defend it in front of a committee. It is a difficult process and obviously not everyone is completing it. We have been looking for other processes for certification, such as graduate studies and a final written and oral examination. Perhaps these might help to increase the percentage of graduates achieving certification.

MR. COLLETT: My second question was, do you know the breakdown of actuaries by area of practice?

MS. SANCHEZ-GARCIA: No, I don't have that. In Mexico, there are a lot of actuaries who go into nontraditional areas such as banking and industry. Also, many wind up working in statistics, marketing, demography, and computer science. In the 1960s, a lot of actuaries in Mexico started going into different fields. Perhaps the saturation level was reached in insurance companies and they started looking for different alternatives.

FROM THE FLOOR: Could the panel speak about the level of actuarial education and professional standards in some of the other Latin American countries?

MR. SALAZAR: I think Mexico is by far the most developed country in Latin America in terms of certification of actuaries or actuarial programs. My experience in other countries in Latin America is that, for the most part, you can count those that call themselves actuaries on the fingers of one hand. Most of these have been trained in actuarial careers either in the U.S., Mexico, or perhaps Spain. There really is not any indigenous program, for the most part, in the rest of Latin America.

MR. WILLIAM J. BUGG, JR.: We've had some comments regarding the potential for life insurance. What about the situation for health insurance in Mexico? Does Mexico have a national health program?

MR. TASCON: There is a national health program in Mexico. The Social Security program, besides providing retirement pensions, also includes medical and hospital services. It covers all workers.

MR. MCCROSSAN: There is some private health insurance that co-exists with the national program. Many Mexicans, who can afford it, often go to the U.S. for treatment.

FROM THE FLOOR: In Mexico, have they developed standard mortality and morbidity tables?

MR. TASCON: Several mortality tables have been developed. One is based upon the experience of insurance companies and the others are from the Social Security system. To value pension plans, however, American mortality tables such as the UP84 table are used.

MR. DAVID S. DUNCAN: How many insurance companies are currently licensed or operating in Mexico? What are the type of life insurance products that are marketed in Mexico? And finally, is there any kind of annuity market?

MR. SALAZAR: I don't know the precise number of companies, but it is probably in the neighborhood of 60-80 companies. They are distributed in three basic tiers. The first tier consists of five very large companies. This includes one government-owned company that is very large and, I believe, handles a lot of the federal government employees. Then there is a tier of medium-sized companies which are much smaller than the upper tier in terms of size and premium volume. That's about 11 companies. And then there is everybody else.

The types of products in Mexico have been traditional whole life, endowment, and term products prior to the 1980 economic crisis and the 1982 devaluation of the peso. To try and address the issue of currency devaluation and inflation during the 1980s, companies mimicked universal life type products. Even though the universal life concept was never approved per se, they started putting together endowments, term products, and whole life products to create a universal life type product. For example, they used a one-year endowment as a means of updating coverage every year. That is generally where the market has been. It is expected that with the moderation of inflation and a period of economic stability, the market will return to more traditional products.

FROM THE FLOOR: What is the rate of inflation in Mexico this year? Under 15%?

MR. SALAZAR: Yes, around 13%.

MR. JAMES A. BRIERLEY: Paul, I was interested in your comments for cross-border selling between Mexico and the U.S. I wonder what the implications for cross-border selling would be under NAFTA between Canada and the U.S. Would this mean that a Canadian company could sell in all the U.S. border states without being licensed? Also, would a U.S. company licensed in a border state be able to sell in Canada without any regulation in Canada?

MR. MCCROSSAN: NAFTA provides for exemptions for existing legal restrictions. Since there are agreements prohibiting those situations right now with respect to Canada and the U.S., basically it's opted out initially. But there is an agreement that the whole area will be revisited, I think by 2000, to allow full cross-border shopping of the type that is being agreed to in the European Economic Community. So, I think the initial answer is, no, but it's scheduled to be addressed in the treaty.