Article from:

International Section News

September 1998 – Issue No. 17

Editor's Notes

by Kevin M. Law

We are fortunate once again to present in this issue of *International Section News* an outstanding selection of articles of interest to actuaries involved with international business including material on a number of different countries and/or regions—Asia, Italy, Taiwan, Ireland, Brazil, Philippines, Spain, and Latin America.

Given the quantity of material in this edition, I will be deliberately brief in this column. I would like to express my appreciation to all of the authors for their contributions, and in particular to Ronald Poon-Affat for his timely lead article on the recent health insurance legislation in Brazil. This is Ronald's second article on Brazilian private health insurance and we look forward to receiving additional material from him for future newsletters that covers various aspects of the insurance industry in Brazil.

As my term is now expiring on the Section Council, I would like to take this opportunity to thank my fellow Council members for their contributions to the Section and for their support in my roles as newsletter editor and as the Chairperson for 1995–1996. Special thanks and appreciation are also due to the excellent, hard-working SOA staff that make possible our activities, functions, and publications. In particular, I would like to personally thank Barbara Simmons, Susan Martz, and Lois Chinnock, with whom I have worked closely over the last several years.

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Foreign Insurance Investors in Latin America: Can They All Survive and Prosper?

by Camilo J. Salazar

Latin America has become an integral part of the globalization process. Multinational insurance companies and international financial groups are making strategic investments in the region equal in size to other investments in North American, Europe, or the Far East.

As regional economies have opened, the transfer of ownership in the financial services industry from local hands to foreign hands has been fast and decisive. In the last few years, the growth in the supply of insurance products and carriers has been impressive. This article explores some issues related to the growth in supply capacity, the relatively slower pace of growth in consumer demand for these products, and the factors that companies can identify in forming their strategies to achieve their objectives.

When a multinational insurance company evaluates an expansion strategy in Latin America, or any other region, it typically relies on data such as:

- Political stability
- Key economic data (economic policy, GDP, trade balance, income per capita)
- Size of the market, labor force
- Demographic profile of the country
- Macroeconomic indicators (inflation, currency, interest rates)
- Insurance penetration and premium density as a percentage of GDP
- Insurance industry regulation.

For many countries in the region, these macro indicators point to a new frontier of future potential and growth. Premium penetration and premium density numbers in these countries make it clear that there is quite a gap to fill.

Understanding the local market context in which these indicators are present today is critical to understanding how quickly these markets will be able to fulfill their future potential tomorrow.

Background

Until the late 1980s, the economic development strategy applied by almost every country in the region was characterized by a high level of protectionism and import-substitution. The state exercised generalized control over all economic activity.

Two main events can perhaps be credited with forcing a dramatic change in economic policy in the region: (1) the debt crisis of the 1980s which exposed the failure of the economic models and (2) the fall of the "iron curtain" and disintegration of the Soviet bloc.

Latin America was a strategically important battleground for the cold war, both on an economic as well as political basis. Under the label of "nonaligned countries," many countries in the region played the United States against the Soviet bloc as a source of foreign credits and economic aid, which helped mask the failure of their own economic policies. With the collapse of the Soviet bloc, the only alternative was to attract foreign capital through open economic development.

The economic transformation of the region has been brought about by a radical change in economic policies in most Latin American countries, with a clear focus toward open and market-oriented economies in which the state plays a very different role than before.

Supply and Demand

The rapid influx of foreign capital and presence has not been matched by an equally fast growth in demand for insurance products. This is not to say that insurance activity is not growing. Both life and property and casualty premiums are growing at rates higher than GDP growth, but there is a mismatch of supply and demand at this point.

On one hand, the supply of foreign carriers and new companies has occurred very quickly. Aided by regulatory changes and the lifting of foreign

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investment restrictions, several foreign groups have established local subsidiary companies or have formed joint-venture relationships with local companies. New licenses have been granted or old inactive companies have been bought and recapitalized.

On the other hand, consumer demand is growing at a more incremental pace. Consumer attitudes change more slowly, and income levels rise incrementally. In some countries, income per capita is still too low and unemployment too high to create a significant demand for insurance products. The lack of additional consumer demand in these markets can also be influenced by the following factors:

- Inflationary legacy
- Cultural perception of insurance
- Regulatory sponsorship of insurance activities
- Logistical factors.

INFLATIONARY LEGACY

During the 1990s the region has, for the most part, come out from under many years of inflationary environments, in some cases severe, as in Argentina and Brazil. The impact that prolonged and severe periods of inflation has on society as a whole, as well as on individuals, is difficult to imagine for those who have not experienced it.

It is probably fair to say that time horizons in these countries are generally perceived as shorter relative to countries that have not been exposed to prolonged periods of inflation. From planning social policy to planning personal savings and retirements needs, these processes tend to be influenced by a shorter-term mentality. Adjusting to a noninflationary environment takes time.

The current generation of political and business leaders in most countries in Latin America has grown up in an inflationary environment and has just in the last few years begun to experience economic stability. In Argentina and Brazil, the transition from hyper-inflation to basically zero inflation has occurred in a very compressed period of time.

CULTURAL PERCEPTION OF INSURANCE

Insurance has had a difficult past in the region. Property and casualty business survived, even under the most severe inflationary pressures, but underwriting and pricing these products for profitability became secondary to investment gains on cash flows. Brokerage companies sometimes took advantage of hyperinflation periods by withholding premium and claims payments to invest them short-term for their own financial gain. In the eyes of the consumer, this negative perception tends to spill over to the entire industry.

Traditional life insurance is not regarded as an effective tool in protecting one's assets from inflationary erosion. Unprofessional market practices, as well as lack of innovation and adequate insurance regulation, helped create a negative image. Many countries had highly inefficient state insurance monopolies and product differentiation and competition was restricted.

"One of the most critical issues that foreign companies face ... is the adaptation of their corporate domestic culture to the realities of the new market environment in which they will now operate."

One of the most critical issues that foreign companies face when establishing a presence in a new market is the adaptation of their corporate domestic culture to the realities of the new market environment in which they will now operate.

Corporate values represent the philosophical foundation of an organization and define how it conducts its business and relates to its clients. Such values are absolute and should not change in reference to the market in which the company operates. The application of those values, however, is relative to the market and the cultural context in which the company operates, whether domestic or nondomestic.

Assume that a well-established domestic U.S. company has as one of its core values, financial prudence. As a result, its financial and investment strategies have evolved over the years relative to the U.S. market in which it has operated since its inception. The political, economic, and regulatory framework present in the United States has, over the years, allowed the development of investment policies that rely on more stable long-term instruments and less on short-term, more speculative instruments.

Assume the company decides to enter a new market where inflation has historically been higher and the investment market has been more volatile than in the United States. Political and economic stability is improving, but historically has had volatile periods. The company then applies the same investment policy that it has developed in the United States, relative to the U.S. market, without adapting it relative to the new environment.

The company could be putting its capital investment in a very speculative position against its corporate values by trying to invest long-term in a short-term environment. Being conservative in this new environment means being short-term focused in order to hedge and preserve the purchasing power of the currency. The relative application of its corporate values would be misguided, although its philosophical value has not changed.

In addition to trying to adapt their corporate domestic culture to the local market, foreign companies also face the challenge of building name recognition and brand presence in a new market in which their domestic prominence at home means little, or nothing, locally.

They find themselves in these new markets increasingly crowded with many of the same domestic competitors they thought they left back home, plus a few other multinational competitors. To the typical local consumer, however, all these foreign players look very similar. They tend to be recognized by their common-denominator attributes, which can be summarized as large in size, financially strong, and foreign.

These three attributes are interrelated. Relative to the markets and economies in the region, the foreign

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parents of some of these companies look uncommonly big by local standards. Their size intuitively projects financial strength and this, in turn, is associated with foreign ownership.

Beyond these attributes, there isn't much differentiation in the eyes of the consumer. Foreign companies, however, struggle to differentiate themselves from one another in pretty much the same way they attempt to do so in their domestic markets.

The consumers they are trying to reach differ from the U.S consumer for whom they have developed their message over the years. The consumer in these countries is at a very different level of sophistication.

Under economic conditions in the past, market competition, in general, was not intense in these markets and particularly weak in the insurance industry, given regulatory restraints and state insurance monopolies. Lack of competition meant lack of choice. Choices in insurance offerings have increased exponentially, but the consumer is still adapting to this change.

To illustrate this point, let's remember how the Japanese developed a foothold in the auto industry in the United States in the 1960s and 1970s. The typical U.S consumer at the time wanted a Japanese car, not necessarily a Toyota or a Honda. The consumer wanted a Japanese car for its attributes of reliability and economy of operation. Years later, as consumers became more sophisticated and mature, they began to differentiate among brands.

TABLE 1

Country	Insurance Premium per Capita	Insurance Premium as a Percentage of GDP
United States	$2,372	8.60
Japan	5,088	12.78
U.K.	1,694	10.33
France	2,268	8.55
Mexico	39	1.48
Argentina	142	1.72
Chile	147	3.06
Colombia	52	2.29
Brazil	90	2.04

TABLE 2
Insurance Premium as a Percentage of GDP

Year	U.S.	Japan	U.K.	France
1979	7.25	4.89	5.83	3.62
1985	7.52	6.94	7.11	4.50
1989	8.78	9.71	9.38	5.99
1993	8.90	12.64	11.73	7.58
1996	8.60	12.78	10.33	8.55

REGULATORY SPONSORSHIP

When doing insurance research on the region, one of the most noticeable macro figures is the relatively low insurance density and premium penetration as a percentage of GDP as compared to developed markets. Table 1, based on 1996 available figures, illustrates this point.

The relatively higher figures for developed countries such as the U.S. or Japan, have evolved over several years (see Table 2). It is, therefore, optimistic to expect to reach the same levels of density and penetration in the region in a few short years.

Consistent government sponsorship of insurance over the years, whether direct or indirect, has played a critical role in developed countries in facilitating the creation of an insurance culture.

This sponsorship and support needs to occur in the context of economic and political stability. Such sponsorship, from favorable treatment of insurance premiums and cash values from a tax perspective, to the creating of compulsory insurance programs for employers and employees has been historically present in developed countries. Historically in Latin America, regulatory authority was exercised to the detriment of promoting the growth of the industry. State insurance monopolies and tariff controls made it difficult, if not impossible, for the industry to develop.

With the economic restructuring in the region, this is changing. With the privatization of the various state pension systems, consumers in these countries are learning, for the first time, about their retirement needs and the level of basic education about retirement savings and its long-term benefit is beginning to rise.

LOGISTICAL FACTORS

Latin America encompasses a population of more than 450 million people. In the countries in which most insurance activity and foreign investment is currently focused, the population is distributed as follows: Argentina, 35 million; Brazil, 165 million; Chile, 14 million; Colombia, 36 million; and Mexico, 95 million; for a total of 345 million.

By any measure, these numbers are impressive, as they represent a group of consumers larger than the U.S. population or the European community. The ability to reach such a number of consumers needs to be put in perspective, however, with factors such as infrastructure limitations in transportation and telecommunications, cost of basic services and income levels, historical patterns, and rural versus urban population distribution.

Conclusions

Latin America has acquired an economically strategic importance in the process of globalization that it did not have a decade ago. The region has attracted significant attention and investment in the international community, and the international insurance industry is an integral part of this effort.

The determination of the necessary and achievable critical mass has been, in some cases, carried out without

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proper analysis and identification of some critical factors such as deeper understanding of market expectations and distribution practices, consumers' historical perception of insurance, and lack of insurance culture. The development of an insurance culture similar to that present in developed countries will take longer than is sometimes estimated.

For some foreign companies that have established a presence in Latin America, their investment and long-term presence is threatened by the difficulty in reaching anticipated levels of critical mass. Many companies will be forced to either invest more capital, consolidate their presence through acquisitions, or exit the market.

Foreign investors face two critical strategic options when entering the region—to pursue a strategy of reaching critical mass in a short period of time through acquisitions or joint ventures, or to reach critical mass in a longer period of time through internal growth. Either strategic option needs to incorporate in its analysis a much deeper understanding of the market and cultural differences and local consumer perspectives and expectations.

This will allow investors to design strategies that will take into account a longer-term perspective for market evolution and achievement of critical mass, which in turn will provide more realistic expectations for capital needs and return on investment.

The industry will continue to consolidate. Foreign ownership will continue to dominate these markets. Those companies able to establish a solid and long-term presence in Latin America will be successful at applying their corporate culture in the context of understanding the realities of those markets in the region in which they are present.

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Call for Papers

"Fair Value of Insurance Business"

The Society of Actuaries and New York University join forces again. A conference on "Fair Value of Insurance Business" will be held on March 18 and 19, 1999, in New York City. The goal is to extend and update the body of knowledge from the 1995, "Fair Value of Insurance Liabilities" Conference; to highlight similarities in various theoretical developments; and work towards resolution of differences and implementation issues. The scope of the conference has been broadened to encourage fair valuation efforts which consider insurance business as an integrated whole.

The conference will:

- Provide an overview and comparison of various theoretical developments
- Provide an update on various efforts in accounting and management reporting
- Suggest how the various theories may be applied to financial and management reporting in practice, and discuss implementation issues and potential solutions.

A call for papers is being held in conjunction with the conference. The goal of this call for papers is to promote fresh perspectives on this challenging topic; to provide a solid foundation for the conference; and to move forward the state of the art on insurance valuation. Papers should bring fair value accounting for insurance forward with respect to recent developments in accounting initiatives as well as management practices. Papers submitted in response to this call may cover topics related to fair value of assets, liabilities or insurance enterprise value.

The Society of Actuaries anticipates publishing acceptable papers in a book. Papers from the 1995 conference have been published in the book "The Fair Value of Insurance Liabilities," Kluwer, 1998. Expenses incurred by authors who present accepted papers at the conference will be paid by the Society of Actuaries.

The target date for receipt of papers is October 30, 1998. The detailed call for papers can be accessed via the Research Section of the Society of Actuaries web site (http://www.soa.org/research/cfp2.html). Or contact Joanne Temperly (Phone: 847–706–3519, Fax: 847–706–3599, E-mail: jtemperly@soa.org) to receive a copy via fax, mail, or e-mail.