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# Session 133PD
# Developments in Mexico

**Track:** International
**Key words:** International Insurance

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**Panelists:** MANUEL AGUILERA†
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*Summary: This session discusses recent developments in Mexico. In particular, the session will address:*

- *Peso devaluation*
  - *economic background*
  - *effect on insurance sector*
- *North American Free Trade Agreement (NAFTA) update*
  - *entry requirements for insurance companies*
  - *new companies and markets*
- *changing insurance market conditions*
- *update in privatization of social security scheme*

**Mr. John O. Nigh:** Javier Compean is the director general of Seguros Serfin, which is, for those of you who do not know, a member of the third largest financial group in Mexico. Our second presenter will be Manuel Aguilera. He's vice president of the Comisión Nacional de Seguros y Fianzas, which is the insurance commissioner's office in Mexico. If you want to do anything with insurance in Mexico, you have to go through Manuel. Ignacio Gurza de Cons is with Tillinghast in Mexico.

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He's often referred to as our ambassador to Mexico. I am John Nigh. I am the practice leader for Tillinghast's Latin American operations.

**Mr. Javier Compean Amescua:** I will try to give you another view of the Mexican market. First, I will give you some historical and current insurance market analysis, the financial and insurance market reforms that have been happening in the last few years, then I'll talk about examples of emerging markets, and end with some conclusions.

First, in Mexico there have been many things happening over the past few years. These things are related to the revelation of the true economic situation, privatization of the economical infrastructure of the country, modernization of the financial sector, as well as the legal and judicial systems, and encouragement for direct foreign investments.

In Mexico, the insurance industry was historically handled with price controls and product. Everything we did we had to go to the National Commission of Insurance for permission. Capital was fixed for companies by line of business. Foreign investment was restricted, as was the granting of licenses to create new businesses.

The Mexican insurance market has a very small per capita income invested in insurance, low penetration rates, a high concentration of premiums in very few companies, a limited number of product offerings, and one main distribution method. By law all business had to be conducted through agents.

Total insurance premiums in Mexico in 1995 were about 23.7 billion pesos, which is about $3.7 billion. The devaluation in 1994 created a sharp drop in this level in dollars to about half of what it was in 1994. The penetration rate of the market in 1996, compared as a percent of gross domestic profit, is 1.48%. In 1994 it was 1.59%. The premiums invested in insurance are approximately $69 per capita. Penetration rates in Mexico are less than the Latin American countries of Argentina, Brazil, and Chile. When compared to Spain, Mexico is much lower. A significant difference between Mexico and Chile is that Chile already has the changes in the laws that Mexico is currently experiencing. Through these changes in the laws, markets develop very fast.

The premiums per capita, when compared against other countries, show wide variations. We have $74 in Argentina, $129 in Brazil, and $145 in Chile. There is quite a difference in how much money is spent on insurance in Mexico compared to other countries even where the economic situation is the same.

To give you some examples, less than 2% of the population have life insurance. Of the work force, about 4% have life insurance. The whole life market in Mexico is almost nonexistent. It is almost all temporary insurance issued to employees. There is no annuity market at all. Only about 4% of homeowners have insurance, and this is related more to prerequisites credit than people buying insurance on their own. Less than 20% of all vehicles in the whole country are insured.

To give you a better perspective of what is happening in Mexico, I will explain the key products that are working there.

**Life Insurance**
In Mexico it is mandatory to have life insurance related to mortgages and there are limited sales of whole life insurance. There is almost no variable and minimal universal life policies. Only 40% of the life market is individual life.

**Accident and Health**
This is a very limited market. The privatization of social security will change this drastically, but currently the accident and health market is only 9% of the whole market.

**Property and Casualty**
Car insurance is 26% of the whole market. We have no mandatory coverage in Mexico. There is an open rating system for pricing. Policies are priced only on motor car experience and do not take into account experience of the drivers. As I told you before, more of home owners insurance is related to loans. Approximately 90% of noncredit-related policies are packaged policies. There is small-to-medium-sized business, usually sold through packaged policies that include fire, theft, and business discontinuation.

This puts you in an undeveloped market where key products still have to be developed. We have to develop car insurance, life insurance, and all the key lines of business in Mexico. We still have to work a lot. Generally, the only developed market is the corporate market where companies have the same standards as any international corporate company. This is due to the entrance of heavy investment and the requirement that policies have benefits in Mexico, similar to the U.S. or Europe.

Following is the distribution of the premiums in the Mexican market. Life insurance is 34% and motor car insurance 26%. Other property and casualty, which is heavily influenced by corporate premiums, is 31%. Only five companies constitute almost 70% of the market. Of these, I might add that Asemex and Comercial America have already announced their merger, and they will probably be a single

company by the end of the year. Combined, they have a 40% market share. The market share of the industry seems concentrated in only a few companies.
Let's discuss some of the changes and what has gone on in the last few years. First of all, banks used to be property of the Mexican government. They were privatized beginning in 1990. There is a group life concept in the financial groups where you can sell insurance through banks in Mexico. We can now have foreign investment in our companies. The government has changed the rules of how the companies operate. Capital requirements are now related to the solvency margin system, not by line of business, similar to the system that is used in Europe.

- Product Development—Today you can develop your own products, only advising or giving information about your products to the National Commission of Insurance.

- Pricing—This depends more on the companies today. In the past pricing used to depend only on assumptions given by the National Commission of Insurance.

- Commissions—You can develop the way you want to pay commissions to your agents.

- Distribution—You can now develop new ways of selling the insurance in Mexico.

- Marketing—You have the freedom to do any sort of announcements or promotions for your products.

- Investments—There is a more flexible way of investing the reserves of the companies.

- Reinsurance—We can handle reinsurance the way you want. Before you had to put about 50% of the risks that you had in the Mexican market, and only catastrophic and accident risks could go to other markets.

We have 54 insurance companies in our country. Two of them are reinsurance companies. Of the remaining, 49 companies are privately owned and two belong to the government. Thirteen of the 54 insurance companies are now integrated to financial groups. Twenty-six companies, about half of the companies that are working in the market, have some sort of foreign relation or a partnership or are owned by a foreign investor.

Table 1 shows the names of the Mexican companies that are owned by foreign companies in Mexico, and the years in which these operations took place. In the last 24 months, a great deal of operations have been established. This is changing the picture of the market completely. As you can see, the names are very well known and are important names in the world of insurance.

TABLE 1
FINANCIAL AND INSURANCE MARKET REFORMS

| Company | Foreign Parent | Year | Market Share (%) |
|---|---|---|---|
| Allianz Mexico | Allianz | 94 | 0.9 |
| Anglomexicana de Seguros | Transocean Holding Corp. | 95 | 0.5 |
| Aseguradora Maya | American Bankers Insurance Group | 95 | — |
| Cica Seguros | Combined Insurance Co. of America | 95 | — |
| El Aguila, Cia de Seguros | Windsor Insurance Co. | 94 | — |
| ING Insurance Mexico | ING | 95 | — |
| Interamericana | AIG | 95 | 1.9 |
| Pioneer Salud, Vida y Seguridad | Pioneer Financial Services | 95 | — |
| Probursa | BBV International Investment Corp. | 94 | 0.7 |
| Reliance National de Mexico | Reliance Group | 94 | 0.4 |
| Skandia Vida | Skandia | 95 | — |
| Tokio Marine, Cia de Seguros | Tokio Fire & Marine | 94 | 0.2 |
| Zurich, Cia de Seguros | Zurich | 92 | 0.4 |
| Zurich Vida | Zurich | 94 | — |

Table 2 shows other foreign companies that have partnerships, but do not have control of the local Mexican insurance company. You can see the percentage of ownership, the year that this happened, and the market share of these companies. Again, as you can see, they are very well-known names in the international market. This has completely changed the picture in Mexico. Five years ago, we had only Mexican companies fully owned by Mexicans; today more than half of the market is in the hands of foreign companies, either partially or completely.

New markets are beginning to emerge in our system. I will give you two examples: Annuities and bank insurance. Those examples are difficult to explain only because the changes in the market are difficult to explain. Like companies that specialize in certain products, some companies will only go to certain types of clients or segments, and international companies may want to only serve their international clients, and so forth. Different ways of doing business are beginning to occur in Mexico.

TABLE 2
FINANCIAL & INSURANCE MARKET REFORMS
FOREIGN INVESTMENTS

| Company | Foreign Partner | Percentage | Year | Market Share (%) |
|---|---|---|---|---|
| Atlas | Winterthur | 30.0 | 94 | 1.5 |
| Banamex | Aegon | 49.0 | 95 | 0.7 |
| Cigna | Cigna | 49.0 | 90 | 0.7 |
| Chubb | Chubb | 30.0 | 91 | 0.2 |
| Genesis | Santander/Met Life | 49.0* | 92–93 | 1.9 |
| Geo New York Life | New York Life | 30.0 | 93 | 0.2 |
| Invermexico | Lincoln National | 49.0 | 96 | 0.2 |
| Monterrey Aetna | Aetna | 44.5 | 93 | 11.3 |
| Principal Internacional | Principal | 30.0 | 93 | — |
| Tepeyac | Mapfre | 49.0 | 91 | 3.3 |
| Territorial | AGF | 32.5 | 84 | 0.9 |
| Liberty | Liberty Mutual | 35.0 | 95 | — |

*Each has a 24.5% stake .

Let's talk about annuities first. The new social security law that was to be effective January 1, 1997, will instead be effective July 1, 1997. This has brought about specialized companies. The coverages provided by these companies are occupational risk pension, disability pension, and survivorship annuities. This will be handled completely by the private sector from July 1, 1997.

The occupational risk pension is a lifelong annuity. Disability must be the consequence of an accident or illness because of a work risk. This is complemented with a survivorship annuity. The base pension is indexed to inflation. Table 3 shows the number of cases we expect to have in the next four years. This is an estimate of the market measured by premiums.

TABLE 3
EMERGING MARKETS–ANNUITIES
OCCUPATIONAL RISK PENSION

| Market Size | | |
|---|---|---|
| **Year** | **Cases** | **Estimated Premiums (millions)** |
| 1997 | 1,540 | 385 |
| 1998 | 3,150 | 788 |
| 1999 | 15,630 | 3,908 |
| 2000 | 16,370 | 4,093 |

TABLE 4
EMERGING MARKETS—ANNUITIES
DISABILITY PENSION

| Market Size | | |
|---|---|---|
| **Year** | **Cases** | **Estimated Premiums (millions)** |
| 1997 | 9,240 | 1,848 |
| 1998 | 23,660 | 4,732 |
| 1999 | 24,940 | 4,988 |
| 2000 | 25,920 | 5,184 |

In case of permanent disability, the disability pension is a lifelong annuity complemented with a survivorship annuity, both of which are indexed to inflation. Table 4 shows the number of cases we expect to cover and the premiums we expect to have in this market.

Survivorship annuities are lifelong annuity benefits for the widow and orphans of the insured (Table 5). They are eventually used as a complement of the disability pension and all of this is indexed to inflation, too.

Table 6 is a comparison of this new market of annuities to the Mexican market today. This is the type of market that we expect to have in the next few years. It is the life market and the growth of the market that we expect through these annuities.

TABLE 5
EMERGING MARKETS–ANNUITIES
SURVIVORSHIP ANNUITIES

| Market Size | | |
|---|---|---|
| **Year** | **Cases** | **Estimated Premiums (millions)** |
| 1997 | 29,350 | 5,870 |
| 1998 | 29,650 | 5,930 |
| 1999 | 30,300 | 6,060 |
| 2000 | 31,300 | 6,260 |

TABLE 6
EMERGING MARKETS
ANNUITIES PREMIUMS VERSUS LIFE INSURANCE MARKETS

| Market Size | | | Market Comparison | | |
|---|---|---|---|---|---|
| **Year** | **Cases** | **Estimated Premiums (millions)** | **vs. Total Insurance Market** | **vs. Life Market** | **vs. Individual Life Market** |
| 1997 | 40,130 | 8,103 | 34.2% | 101.3% | 254.7% |
| 1998 | 56,460 | 11,450 | 48.3 | 143.1 | 359.9 |
| 1999 | 70,870 | 14,956 | 63.1 | 187.0 | 470.2 |
| 2000 | 73,590 | 15,537 | 65.6 | 194.2 | 488.4 |

On the other hand, bank insurance is a new development in the Mexican market, and we expect it to change the market completely. Our agents today are concentrating in the upper income-level clientele. Through bank insurance, we expect to develop products for the medium client income market.

To make a comparison with the traditional market, from the distribution point of view, the traditional market distributes through agents. Banks will do it with their own employees, in most cases. The size of the agent force in Mexico is about 40,000 registered agents. But, in reality, we think there are about 6,000 agents handling 80% of the market. The three major banks' employee sales force alone represents about 8,000–9,000 agents.

With regard to commissions, bonuses, and promotional events that companies working with agents must provide, we have quite a different situation with banks. You must pay the bank a commission, but it is not as expensive as the commission that you pay to an agent. According to the relationship that you have with the client, the traditional company will always depend on agents and insurance products. On the other hand, the bank's relationship with its customer is tied to the bank's products and its sense of trust.

We think that the pricing of insurance sold through the bank will be quite different from the pricing of the agent companies, because some marketing expenses are borne by the bank, such as administration, systems, communications, etc. These expenses can also be shared with the bank. Thus, the expenses go down and the pricing can change.

We expect further developments in the law. We expect to have tax incentives for insurance. Life insurance can be used as a complement of pension funds. With regards to health insurance, we think the partial liberalization of the social security health services will produce HMOs in Mexico. We are also expecting compulsory motor car liability insurance to be a reality in Mexico.

To show you a little bit of the potential of the Mexican market, we have a population of 91 million. The labor force, even by the smallest measure, is 36 million people, which is about 40% of the total population. Formal employment in the country is almost 21 million people. Of these 21 million people, they either have social security in the Institutes of Sociale or in the system that works for the government employees. Between these two institutions, they handle about 12 million cases. They, therefore, leave out of any social security over nine million people of the working force. I think these numbers are very important. Fifty percent of the Mexican population is below 19 years old, 30% between 20 and 39 years old, and 20% more than 39 years old. You can see there is a very large emerging labor force in our country.

About 1.5 million people have individual life insurance policies. Individual health insurance policies are owned by only 190,000 people. Only 2 million vehicles out of 12,700,000 are insured. Of 16 million homeowners, only 650,000 have insurance.

This gives you a picture of a picture of what is going on in Mexico. What we see is that the financial changes in Mexico, the new pension funds, and so on, will solve the economic and financial situation of the country in the long run. Mexico's ups and downs have created a very difficult situation for business, but through pensions, long term investment, and long-term savings, we expect that the economy of Mexico will be more stable.

The new players, new companies, and new ways of doing business in our country will change the market completely. The population and the possibilities that we have of selling insurance through many new channels, I think, will give you a picture of a really strong emerging market in our country.

**Mr. Manuel Aguilera:** The National Insurance and Surety Commission is the governmental regulatory body of the Mexican insurance market, as part of the Ministry of the Treasury. During the last, at least, six years, we have been part of a very deep process of deregulation and liberalization in our market. We have also made important changes in the way that we supervise insurance companies. What I am going to present is part of the main recent developments in the Mexican insurance market, from the perspective of the regulatory body.

I will discuss the modification to the reinsurance regulation, and then I will explain the recent changes in the social security system that will start in 1997.

As you know, the retention capacity of an insurance market basically depends on its financial strength. The success of the retention capacity in this kind of market has to be complemented with the support of international reinsurers. Consequently, the proper insurance regulation has to be designed according to the specific features of each market. One of the key problems in the case of emerging markets is the relative lack of financial resources. In most of the cases, Mexico included, international resources must be used to compensate for the limited retention capacity of their domestic markets.

In 1991 the proportion between the retained premiums and the premiums written in the Mexican market was 70%. That declined to 66.6% in 1995. The most important change was between 1994 and 1995 because of the economic crisis in Mexico. That had a specific impact on the financial markets.

Under these conditions, an insurance company that complied properly with the standards of a retention-oriented regulation, as we used to have in Mexico, may have failed just because of the quality of the foreign reinsurer. This situation may affect, on one hand, the solvency of the domestic insurance companies, and, on the other, the interests of the policyholders. Therefore, in markets with a limited retention capacity, like in the case of the Mexican insurance market, it is necessary for the insurance regulation to make an indirect supervision on reinsurance, considering specific actions to control the quality of the reinsurers that participate in the domestic reinsurance market. I stress indirect supervision because I think that the regulation has to put the right incentives in place for the insurance companies to use a quality reinsurer, but not to oblige them.

The former regulatory scheme in Mexico was focused towards solvency through the retention limits of insurance companies. Insurance companies that followed this scheme of regulation, however, could be facing liquidity and insolvency problems because of the reinsurer's failures. In a retention oriented regulatory scheme, like the one we had in Mexico, the excess over the insurer's retention capacity has to be ceded to a foreign reinsurer, directly or through a reinsurer broker. However, if the reinsurer broker does not act properly, as has happened in the past in Mexico, or if a foreign reinsurer does not have the financial strength to meet its obligations with the insurance company, they might face some liquidity or insolvency problems in the insurance companies.

Therefore, the main deficiency of the former Mexican regulation was the lack of adequate incentives in the scheme to cede risks to high-quality foreign reinsurers. In other words, we think that it was necessary to stress not only the retention regulation but also the quality of the reinsurer.

Mexican authorities, considering this element, have recently introduced some changes to the reinsurance regulation. These modifications were based on three elements. First, a structural change on the basis of the general foreign reinsurance registrations at the Ministry of the Treasury. Second, the introduction of a special technical reserve to prevent the use of a nonregistered reinsurer. We call this the special reinsurer quality technical reserve. Third, a reorientation of the current scheme of reinsurance brokers. I will explain to you briefly the main features of each one of these changes.

Up to 1995, the general foreign reinsurer register was granted to foreign reinsurers, after considering a financial evaluation performed by the National Insurance Commission and the Ministry of the Treasury. The experience has shown us that the information that we used to receive and evaluate was not enough to properly determine the quality and solvency of the foreign reinsurers. In practice, the Mexican authorities were directly assuming the responsibility of the solvency of foreign reinsurers.

I will give you some data to illustrate this idea. Referring to A.M. Best's reinsurer ratings, for instance, only 31% of the foreign reinsurers included in the register in 1995 were rated, of which 90% had adequate ratings and 10% had vulnerable ratings, 22% of the total did not reach any rating, and 47% were not rated by this agency.

Referring to Standard & Poor's ISI ratings, only 30% were rated, of which 77% had adequate ratings and 23% had vulnerable ratings; 10% of the total did not reach any rating, and 60% were not rated.

The main change in the regulation in the reinsurance sector was the following: the register will be granted, beginning in 1996, only to insurers that have attained a satisfactory evaluation by an internationally accredited rating agency. The requirement of legal, administrative, and financial information that we used to ask to evaluate a foreign reinsurer has been switched to a rating certificate granted by a rating agency. The current list includes the most important rating agencies and the minimum ratings to obtain the register. These are as follows: Standard & Poor's—Triple B minus or better; A.M. Best—B+ or better; Moody's—BAA3 or better; and Duff and Phelps—Triple B minus or better. At the same time, the register can be automatically revoked when the rating of the reinsurer goes below the minimum required rank or if the reinsurer does not present to the Nacional Insurance and Surety Commission (CNSF) annually a valid rating certificate.

The second part of this regulatory modification is the introduction of a special reinsurer-quality technical reserve. Besides the sanctions that an insurance company will receive when operating with a nonregistered reinsurer, it must also create a special reinsurer-quality technical reserve in order to reflect the additional risk resulting from the use of a low-rated reinsurer. The intention of this measure is that if the foreign reinsurer is a low-rated one, or if it is not rated, the insurance company is taking on additional risks or, in effect, an additional retention. This special reserve will consider the resources necessary to support the risk of the additional retention of the insurance company.

The following formula is used to calculate this reserve. In general terms, the reserve is equal to the amount of the premium ceded and the nonproportional reinsurance costs paid to a nonregistered reinsurer for each one of the nonregistered reinsurers that the company used.

$$R_{ter} = \sum_{i=1}^{n} [(P_c - P_{rrc}) + C_{np}$$

This reserve can be used if the nonregistered reinsurer is unable to fulfill its obligations. It can be liberated fully at the latter of the end of the first year of its creation or when the reinsurance contract terminates.

Because all the ceded risks to a low-rated reinsurer are considered an additional retention risk, the operation with nonregistered reinsurers would also impact the capital requirements of the insurance company, which would affect its solvency margin.

Finally, the third part of this modification consists of a change in the reinsurance brokers' regulation. According to Mexican law, there are two types of reinsurance brokers: those domiciled in the country, which must have the authorization of the CNSF, and those not domiciled in Mexico. We have detected, during the past few years, several irregularities in the reinsurance brokers operations. Because the behavior of reinsurance brokers is important for the institutions' solvency, it has been decided by the Mexican authorities to adopt a domiciled brokers scheme, beginning from 1997. Therefore, foreign, not domiciled reinsurance brokers, which are registered in Mexico, would have to establish a representative office when the current registration ends, which will be within five years. They will have to follow the new regulation and must be domiciled.

Finally, this point is about to be discussed in the Mexican Congress. We are proposing to the Congress to consider it to be a crime for brokers to misuse ceding companies' resources, which results in the insolvency of insurers, as well as the intentional delivery of false information to the CNSF.

I feel it beneficial to give you an overview of the recent changes in our social security system. This is the second main event that has happened in the Mexican market in the past few months. As you know, the general purposes of the Mexican social security system are to guarantee medical assistance for uninsured people, to protect means of support and the needed social services for the individual and group welfare, and to grant pensions. The recent changes have to do with this third purpose. Social security in Mexico is considered, even after the changes in law, as a domestic public service. The Social Security Mexican Institute (IMSS), an autonomous body, is in charge of the organization and management of the social security system as it is set in Law. The variables that caused the IMSS to originate, such as the health level of the population, the demographic structure, and the employment levels, have changed dramatically in Mexico recently.

The IMSS has decided to change and to establish a new social security scheme so as to improve the purchasing power of the pensions, raise quality and improve service, increase the financial stability of the system as a whole, and increase domestic savings. I should say that this last purpose has become one of the main goals of Mexican economic policy in the last several years.

In the new pension system, the distribution scheme changes into a capitalization system. Under the revised system, the worker's contributions are deposited in an individual account managed by a retirement funds administrator (AFORE). During the productive life of the worker, these resources of the individual account will be managed by the AFORE. When the worker's retirement occurs, those funds will be used to pay the pension. The pension to be received is not determined by the salary level and the worker's years of service, but on the purchasing power of the accumulated fund. The insurance company will be an important part of this new system. Pensions related to workers' compensation and disability and life insurance will be granted by a private insurance company under the worker's or beneficiaries' choice. This system will start in July 1997.

The pensions of retirement, dismissal at old age retirement, and old age retirement will be managed by an insurance company, or, at the election of the worker, by an AFORE. Even though this system also starts in July 1997, it is estimated that the retirement pensions will be paid by an insurance company in 15 or 20 years.

Insurance companies will therefore grant life annuities to pensioners and survival insurance to their beneficiaries. Optionally, the authorized institutions that managed the individual accounts (AFORES) will grant the scheduled withdrawals, at the election of the worker.

For the specific case of the insurance companies' participation, they will be able to obtain a specific basic product with two parts. The first part is a life annuity. It's a regular payment granted by the insurance company to the pensioner while he or she is alive. The second part, the survivor's insurance, guarantees an annuity upon death to the pensioner's worker's beneficiaries, according to the social security law.

How will this system work? In general terms, when the worker's retirement and disability occurs, he will have an individual account at an AFORE. The IMSS determines the benefits that the worker has according to the social security law. The IMSS calculates the single premium needed for an insurance company to meet this obligation. The IMSS compares this amount with the money in the worker's individual account, and the difference between these two amounts is complemented by the IMSS as a lump sum. The single premium which is paid to an insurance company during the transition period will be funded by two parts: the employee's individual account, which comes from the AFORE, and an insured lump sum that comes from the IMSS. With this single premium, the insurance company will pay the life annuity or the survivor's insurance.

We have some projections for the next ten years about what's going to happen with this type of insurance. We feel that the pensioners, considering only workers' compensation, disability, and life, in 1997 will be $35,000 and by the year 2006 it will be $74,000. The annual premiums for these risks will be $1.2 billion in 1997. This amount represents about 45% of total written premiums by Mexican insurance companies in 1995. By year 2006, this amount will be $2.6 billion.

The accumulated reserves from these risks will start in 1997 at $1.2 billion, and by year 2006 this amount will be $20.1 billion. That represents about 8% of the present gross domestic product of Mexico. This represents the most important impact of this new system—creating domestic saving in Mexico.

Due to the participation of the insurance companies in the social security system, the CNSF, as a regulator of the market, assumes certain regulatory responsibilities in order to guarantee the appropriate performance of this new system. The CNSF will have essentially three responsibilities.

First, to issue a technical and financial basis for the calculation of the single premium. From the technical point of view, we have the responsibility to evaluate the mortality tables on the technical notes in order to calculate the life annuities and the schedule withdrawals. From the financial point of view, we have the responsibility to determine the discount interest rate that will be applicable for this calculation, or the procedure to estimate this interest rate.

The second responsibility of the CNSF will be to issue the general rules with which the insurance companies that grant life annuities on the survivor's insurance must comply. It is important to stress that these general rules consider a system of technical reserves specifically designed for this kind of business. We have support from the World Bank through a specialist from Chile to design this specific system. The general rules also have a solvency margin system specifically designed for this type of activity, as well as the obligation for the insurance companies to participate in the creation of a private fund for the market to prevent the insolvency of a pension insurance company.

The third responsibility is to perform the examination and surveillance actions, in order to guarantee the solvency of the system.

Finally, I will just mention the general requirements for insurance companies that plan to participate in this new market. In order to achieve a proper operation, only specialized institutions will get the authorization to pay social security pensions. They will have to be considered for this special purpose.

However, once the law is put into effect, a five-year period is established for those life insurance companies that are eligible to grant life annuity payments in order to be considered as a specialized institution. Insurers that participate in the social security system must always cover the basic benefits granted by the IMSS and can offer additional benefits to the pensioners. These additional benefits will be the competitive element in this new market. Therefore, the standardization of a minimum product according to the law conditions is going to be researched in the future. During this five-year transition period these companies must perform separate accounting for this type of insurance operations, in order to be sure not to mix them with other lines of business. The reserves constitution will guarantee the system's solvency and permanence.

Finally, due to competition and economics of scale, we think that the inclusion of private insurers to the social security system will promote cost reductions and optimize benefits. We also think that this new social security system will be a very important element to increase the amount of domestic savings.

**Mr. Ignacio Gurza de Cons:** I seem to remember that part of the theme of this session was what has happened since NAFTA, I decided to overextend the period to the last five years. Just a reminder, NAFTA came into effect January 1, 1994. Just the country seemed to finally have reached the level of single digit inflation rates came December 1994. We have the so-called errors of December, that led us to the internationally known Tequila effect, also known as hangover.

Our inflation rate went up from single digit back to the double digit levels. In 1995, it was 52%. The forecast for 1996 is 28–30%, which is huge, but it is a big improvement if you compare it to what happened the year before. The Mexican government has been making very serious efforts to keep inflation under control and maintain, at the same time, economic growth, which is not an easy trick to perform.

The average rate of exchange of the Mexican peso to the U.S. dollar in 1992 was slightly over 3:1. Until 1994, we were about at this level and then came the Tequila effect. We suffered a 100% devaluation. When Javier was presenting the market features, there seemed to be a sharp decrease in the volume of premiums from 1994 to 1995. Actually, there was a very strong growth when expressed in pesos. But when you divide the currency rate by half, which is basically what happened, it immediately produced a decreasing equivalence in the U.S. dollars. That is something important for you to keep in mind when you look at the figures.

I didn't forecast the average rate of exchange for the Mexican Peso for 1996; the rate of exchange has been fairly stable in the neighborhood of 7.5:1. Last week we started having a slight slide in the Mexican peso; Manuel gave me more updated information. It was 8.10:1 by the end of last week. I honestly don't know what the final answer is going to be.

A couple of things are important for you to keep in mind. When trying to make an assessment of the impact that NAFTA has had in the Mexican market remember that for several years foreign investment was banned in the Mexican insurance market. There were a few insurers with minority positions held in some of the main insurance companies, but that was it. As part of NAFTA, foreign investment has allowed us two different fashions of foreign investment. The first one is a joint venture and the other one is called the formation of wholly owned subsidiaries. The difference is that each one has specific limitations. If a U.S. or Canadian company wants to get into the Mexican market under a joint venture system, their ownership is limited. The limitation changes until the year 2000 when they can own 100%.

The other alternative is to do it through a wholly owned subsidiary, in which, by definition, ownership can be 100% immediately. There is a limitation in terms of market share. The limitation of market share by the subsidiary is graded off by year 2000 when it is going to become basically a free game for foreign investors. I think it is important to keep this in mind, when we look at the little bit of analysis of what has been foreign investment in Mexico.

Mr. Compean was explaining to us that there are 54 insurance companies operating in the Mexican market. Twenty-six of these have a portion of their stock owned by foreign investors. That is, roughly speaking, one-half of the insurance companies have some sort of foreign investment participation. Let's look a little bit closer and see what NAFTA has to do with that. Ten of the 26 companies with foreign investment were in Mexico before NAFTA; in other words, they had investors who have been in the country for a long time before NAFTA. However, 16 of the 26 companies with foreign investment, 60% of the total are newcomers to the market, post-NAFTA deals.

Something else that is happening, is that historically the Mexican insurance market has been of composite insurers with the insurance companies writing life, health, property and casualty, and different lines of business. One of the things that has happened is that the authorities have been encouraging the creation of specialized insurers. Most of the newcomers have applied for licenses to issue specific lines of business. In other words, we are starting to have a similar environment as in the U.S. with life, health, and automobile insurance companies. The newcomers target specific markets, looking for the market niche. Historically in Mexico what has happened is that the big companies pretend to be universal insurers, offering products to and trying to have a solution for everything. This is changing. Together with foreign investment, we're going to start having specialized insurance, not even counting the annuities companies that were described by Mr. Aguilera.

What else has happened? If you remember, NAFTA allows foreign investment under two options, either joint ventures or wholly owned subsidiaries. Twelve of the companies with foreign investment are through joint ventures. Remember, there were ten already in the Mexican market. What this feature tells, basically, is that two new insurance companies decided to enter into a joint venture agreement with groups of Mexican investors. The other 14 are wholly owned subsidiaries. But remember, this is brand new. This is something that basically started last year. A full 20.9% of the market is owned by the 12 companies that have foreign investment under a joint venture basis. However, the other newcomers have already managed to capture 5% of the market share.

In the future, there's going to be a couple of big questions. The first one is about the regulation. I couldn't emphasize more that the difference between Mexico now and the late eighties is a big change that came in the position and in the attitude of the authority towards the way the markets operate. In 1989, the Mexican insurance market was probably one of the most highly regulated markets in the world. You had to apply for and obtain authorization to do everything. Manuel was telling me a story of a few things that remain from this remote past. If an insurance company wants to give the employees a holiday, that is different than allowed by our schedule of mandatory holidays, it has to apply and obtain an authorization from the Commission Nacional de Seguros y Fianzas; it is ridiculous. However, from my perspective, the most important change in the way things operate is that the insurance commissioners are going to their basic function. They are the ones responsible to oversee the solvency of the market. They are the ones responsible to make sure that the insurance companies remain sound, but other than that, it is a free market. Everybody is able to try to get hold of market share doing whatever practices, as long as they are legal.

The second important thing is the changes to social security. I think it would be redundant for me to spend time, describing what has happened in pensions; both Mr. Compean and Mr. Aguilera provided us with a detailed description. However, there's another element that is still a big question mark—social security operates in pensions and we know what is going to happen in that market. It also provides universal health care coverage to the workers. Something that has already been defined in the law is that social security is going to give the option for companies to use private services, instead of paying contributions to social security. The only thing that has not been defined are the regulations that are going to tell us the detailed way in which it is going to work. This is something that has to be defined in the near future. This could provide some major change in the way the Mexican insurance market operates. It would immediately open a huge gate of opportunity for health insurance providers.

**From the Floor:** I wanted to say a word in concert with what Mr. Gurza de Cons has just said about the regulatory reform that has taken place in Mexico. I happen to have been involved and, indeed, one of my former colleagues is working closely with the commissioner's office in Mexico. He was telling me, just the other day, that in his opinion, what has been done in regulatory reform in Mexico is a world class model. I don't mean for developing countries. I mean, the developed countries could learn a great deal from what Mexico has done in its regulatory reform. I think that's quite a compliment because, as has been said, this transformation has taken place in less than a decade. Mexico has laid the groundwork for a regulated insurance industry that will be ready to meet the huge growth that your figures forecast. That's a startling rate of growth. Manuel, you talked about the social security reform. There's one thing that I didn't hear in your remarks, that I thought was still an element and that has to do with the transitional group, because I was under the impression that the IMSS, the social security administration, will continue to offer a guarantee of a minimum benefit to workers who are now in the work force, and this, as I foresee things, will be a very complicating issue going forward for the government, particularly on a fiscal standpoint.

**Mr. Aguilera:** In fact, the transition period we think will take us about 25 perhaps 30 years to pass from the old security system to the new one fully. In the case of workers' compensation and disability and life, the new system will really start in July 1997. I mean the people who have disability problems or workers' compensation, will in fact, use the sum that they have in their individual account and the government will complement this sum in order to have sufficient premium for the insurance company to pay the pension in the future. In the case of retirement, most of the people will have the possibility to choose between the old system and the new one. The amount in the individual account of the people will be very small in the next years. When they retire or their retirement condition appears, we're sure that the people will prefer to go to the old system in order to have the minimum pension, and not to use the very limited funds that they will have in their individual account, to have a smaller pension. We think that after 25 or 30 years, the amount of resources in the individual accounts, in the AFORES accounts, will be sufficient to purchase better pension than the minimum offered now according to the old law. We think that during this transition period, the retirement pensions will be granted by the social security, and then by the insurance companies.

**Mr. Gurza de Cons:** You have to say, in other words, the transition comes from the fact that we are switching from a defined-benefit to a defined-contribution system. You need time when you're working on a defined-contribution system to build up the reserves that would enable you to pass the level of minimum guaranteed benefits.

**From the Floor:** In some of the other countries in Latin America—Chile, Peru, and Argentina—they established what was called a government share. For example, you start out with projected benefits and it would be a lump sum. A private insurance company was responsible from the beginning for providing that lump sum. The lump sum is paid for in three parts. The first part was whatever was in the fund of the worker. The second part was called government share, which had to do with a proxy for past service. The third amount was provided by the private insurance sector and, in fact, it's something that I've been involved with in these countries—providing reinsurance. These are big markets. My understanding is that the original design was that these benefits be privatized insurance and provide part of the lump sum through the private sector. Now my understanding is that that is not the case. Could you explain why it isn't the case now, and when you see that aspect of it coming into the private sector?

**Mr. Gurza de Cons:** You asked two questions, but the answer to the second one is, I don't know. The first question was is this how the essence of the system works? We're switching into a defined contribution system, on which each employee will be owner of their contributions earmarked under the AFORE account, and we will even be able to switch from administrators as often as once a year. In that sense, it is identical to the Chilean system. What happens is that in the system you described, there are three sources of income. The first one is the government, the second is individual accounts, and the third is an insurance company to cover the difference. In Mexico, the way the law was structured, individual insurance and private insurance companies do not have a piece of the action. It is just the government that is involved through our taxes. The balance in the individual account, the area in which insurance companies are going to be able to participate, is going to be in the annuities which Mr. Aguilera was explaining. This is going to create the huge growth potential in the market with percentages of 100% at least at the beginning.

**Mr. Paul S. Bell:** We've moved from January 1 to July 1, 1997. Can you explain any reason why?

**Mr. Aguilera:** The reason is mainly an operational reason. We have been designing all the regulations, all the rules that have to be published for the insurance companies' operation and also for the authorities' organization. We have seen that it presented too many problems for us to finish this regulation and the rules. We've been working not just with the government. We have also been working with the players in the market, to make proper regulations and also taking the opinion from experts from different countries. This is one of the reasons. The second reason is that now in Mexico, we're trying to introduce a new registration code, a new demographic code for multiple purposes, including social security, elections, identification, etc. The people from the private sector considered that this number could serve to avoid many of the identification problems with their individual accounts, because of the similar names. It has been decided to postpone for six months the start of this new system, in order to make it easier in the future. These are the two main reasons. Both of them have to do with operational things, not political reasons.

**From the Floor:** Is it anticipated that the sales will start before July 1 or will the sales will not be allowed to start until the second half of the year?

**Mr. Aguilera:** The law will go in force in July 1997, so sales and everything will start July 1, 1997.

**Mr. Gurza de Cons:** We have waited 50 years to fix the system. I don't see any problem in waiting six additional months. On the other hand, I think it is too important a change. We cannot allow it to fail. I think it is reasonable to wait an additional six months.