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Life in the Americas

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Summary: Individual life insurance penetration in Latin America has historically been so low as to be considered virtually nonexistent.

Panelists discuss recent developments throughout Latin America that many experts believe will lead to one of the highest growth individual and group life insurance markets in the world.

Mr. James F. Toole: I'm with Milliman & Robertson's Latin America practice. Today we're going to be covering three of the hottest life markets in Latin America: Argentina, Brazil, and Mexico with, perhaps, an extra side of health.

We're very fortunate to have on our panel Steve Putterman from Aetna, Jean Siedle from Chubb, and Lisa Kuklinski from MetLife. I think I can safely say that you would be hard-pressed to find a room in America with more experience in these markets, so take advantage of it.

First up from south to north and in alphabetical order by country is Mr. Steve Putterman speaking on Argentina. He has 21 years of experience, the last 9 with Aetna. His positions within Aetna prior to joining their international division include life pricing, head of life marketing, and market strategist for Aetna Retirement Services. His responsibilities in Aetna International include being GAAP actuary for the Americas, business development, and life insurance platform development. In addition, he is country manager for Argentina, which means he handles all of the coordination from Hartford of Argentina issues including financial objectives, capital, personnel, and market development.

Mr. Steven L. Putterman: It's my pleasure to be before you and speak about the Argentine life insurance market. It's particularly a pleasure that it's Argentina because I've had the pleasure of visiting many countries, but the thing that struck

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me as I walked the streets of Buenos Aires was the air. As I turned to the president of our local operation, I said, "The nicest thing is the air is so clean. You know, they could almost name a city after that." And he said, that's why you're in marketing.

Buenos Aires city proper has about 3 million people. The greater Buenos Aires area, which is where most of the activity takes place in the country, has 11.3 million people, and the entire country has 36 million people. The life expectancy at birth is about 74.5 years, so they're not having high early mortality that you might think would be associated with certain non-fully-developed countries.

The exchange rate is very easy for me to keep track of. It has been one peso per dollar since the 1991 convertibility law was enacted. There were rumors a couple of months ago, as Brazil was having their economic crisis, that they might actually convert to the dollar but that sort of died down a bit. In fact, I think last week there was a slight stock market correction because there was a rumor they were going to loosen it up, so it might float more freely, but I think that was just a rumor to try to depress some stock prices that had gone up earlier. Gross domestic product (GDP) per capita is the largest in South America, at more than 9,000 per person, which is more than almost double that of some of the other countries. I think Mexico is a little closer. We'll see later.

As for the SOA, I'd like to tell you there are 200 actuaries and I've met 5% of them, so I'm slowly building up the count. To become an actuary in Argentina, you can only get the degree from the University of Buenos Aires. It's a 6-year program with 37 courses. You have to pass exams, although recently (I think this year) you can now take SOA courses in Buenos Aires. I don't know if they're going to find that easier or more difficult.

In the past there was a reasonably strong life insurance market, but unfortunately hyperinflation wiped out most of the value over time. The contracts in the last bout of hyperinflation, which I think was in the 1980s, were pretty much guaranteed contracts, so when exorbitant investment returns became possible, the insurance companies kept the profits. Since they had no mechanism to distribute those to the policyholders, the policyholders experienced a loss of value and the industry as a whole suffered a loss of trust.

I'm going to give a few parallels in the property and casualty (P&C) business from the readings I've gone through. There was never really tight pricing to begin with, but through the periods of hyperinflation they pretty much gave up on technical underwriting and were just trying to lower premiums in order to get more cash flow so their investment income would cover any potential problems. It was a little crazy.

Things got even worse on the P&C side continuing the monopoly of the Instituto Nacional de Reaseguro, which is the state-owned reinsurance company. They tend to take most of the worst P&C risk, so obviously that agency ran out of money. A lot of the small companies that had mortgaged their future through the state-owned reinsurance lost out, so they're slowly trying to dig out of that hole. There's an 8.3% premium tax and that will grade it down to zero by 2002. This is strictly P&C, but I just want to give you a perspective of the turmoil hyperinflation caused and the lack of controls and requirements.

Individual and group life is 18% of the total market. For AFJP, which is the retirement plan, the privatized components, with some mandatory coverage for disability and survivorship, is 6%. Annuities, the AFJP accumulation and the payout, is about 9%, but the market is still primarily a P&C market at 67%.

However, there is hope for the life markets. Table 1 shows individual and group life. The group market is the dominant market right now. Between 2000 and 2005, life will be taking off based on a lot of factors, which I'll try to cover, but it's just overall. These are very small numbers, but group will stay in relatively the same proportion of GDP and the individual life business is expected to grow.

TABLE 1
TOTAL PREMIUMS/EXPECTED GROWTH
(MILLIONS US$)

Life	1997	1998	1999	2000	2005
Individual Life	153	172	285	399	1368
Group Life	826	790	840	865	1100
Total	979	962	1125	1264	2468

Compared to GDP, individual life is .05% and group life is .25%, for a total of .3%. The U.S. is a little under 4%, I think, while some of the Asian countries are even a little higher. There's just a lot of potential here because it's so underpenetrated. The total insurance market, including P&C, is 1.8% of GDP.

The two largest life insurance companies are Caja Seguros de Vida, which is primarily group insurance, and La Buenos Aires, actually in combination with New York Life, for the life piece. In total they manage a little less than 30% of the assets and 60% of the equity, so there's a domination here of the early companies that have been there.

The group market is really broken into three pieces, and the techniques to get the business varies. Unions are very strong in Argentina, and the Obras Sociales, which are the health deliverers under the unions, have a very strong presence. The way to conduct business with the unions is through contacts, so as a foreign company coming down you'll have some difficulty penetrating that, but that's why it's wise to work with local partners so you can make the relationships and establish some reasonable contacts.

Everywhere I go in South America I seem to hear that group life is a loss leader. No one seems to be making money. It may be based on their pricing maybe on competition or simply the foreign companies' attempts to establish market share.

Then there's credit life through the banks. There are some companies that have aligned with the banks to penetrate that end of the market, but this is the area where perhaps in the future there will be some growth in the mass marketing. I'll refer to that a little later.

There are a lot of start-up companies. Even though La Buenos Aires started in 1980, I think New York Life started the life venture with them in the mid-1990s as well. Eagle Star is 100% individual. They have a unit-link contract, which I think has a choice of dollars, pesos, or eagles, which is a type of currency index that they've established. Today they are number one in the individual life market, but there's a lot of complaining from the other companies because their product is very much like an annuity. There's a little bit of risk and they count the premium at 100%, so they feel there's a little bit of a distortion.

Aetna Vida, our entry, was a start-up in 1995. We're three-quarters individual and sell universal life (UL). It's our only affiliate in South America that has a UL product. There are some advantages, particularly for reserves. Statutory reserves in Argentina are all net-level. There are no expense allowances in early years. However, for UL you can hold the account value, so, if you have some front-loads, you'll have a little bit of relief relative to a whole life (WL) reserve.

The product flexibility still hasn't been managed and I think it's conservative in the pricing as it will have front-loads and back-loads. Even though you have the flexibility, you still need to focus on who your target is and what the need is you're trying to promote and ignore the rest of the flexibility. For your own administrative purposes, you'll have the flexibility, but for marketing purposes, you have to keep it simple. MetLife has been there since 1995; ING since 1997 with a variable product.

Distribution. From our own experience in Aetna Vida, we get about a 50/50 split between independent brokers and our own sales force. "Own sales force" is the formal term that they use for the career system. I thought it was just an explanation, but it's actually the title. We've had some success with the brokers because they've been able to cross-sell their P&C customers. The career system is taking a little longer to start up. The ability to recruit, train, and retain is difficult, so persistency of the agents as well as some of the business written by the career agents is an issue that most of the different career companies are working on trying to improve. The "own sales force" pretty much focuses on individual markets. The brokers will do the comprehensive risk. They'll have some of the P&C, and they'll do some group life and also individual life.

Pricing. No talk to the SOA would be complete without at least the mention of commutation functions, and that's really the basis for most of the pricing down there. It's a pure risk, plus they'll put in some explicit loads. Even if you use other approaches, such as asset shares, you have to file with the superintendent showing the technique in commutation functions, so you have to go back to that.

In addition to having commutation functions for the initial premium, they tend to do a very short-term cash-flow analysis, almost a year or two or three. They're not always taking that longer term perspective, and a lot of that is just the remnants of hyperinflation and not worrying about the long term. But as more companies come down from the U.S. they're importing things like PTS and TAS, so the asset shares are becoming a little more prevalent, but they can't use that for filing.

Mortality. As far as mortality, most companies are using 60 CSG and 80 CSO with very little grading going on, usually flat percentages. For the group markets, most of the companies file using 100% of the 60 CSG, but, just as in the U.S., they feel they have a little leeway in group pricing where they can go. They'll go a little lower in actual quotes and that probably leads to some of the underpricing in the quotes and in the unprofitability of the market. But in general they use the flat percentages of the 60 CSG or the 80 CSO. You file with commutation functions based on these tables, so you tend to see that your guarantees for valuation purposes and your current pricing are using the same percentages as that of the table.

The minimum that the superintendent will accept is 80% of the 80 CSO; however, if you have a reinsurance arrangement we can cede it at a lower percentage. If you have a letter from the reinsurer you can file with those rates, so there are some trade-offs.

Underwriting. What little there is! In group business, basically the only requirement is actively-at-work. One theme I've heard throughout South America is they don't like to be stuck, so no blood tests. Most of the products, and these aren't large face-amount products to begin with, are simplified issue, but when you go above $100,000 and there is reinsurance involved they'll probably go on what the reinsurer requires and do HIV and blood testing.

So from the loose periods of hyperinflation and insolvencies, the government has gotten a little tighter. There are some stricter reserving rules, particularly on the P&C side, to get some more credibility to what's happening. Effective this past October there were some new minimum capital requirements, and, ultimately, there's going to be a lot of consolidation because the smaller companies won't be able to post the capital. It's also an opportunity for more solvent, financially secure companies to come in from foreign jurisdictions, which is part of this consolidation.

Off-shore life policies. The life insurance that did exist throughout the inflationary periods, particularly at the higher face amount, was off-shore policies. The issue now is what do you do with them? If you look to replace them, it's a new policy issue, which is at the current age. It should also have a change in health and it could be subject to new surrender charges, which is a problem. If they keep it, theoretically they're breaking the law, so some companies that were off-shore are now moving on-shore. They may come up with some conversion programs within the company, but I don't think it's the greatest opportunity for domiciled insurers to try to get that business.

Future trends. As I said, there will be consolidation forced by the higher minimum capital, and that's an opportunity because I think through consolidation companies will get critical mass; maybe they could be more efficient in their pricing and offer more competitive products. I saw in a report by Solomon Smith Barney that the life insurance business will grow by eight times in the next five years. Don't forget you're starting with .05% of the GDP, so if you get all the way up to .4%, those are the numbers we're talking about. They feel that the drivers are going to be the economic stability and the low inflation rates, which have occurred since the convertibility law was established.

The fact is that the market is underpenetrated. There's more deregulation now allowing the foreign insurers to come in and own the companies, and the small companies will be consolidated as I said before. They also feel that bancassurance and private pension fund managers are now going to utilize techniques of mass marketing that really haven't been employed before, which will increase penetration. It could be that lead generation in trying to understand the customer need instead of simply being the product pusher, which a lot of these agents are today. And related to this is technology and customer service.

A lot of ideas are being imported from outside of South America, which I think will help drive future sales. Thus, it's the awareness, education and, hopefully, the truthworthiness of the companies based on the new solvency criteria, and also the financially secure companies coming in, that will create a more open environment and a lot of opportunity for growth.

Mr. Toole: It's my pleasure to introduce next Jean Siedle, who's going to be speaking on Brazil. Jean is the manager of Chubb's Latin America region with responsibilities for accident, benefits, and life products in five countries. She is currently responsible for the development of new business and the expansion of existing business including marketing, product development, underwriting, infrastructure, systems, and, of course, profitability.

Jean runs operations in Brazil, Mexico, Columbia, and Puerto Rico as well as start-ups in Chile and Venezuela, which are less than a year old. Argentina is scheduled for launch in 2000. Jean is a CPA and, unfortunately, her demeanor flies in the face of all CPA stereotypes.

Ms. Jean Seidle: The goal of my presentation is to not only give you my perspective on the market, but also to give you a sense of what's happening culturally in Brazil.

It's a huge country: 3.2 million square miles with a population of 163 million versus the U.S., which I believe has somewhere around 220 million. The next largest country in Latin America is Mexico with 100 million; Argentina has 35 million, and you can go as low as Chile with 14 million. From a size-and-demographic perspective it's a wonderful market to work in. The currency is the Real and we'll be talking a little bit about the devaluation that occurred recently, which is wreaking havoc on our portfolios. Most of the people live around the major cities. In the interior of Brazil and in the north, it's much more sparsely populated.

Although the poverty rate is running around 60%, there is an 80% literacy rate. I'm not sure exactly how they're measuring that statistic.

Chubb has seven branches. We are a composite company—a joint P&C and life operation. Has anybody had experience in composites? Let me tell you they can be very interesting. There can be quite a bit of internal struggle for allocation of resources.

Brazil has a very rich culture, natural beauty, and the people down there have a lot of joy in life. They're much more interested in their next meal or the family reunion than in what's going to happen next year. Sao Palo is one of the most cosmopolitan cities in Latin America. And, of course, they are football fanatics there. When I was down there during the World Cup, they brought in a big-screen TV for the employees, gave everybody the afternoon off, brought food in, and they watched the Brazil game. And then when they made it through the next round (I'm more of a soccer mom than a football enthusiast), they actually gave everybody the day off and the country emptied. I was looking out the window, we were up on about the tenth floor, and there was not a car on the highway. Anybody who goes to Brazil knows about their famous terrible traffic, so it was akin to a hurricane warning in Miami.

There's another side to Brazil, too. It's not so easily seen from the U.S., but it's really sad from my perspective and in time it's a little scary to be traveling down there. Poverty, crime, corruption, drugs, racism, and pollution are really terrible. They're all a part of everyday life in Brazil. People in our office have been kidnapped; you have to be very careful when you're traveling in Latin America. Every country faces these same issues to a greater or lesser degree, though, and that's how you take the country—the good with the bad.

Now that we've seen a little bit about the culture, let's start taking a look at how Brazil compares to the rest of the region. The fact that some numbers are missing really illustrates the lack of information and the lack of timeliness of information. I wanted year-end 1998 but it was unavailable for a lot of places, so I'm going to fill in the blanks on some of these as we go along.

As exhibited in Table 2, you can see from a demographic perspective that Brazil is just a dream come true for an insurance company. It has a huge population and a nice GDP, even though their GDP flattened and really faltered quite badly in 1998. It is a nice-sized total market. The life insurance sector is very good, with over 50% of the total market. It's a very viable, and I would even dare to use the word "vibrant," market. It's not like the U.S., but it's definitely active.

TABLE 2
REGIONAL COMPARISON

	Brazil	Argentina	Chile	Mexico	Colombia
Population	162.9m	35.7m	14.6m	99m	40m
GDP	766b	307b	77b	424b	95.8b
GDP%	0.02%	8.6%	7.1%	4.6%	3.1%
Ttl Ins Mkt	$19.4	$4.8	$4.32	$3.5	$1.6
Ttl Life Mkt	$11.3		$1.84		
Growth %		3.6%			
Penetration	2.2%	2%	3.5%	1.4%	2.4%
Concentration					
Unemployment	5.5%	13.7%	6.1%	3.3%	17.5%

The growth number is empty in Table 2, but it's really growing overall at a rate of 15–20% per year. The penetration is another reason why we're so interested in the country. There's a long way to go because there are a lot of people who don't have insurance and there are a lot of people who just have a little bit of insurance.

I included the concentration number because there's the phenomenon in Latin America of the big megafinancial conglomerate. Long before Citigroup was a reality, we were facing the competitive pressures in Latin America, and particularly in Brazil, of the megafinancials. You have groups of insurance companies, banks, and pension companies joining forces to sell their whole portfolio of products. That can be a difficult competitive point for a smaller company like Chubb, so basically our strategy has only been successful in niches.

Let's take a closer look now at the Brazilian market itself as shown in Table 3. The life market is growing at a respectable 15%. Personal accident is a tariff market. The rate is mandated and there's not a whole lot of interest. It's sold mainly through mass marketing and bancassurance. If you're in the health line of business, at 33% the growth is really starting to take off and will be growing quite significantly over the next few years.

TABLE 3
BRAZILIAN MARKET STATISTICS

	1995	1996	1997	1998	Annual Growth
Ttl Mkt Wp	14,045	15,111	18,394	19,395	12.7%
Life	2,406	2,830	3,335	3,474	14.8
PA	449	459	512	554	7.8
Subtotal	2,855	3,289	3,847	4,028	13.7
Health	2,152	3,018	3,975	4,289	33.1
Subtotal	5,007	6,307	7,822	8,317	
Pension	859	1,166	1,911	2,973	82
TOTAL	**5,866**	**7,473**	**9,733**	**11,290**	**30.8**
ABL/Ttl Mkt%	41.8%	49.5%	52.9%	58.2%	13.1%
Capitalization	2,408	5,727	4,420	3,508	15.2

The highest growth rate is in the pension area with 82%. Social Security reform is taking root even in Brazil, where they're shifting the responsibility more to the individual. In the health area, people are buying private insurance as a supplement to the government-provided insurance, which is not viewed as being very good. And on the pension side, the government basically provides for the lower-income people. Anybody who has an income above a few times minimum salary really needs to go and save their own money. And you can see that accident benefits and life is almost 60% of the total market.

Currently there are a lot of different things going on in Brazil. There's a lot of economic instability with the devaluation. There's a lot of internal and external debt. The unemployment rate is rising. I find it interesting, though, that they're not panicking in Brazil. Although there's more of a sense of unease and worry, they're acting more like they're just going to keep on course and this will all go away in a very short period of time.

The political scenario down there, which is typical of Latin America, has been intensifying over the last six months. Some of the states within Brazil have actually defaulted on their loans to the federal government and have refused to pay them back, so there's a lot of fighting between the various leaders of the states. There's a lot of infighting all over the place. Too much reform, not enough reform. Too fast, too slow. Do this, don't do this. Don't take my perk, take somebody else's perk.

And then you have the issue of international credibility. Is the Real plan falling apart? Is Brazil really world-class or able to join the worldwide community, or are they going to fall back into their old ways, i.e., hyperinflation, and not achieve their potential? You also have continuing social issues to contend with.

What's the government response to all of this? I talked before about the Social Security reform, i.e., shifting responsibility to the individual. This is consistent with what's happened in many other Latin American countries, but much slower. The currency was devalued. It was basically one-to-one with the dollar less than a year ago. After the first of the year, it was all the way up to two-to-one and now it's about one-and-seven-tenths to one. Unfortunately, I saw my portfolio halved in value practically overnight and it's wreaking havoc on my financials and other people within the country.

All your normal fiscal, belt-tightening raises have been denied, and there are layoffs in the public sector, which is consistent with what you would see in the U.S. if there was any kind of recession going on. However, it has not been taken very well, I can say, by the government sector.

Privatization is going on all over the region. The IRB (Brasil Resseguros, S.A.), the state-owned reinsurance company, is the monopoly for reinsurance. That's in the process of being privatized and I can't even count the years. How many years has the IRB supposed to have been privatized? Four, five? It's about to happen. It's always about to happen, but I think it really is going to occur. They did write a law that it has to be accomplished by the end of the year, but laws have been ignored before. In the past utilities and other state-owned businesses have gone the privatization path also.

Regulation. The two groups that I'm mainly interested in are the IRB and the Superintendencia de Seguros Privados (SUSEP). SUSEP is responsible for the product development and getting your policies approved, which is a very time-intensive and difficult process. It can take, at least for our company, anywhere from 6 to 12 months to get a product approved.

There are basically two sets of rules. You may have 30 or 60 days, according to the written rule. If they don't respond to you within that time, your product is fine—go ahead and use it. But there have been many instances of six months later when the SUSEP comes back and says "Oh, no, no, no, you must change this product." And, as a result, you have to pull your product off the market and basically relaunch it. Some companies say they're going to wait until SUSEP gets back to them no matter how long it takes because it's less painful to wait six months than it is to go back and relaunch a product.

I would say that the IRB is basically insolvent at this point. They will accept any risk. I was trying to remember, what is the slogan of that company in the U.S., "We'll accept anything"? It's almost like Mikey and Life cereal—a "we'll-eat-anything" type of thing.

There's one interesting thing from a market and competitive perspective that we really need to consider with the IRB being privatized. We use intercompany coinsurance quite a bit down there to avoid the high cost and the red tape of the IRB, so theoretically when the IRB goes away and the market opens to reinsurers, what's going to happen to the practice of coinsurance? Is reinsurance going to replace coinsurance? Are the prices going to be dropping as the reinsurers come in? Those are some very important competitive issues for us in Chubb.

There are some marked peculiarities that I thought would be interesting to bring up that are more from the marketing perspective. Did you know that nobody dies in Brazil, particularly the men? They never die. You need to focus on products that emphasize their quality of life or specific risks that they will be more willing to admit can happen to them.

Now the other interesting aspect of the life market is that Latin men don't want their wives to have too much fun after they die. Giving or leaving a lot of insurance to support their family goes against the expectation that a widow should grieve an appropriate time and be downtrodden. Therefore, you must be kind of sneaky about how you market your product so you don't focus on their unlimited life span.

Underwriting. Steve talked about underwriting. There really is minimal underwriting for us. There's a lot of guaranteed issue or short-term, maybe a short-form questionnaire—three to six health questions, if you can get that. People do not want to share their personal information with an insurance company. They don't want them to know their financial status or know about their health.

Pricing. Regarding product design and pricing, products are very simple. They're often the same products that the other companies have, and pricing, unfortunately for Chubb, is also on a cash-flow basis. Chubb is an underwriting profit company, and that puts us at a bit of a disadvantage because each of our products has to stand alone. Good or bad, that forces us to compete in other areas. For instance, Chubb is legendary for its claim service. Our service in general towards brokers and individuals is very good. Our relationship building is how we differentiate ourselves in the market because our prices are somewhat higher.

The investment issue that's important to me as the leader of the zone is that I can't match my assets and my liabilities. There are no long-term investment vehicles available in Brazil, so when you talk about getting into even a ten-year return of premium product, I can't buy the assets to back them up. So that's a definite concern and a constraint when you're entering the individual market.

Distribution. In Brazil they do anything and everything. There's a strong broker market that's well-developed. They don't have the control on pricing that I've seen in other countries such as Mexico, where I think the brokers are insane and they dictate what the market will do. Of course, there's a lot of price pressure but it's an easier market compared to Mexico. Bancassurance is very common. All these megafinancial conglomerates are all using their banking arms to go after the customer.

There are some companies that are starting to develop a direct sales force, but I believe they've found it to be costly. There are quality-of-people issues, and there have been some recent regulatory changes. They put a premium tax on the individual life product, which is going to have a dampening effect on the sales.

Direct marketing is pretty big in Brazil. Credit cards and insurance companies that set up their own direct marketing offices are all thriving. Insurance clubs are a novel way to do that. Work-site and payroll deduction is just getting started, but there's a lot of potential in that. Finally, there are branches of insurance companies and banks, joint ventures, kiosks in airports and malls, and insurance storefronts.

However, there are some potential areas for growth; for example, reaching somebody on a one-to-one basis by use of seminars, as they often do with the brokerage houses or the financial planners here in the U.S. That would be one way to reach people. The whole block of self-employed people really is very underinsured because nobody wants to address the risk. You can't get the price right now for the risk. And there are some opportunities in geographic expansion. Insurance companies are in branches just like a lot of people who live in tight clusters. Geographic expansion may bring growth in the future.

Products. Products are pretty standard. I'll get to the capitalization in a minute, but the thing with Brazil is that you use this basic portfolio of products and package them in such a way that you can reach your marketing niche. It's all the same. It's all group life. It has pretty standard conditions, but you sell it for a different reason.

Prevedencia (FAPL and PGBL) are the pension products, which was the market with 83% growth. This capitalization product was an interesting market last year with $3 billion but as my employees in Brazil would say disdainfully, "That's not insurance." And it really isn't. It's a savings plan with a lottery. People get into it because they feel they have a better chance, or they would rather get some money by being in a lottery than admitting that they might die eventually. For a noninsurance market it is quite substantial.

What do I see for the future? From a competitive perspective, the control of the distribution, given the megaconglomerates, is going to determine your success. Is pricing going to get softer as the IRB goes away and reinsurers flood the market with capacity? Cash-flow underwriting is still going to be a practice. How will the IRB privatization go? Will it be good or will it be bad? On the other hand you have some tremendous opportunities down there. If you're with a penetration of 2.2%, 167 million people, and hopefully a slowly rising standard of living, there theoretically should be a stream of business for the next 30–50 years, so that's what I'm counting on. Customer service is not a big thing down there and you can differentiate yourself, which is an opportunity for Chubb.

Alternative distribution versus your standard U.S. distribution is the norm, and there are a lot of different ways to reach the people here. I think that eventually individual products will be an opportunity, but not now with the increase in the premium tax from 2% to 7% that just recently went in. It's not a tax-advantaged product. Everyone is looking towards the Prevedencia because it is heavily tax-advantaged, plus all of the positive things that come out of Social Security reform. Theoretically we should see people wanting to save more money and guard against the risk of death or enhance the lives of the people who are still around.

Another area that's underserved, just before I close, is the affinity market. Chubb is having a lot of success in this area. When you define affinity in a broader term than just professional association and you think of groups of people and you reach them, it's quite an interesting way to go in Brazil. Those are my thoughts and experiences, and I hope you all have a chance to come to Brazil one day.

Mr. Toole: Next up we have Lisa Kuklinski, assistant vice president and actuary with MetLife. She spent her nine-year career at MetLife, where she progressed rapidly through the exams. She is fluent in Spanish and spent five years in MetLife's International Department with the last two in Mexico, where she served as chief actuary of Seguros Genesis, MetLife's wholly-owned subsidiary. She was responsible for all the actuarial functions including pricing, valuation, financial reporting, business planning, profit management, and reinsurance for all lines of business, including individual group life, A&H, and pensions. She recently returned from Mexico and is responsible for the individual annuity line in MetLife's upcoming demutualization.

Ms. Lisa S. Kuklinski: I am going to be deviating from the program a little bit; I'll be talking about health in the Americas as well as life in the Americas because as we will see, the health insurance market in Mexico is very interesting and important.

I'll start off by presenting some demographic and economic information to put the industry into context. We'll do a short industry overview and then I'll talk about each of the lines of business in detail: individual life insurance, group and association life, and health insurance. Then we'll talk about distribution channels and wrap up by playing futurist and looking at the future growth outlook for Mexico.

Demographic overview. Mexico's estimated July 1998 population was 98.6 million, just over one-third of the U.S. population, making it the second most populous country in Latin America. Mexico has a very young population; 36% is under 14, 60% between 15 and 64, and only 4% over 65. If you've ever visited Mexico, you'll see very few older people; all you see on the streets are much younger people. The growth rate is high at 1.77%, and the life expectancy is 71.6 years.

Economic overview. Mexico's 1997 GDP was $694.3 billion, which was orders of magnitude smaller than the U.S at $8.1 trillion. The real growth rate in 1997 was 7.3%, and growth has been generally very strong since the 1994 valuation, even though 1998 was a difficult year with oil prices going down. GDP per capita is 7,700, somewhat lower than what we saw in Argentina. Insurance premiums were only $4.1 billion, and Mexico's insurance penetration is one of the smallest in Latin America—in 1996 it was 1.2%. In 1998 it reached 1.5%, so it finally recovered from predevaluation levels.

Industry overview. It's a very crowded market. There are 52 private companies licensed to operate and a great deal of the insurers are multiline; 30 of the 52 are licensed to operate in all lines (P&C, life, and A&H). There are 11 P&C specialists, but companies that specialize in life or A&H are quite few; there are three that are life-only and there's only one that specializes in A&H. That's the first clue that the life and health markets are linked. In fact, this is the only place in the world where MetLife sells health insurance policies because we feel that it's necessary in order to complement our group life.

I'm going to talk about some of the regulatory changes that we've seen, such as the 1997 privatization of Social Security. I'm not going to go into these topics in detail because they are big topics in and of themselves, but they're important because they're tremendous steps for Mexico. This is where Mexico is really starting to put a greater emphasis on savings and long-term capital accumulation. Also, many insurance companies' affiliates have participated in these privatizations. And finally, this is part of a greater wave of privatizations in the telephone industry, railroads, and upcoming privatizations in oil refining, electricity, and maybe even health insurance.

The AFORES are administrators of retirement funds. Basically, this is for the transition from the underfunded pay-as-you-go governmental system to IRAs where the employee freely selects the AFORE. Therefore, the AFORES are for the accumulation phase while the annuities are for the payout phase. In the annuities market, the annuitant selects 1 of 13 annuity companies, and Social Security purchases an immediate annuity for the payout of death or disability benefits. Eventually these annuity companies will also be for retirement benefits, but at this point the AFORES funds for the purchase of retirement benefits are starting out basically from zero. There were some rollovers from the old system but very little, so it will be about 20 years before the AFORES accumulate to something that someone can decently retire with.

It's a competitive market. Every morning the newly eligible annuitants are published on the Internet, which is a great technological advance and saves companies the trouble of telephoning funeral directors and hospitals to find out who may be eligible, which is actually what happens in other countries like Chile. The annuitants do get besieged by different companies trying to offer their services, but that's what they have to do because basic benefits are the same for all companies. Companies compete on market reach and on additional benefits, which are somewhat restricted.

Another important regulatory change is the implementation of Incurred But Not Reported (Claims) (IBNR). Before 1996, no IBNR was required. These reserves were phased in 50% in 1996 and 100% in 1997. The company is free to choose its IBNR methodology, but it must be filed with the Insurance Commission, so if you're calculating loss ratios from the 1990s, you need to be aware of this fact.

Minimum capital requirements have existed for as far back as I know. They're not as complicated as risk-based capital or minimum continuing capital and surplus requirements. In life insurance it's a percentage of the sum insured, regardless of what reserves you might be holding, and in health it's a percentage of either premiums or benefits paid in the last 36 months. The net capital requirement is compared to the change that took place in 1997. Previously it was compared to statutory surplus; however, now you compare it to assets backing surplus, which is calculated using a crude asset allocation formula. The industry is right now lobbying for the deductibility of insurance premiums, particularly on health insurance. I think it would be a major feat if they accomplished it, but certainly anything is possible.

Another interesting development is the emergence of Standard & Poor's (S&P) ratings. S&P has been very busy in Mexico. A lot of companies have voluntarily obtained ratings, and these ratings are touted in advertising. I had the opportunity to participate in Genesis's meeting with S&P and it was interesting. It was more like you would expect in the U.S. with a lot of emphasis on profitability and growth, rather than just plain solvency. The scale used in Mexico is a special MX scale which starts at MXAAA and works its way down, which makes a lot of sense because it would be very hard for an insurance company to have a rating higher than the sovereign rating of Mexico, which is BB. You don't want that to be the best that you can hope for.

Moving on to some numbers. In 1998, insurance premium growth for life and health was only 26.9% nominal. With inflation of 18.6%, this means that real growth was around 7%. This is a fairly typical growth rate for the 1990s. Compound growth from 1991 to 1997 was 7% per year, 7.6% real, even with a 23% drop in 1995 following the devaluation.

Life and health premiums reached 19.4 billion pesos and the breakdown by line of businesses is as follows. You do see a lot of life insurance, with group life dominating at 41% and individual life at 34%. Our A&H product, hospital and surgical, was the most dominant at 22%. Personal accident was at 2% and major medical, which I think is a large future growth area, was at 1%.

Table 4 shows the top ten companies that you see in the market. As you see, it's really concentrated towards the top three companies, GNP, Comercial América, and Monterey Aetna. These 3 account for 68% of the premiums in 1998, and as you can see there's a very large gap between third and fourth place, with Inbursa at 6%, and Genesis at 5.1%. AIG Mexico was a new entry into the top 10, and we have 28 remaining private companies fighting it out for the 10% that's left.

TABLE 4
INDUSTRY OVERVIEW

Company	Premiums (MXP Millions)	Market Share
Grupo Nacional Provincial	5,858.9	30.2%
Comercial América	4,488.5	23.1
Monterrey Aetna	2,778.5	14.3
Inbursa	1,168.7	6.0
Génesis	958.4	5.1
Banamex Aegon	658.5	3.4
Tepeyac	540.1	2.8
Bancomer	515.1	2.7
Atlas	259.8	1.3
AIG Mexico	226.6	1.2
Remaining Private Companies	1,951.2	10.0

Individual Life. With individual life insurance you generally have a choice of currencies—pesos or U.S. dollars. U.S. dollar policies are popular for their value retention, but in times of devaluation, lapse rates can be high because the peso equivalent of your premiums can effectively double. We saw a lot of lapse in Genesis in our U.S. dollar policies for that reason and had an exchange program actually to get people to conserve the policies by moving over to peso policies. There are also inflation-indexed currencies. In Genesis we have our in-house currency, the Uvac, which is generally linked to inflation and offers more stability versus the peso than the dollar policy. The government has now introduced the UDI, which is indexed to inflation, and they also have securities based in UDIs, basically real interest rate securities, so who knows, maybe we'll see UDI policies in the future as well.

Ten to 20-year term insurance is definitely the biggest seller, but there are some WL and endowment policies. These are generally traditional with excess interest dividends. One thing that I found amazing about term insurance in Mexico is that you are required to offer a cash value, and this cash value must be a percentage of reserves following the humpback pattern of term insurance reserves and following no savings need that I can think of. The Insurance Commission says it is a percentage, so theoretically you can take it to the extreme and make your cash value 1% of reserves, but when we tried to do that we actually met with resistance from the agent. This is something that's illustrated and used to support the sale.

On the largest cases, I saw more competition from U.S. companies engaging in cross-border selling than from other local insurance companies. High income insurers are willing to fly to Texas and get their underwriting done there. The perception was that U.S. policies were cheaper. I think that's true in general but you have to make sure that you're comparing apples to apples.

A few companies are selling UL, and I know of at least one that is developing it. Variable life is virtually unknown. As far as I know, its sale is not prohibited, but I think the first company to introduce it would have a lot of explaining to do to the Insurance Commission because they are fairly conservative.

Deferred annuity policies are also available. They tend to be front-end loaded. My understanding is that their taxation and tax deferral depends on the basis of the premiums that you pay in, but in general people don't think of them as a preferred savings vehicle. You don't see the same competition on credited rates as you see in the U.S. A better deal is some of the high-yield savings products that insurance companies can offer. In Genesis one thing that we did that was very successful was to offer a high current rate with liquidity option as the life insurance settlement rather than paying a lump-sum check straight out. This option was so popular we offered it on its own as a stand-alone savings product. These products really compete favorably with banks because banks are not competitive in the interest rates that they credit to general small investors.

Immediate annuities are starting to get more exposure, really leveraging off the development of the Social Security annuities, because their pricing is not regulated as it is on Social Security. You see a lot more pricing and product variations. The two companies that I know of that offer them have them available in three flavors: pesos indexed to inflation, U.S. dollars, and pesos with dividends. There have been a few large cases, but really sales have been few and far between because this is a product that depends on capital accumulation, so it may be that its time has not quite come.

Just to round out the discussion, there are also education products. These tend to be fairly complicated endowment products and are not big sellers. I know of two companies offering dread disease products, but the list of covered diseases tends to be short. It's not very competitive as it is in South Africa or Asia. Companies are generally very experimental and willing to try anything that might catch on.

Group and Association Life Insurance. Here we're talking one-year term insurance. Every policy I've seen has been in pesos. Generally, the benefit is a multiple of salary. You can choose between dividend-paying policies based on a company's own experience if it's large enough to be credible and on pooled experience. I've seen a lot of growth lately on nondividend-paying policies. In this market you also still see "dotales" (endowments) being sold. These are tax-sheltered savings products. They basically created a way for companies to make income available to employees on a tax-free basis. They were a little bit too tax-sheltered, so the government started to require withholding. Since the withholding is problematic, a lot of companies did withdraw from this market, but there are those that continue to sell it and I'm not really sure how they handle the withholding issue.

Health. In 1996, Mexicans spent 6.5% of GDP on health-related expenses. Private expenditure accounted for the largest part at 65%; public expenditure through the Social Security Administration accounted for 32%, and insurance premiums only accounted for 3%, which indicates tremendous growth potential. I really think that health insurance is the sector with the biggest potential for growth. We've seen the biggest growth in this sector over the 1990s, although it did start from a very low level. The other factor is that the government is likely to privatize the health insurance industry, or at least the Social Security piece, so that's 35 million potential insureds. One interesting thing about Social Security is that it's estimated that 30% of the people who are eligible don't use it because of the low service level. People who can afford it are really encouraged to spend outside the system.

The biggest product we saw, which accounted for 22% of premiums, is hospital and surgical. It's called *gastos medicos mayores* and for the longest time I thought that meant major medical, but it's really not that. It's just simple hospital and surgical, a daily benefit if you're in the hospital. It gives you a schedule of covered surgical operations.

The deductible on coinsurance is covered on a per-sickness basis as opposed to an annual basis as you see in the U.S. Cost varies by location, with Mexico City having the highest costs. Coverage is generally available only in Mexico; if you want coverage outside of Mexico, you have to pay for it. In Genesis only about 1% of our insureds have elected to pay for this option. Exclusions are strict: AIDS in the first five years is excluded and maternity except for cesarean is excluded, as are organ transplants and plastic surgery.

One phenomenon that you definitely see is that group claims tend to place life and health insurance with the same company. The sale is really not separated; it's generally done through the same broker and placed with the same company. It's based on relationships and on trust and the level of service.

A recent development is true major medical, which is called *salud* or, simply, health. This is a small, but very fast-growing product line with more than 5% nominal growth in 1998 and three new entrants into the market, thereby doubling the competition. Salud offers "first aspirin" coverage, and I think this market has really interesting potential. Looking at the medical expenditures by type, the supplemental medical expenditures that this would cover—doctors' visits, medicine, lab work, etc—accounts for 60% of all pesos spent on health insurance.

We're also starting to see HMOs crop up. Harvard Health Care is one example. HMOs are not subject to capital requirements as insurance companies are, so insurance companies see this as a threat, but I think perhaps insolvencies and a few bad years for HMOs could level that out or perhaps change the laws.

Comercial America, the insurance company, also has a 49% participation in a hospital. In response to the HMOs and to other insurance companies getting involved in the distribution, companies like Genesis are seeking alliances, agreements, and discounts with doctors and hospitals and other providers.

Distribution. Just as we saw in the products and in Brazil, companies will try anything to reach customers. Independent agents are probably the most common, but persistency does not tend to be high because they're not loyal to one company. Companies are developing career agency forces. Work-site marketing, I think, is one of the most interesting distribution channels and a great way to reach large numbers of people to sell simple term insurance. Premiums are collected through payroll deduction, and persistency tends to be very high. In Genesis, for example, first-year persistency on our work-site marketing cases was 90–95% as opposed to the 70% or so that we would see on career agency or independent agents.

Bancassurance is gaining a lot of speed, too. Many insurance companies have alliances with banks, and banks are developing products to sell. There are also cross-selling opportunities with AFORES and annuity companies because in order to access these markets, companies had to develop and train large field forces. I haven't seen Internet selling, but Genesis does have a Web site for informational purposes.

Commissions on life insurance tend to be heaped towards the first-year arrangement. As you see in the U.S., first-year commissions are about 55% or so. In health insurance, and with the one-year term, commissions are generally level.

In group and association life and health, sales are very heavily dominated by brokers. Independent agents may handle smaller cases. Some companies are developing career group sales forces, which may be a good way to go after smaller companies that the brokers tend to ignore. An interesting development is in worldwide markets such as MAXIS. This is a great thing for multinational insurance companies. Basically, a company with operations in Mexico, the U.S., Europe, etc, can place its insurance with one of these networks and have one single negotiation and sharing of risks between the countries and get a great volume discount. I think that could work well in Mexico because so many companies have operations there.

Commissions are generally level and higher than what you would see in the U.S. I've seen commissions start as high as 20% and work their way down with the size of the group.

Finally, we'll wrap up by talking about the future growth outlook. Insert 1 shows all the different forces at work in the Mexican market. Starting at the top we have the political environment. I think the penetration will never reach U.S.- or even other Latin-American-type levels until we have a higher per capita income and a better distribution of income; however, one of the things that could propel this growth is the possible health insurance privatization along with the AFORES and annuities. That could really encourage growth into the future.

INSERT 1
FUTURE GROWTH OUTLOOK

Political Environment

- Possible health insurance privatization
- Year 2000 Presidential Election

Emerging Distribution Channels

- Bancassurance: individual life and group life (corporate clients)
- Captive field forces (leverage AFORE sales force)

Changing Customer Needs

- Greater demand for information and faster service
- Demand for more extensive coverages

Increasing Competition

- HMOs and hospitals entering the health insurance market
- Price-driven market for new competitors

One thing that we do have looming as a threat is the year 2000 presidential election. A crisis hit immediately after the last one in 1994 when Ernesto Zedillo was elected president. The peso crashed at about 55%, inflation skyrocketed, and growth plummeted. This is something that seems to happen in Mexico after presidential elections, although things have been fairly quiet during this presidency, and by quiet I mean inflation under 20%, which is good. Ernesto Zedillo has also made it his expressed goal to not have this happen. Anything can happen, and if it does occur, obviously this will have negative implications for Mexico on the whole and for the insurance industry as well. I think if it doesn't happen and if Mexico can successfully ride out this change in leadership, confidence in this country will really soar. I think then we can see a lot more for our investments.

We have the emerging distribution channels that we mentioned that will help companies reach new niches of customers like bancassurance, individual life, and group life and the growth of captive field forces. Obviously, these will require capital investment as well. Customer needs are changing. There's a greater demand for information and faster service. Something that we did in Genesis that was very successful was to guarantee service. We would issue policies in 5 days, pay claims in x number of days, and pay someone 50 pesos or so if we failed to meet that guarantee.

There's also a demand for more extensive coverages like what we saw on health insurance. On the other hand, competition is increasing with the HMOs and hospitals entering the market, and the market is becoming increasingly price-driven.

On group life, I think you could say that there's a premium war going on. I've also seen prices come down a great deal on U.S. dollar individual insurance policies. With all these factors I think we will see more insurance growth than economic growth on the whole, and definitely faster growth than what you would expect in the U.S.

Mr. Toole: We are going to open up for questions, and I will serve the first one. One thing that we didn't get into in these different markets was the persistency of the life products. I was wondering if we could go down the panel and just say what we think they are.

Ms. Kuklinski: In individual insurance in Mexico, first-year persistency is not that great. I think it is 60–70%, but, like I said on work-site marketing, it could really be much higher above 90%. Group insurance is probably around 85% or so, at least using Genesis's experiences.

Ms. Siedle: For Chubb on the group side we have a very good persistency, about 95%, and the rest of our portfolio is mass-marketed products, so the persistency tends to be lower, probably around the 50% range. You have a constant movement on your portfolio. It's one of the problems with making money in that business.

Mr. Putterman: Argentina is interesting because persistency on the individual life business is directly related to channel, and, contrary to the patterns in the U.S., the broker-sold business is better because they have the established client base from the P&C products and they're able to cross-sell. The issues with the career salespeople is they're starting from scratch and typically they're having their own difficulties being successful in the business. There's a direct relationship. If the career agent fails, the orphan policies tend to go off the books despite our retention efforts there. I would say there is maybe 85% persistency on the broker business and maybe 70% or less on the career business.

From the Floor: I was wondering if you could discuss further the pension privatization and the annuities market.

Ms. Kuklinski: In Mexico we have the recent privatizations of both the accumulation phase and the payout phase. Growth has been rapid with the AFORES, which have very good participation by the workers. Just about everyone signed up. On the privatized annuities, it has not gone up as quickly as was originally anticipated. I think one of the factors is that now that the government has to pay for the pension up front, it's been a little more selective in choosing who can get a lifetime pension and who can't. They've put a lot of people onto temporary pensions.

From the Floor: So do workers contribute or is it a government-planned pension?

Ms. Kuklinski: They're contributing for their retirement phase. They won't have enough to retire on and to purchase annuities. The ones who are currently being approved are just for death and disability with survivors benefits. On the private side there are some pension savings on the accumulation phase. We've had a few big cases on payout annuities, but in general growth is slow and choppy.

Ms. Siedle: The pension market in Brazil is not privatized. Basically, you have the state or government subsidy and they're encouraging private purchase through the tax vehicle.

Mr. Putterman: Just a couple of comments. There are a lot of similarities, I think, among Argentina, Mexico, and Chile. When the privatization first took place, it was a question of branding and having the most people on the street to capture as much of the market as possible. Once that happened, a lot of these employees were temporary employees, so they were all laid off. It was just to get the people in. The secret to success is keeping the policies on the books. Even through the accumulation phase you can switch your funds and I think in Mexico—I'm not as familiar with Argentina because we're not in that line of business—they're starting to put restrictions on how often you can transfer. They're trying to control it, but the bulk of the business is the group business that's been privatized; nonetheless, you do go after it individual by individual. I know in Mexico they are signing up the people coming out of the factories. We were fortunate our partner is a bank and through their group relationships we were able to establish entry-to-collect and have the presence before the employees, so we have, I think, a leading market share in the AFORE market in Mexico. That first swoop is the critical time and we were lucky; we had brought people in who had done it in Chile and helped run our Mexican operation.

Ms. Seidle: Recently I was with one of our bigger clients and there were posters plastered all over the place from, I think, Bradesco. They were having pep rallies and trying to get all of the people to sign up for their retirement plan, but the place looked like a campus covered with flags and banners. They were giving out things and there were representatives walking around with these badges, so there was a big push to capture those groups.

Mr. Toole: I think it's important to note that these AFORES in the accumulation phase are completely separate from the life insurance companies that pay out the benefits. These are for solvency reasons. The different agencies are running them and guaranteeing them, so when somebody in an AFORE becomes disabled, they then have the option of choosing what life insurance company they're going to use to their benefit and usually it's based on which one is producing the best additional benefit at that time. But there is a theory that if you're with x, y, or z AFORE, you'll go with the associated company with the life insurance, but we have yet to see whether or not that's going to be the case.

From the Floor: Steve, you are anticipating a big upturn in life sales in Argentina in the next five or six years. What drives that prediction?

Mr. Putterman: Part of it, I think, is if inflation stays down, people can begin to think about savings over the long term. Then, as we import the knowledge of target marketing, just the whole aspect of serving the clients, recognizing what their needs are, and not just pushing a product at them, I think we can import some of the U.S. marketing capabilities and the combination of mass marketing and focused individual distribution. Therefore, I think it's just a matter of doing it right because they've well-nigh floundered at it for many years. I think that's the greatest opportunity. We haven't tried all the ways yet.