# International Section News

February 1999 – Issue No. 18

INTERNATIONAL SECTION NEWS

NUMBER 18 FEBRUARY 1999

## Chairperson's Corner

*by Bruce D. Moore*

The International Section has been very active over the past year in a number of areas. The regular ongoing activities common to all Sections continued at an impressive pace. In addition, a number of special activities unique to this Section were continued or initiated. As members of the Section, you can all make valuable contributions to these services to your fellow members, and I urge you to do so. The ongoing recurrent activities of the International Section include the following:

1. The Section newsletter, under Kevin Law's prolific leadership, was published three times in 1998, full of interesting articles in each. This is one of the most valuable

*(continued on page 9, column 2)*

# Jamaica's Life Insurance and Financial Sector Crisis

*by Janet Sharp*

It is the last quarter of 1998 at the time of writing, and the story is far from over. The Jamaican financial and business sectors are reeling from a combination of high inflation, tight monetary policy, and poor risk management practices. The economy is in poor shape. Even though inflation has been tamed over the last three years, and the currency has been somewhat stable, growth has been minimal and businesses are closing every day, unable to meet their debt obligations.

In January 1997, in response to a call from the leaders of the life insurance industry, the government established the Financial Sector Adjustment Company (Finsac) to assist in the rehabilitation of the ailing financial sector. To date, Finsac has provided bailout packages to life insurance companies and commercial banks to the tune of JA$73 billion (US$2 billion) with estimates that the final figure may be closer to JA$100 billion (US$3 billion). The long-term impact of this is alarming when the cost is looked at in relation to Jamaica's Gross Domestic Product (GDP). At an estimated 66% of GDP, this compares unfavorably with the cost of bailouts in other parts of the world, the closest being that for Indonesia at 20% of Gross National Product (GNP).

*(continued on page 8, column 1)*

## In This Issue

**Jamaica’s Life Insurance and Financial Sector Crisis**
*continued from page 1*

## The Problem

For the most part, it was the age-old problem of asset/liability mismatch. Administrative and marketing expense overruns, inadequate capitalization, ineffective regulatory supervision and imprudent boardroom decisions contributed the rest.

## How Did We Get There?

The stage began to be set in the early 1990s when the foreign exchange market was deregulated. The currency depreciated 156% in one year and inflation jumped to 80%. To stem the currency speculation, a tight monetary policy was employed and interest rates rose dramatically. As the central bank increased the cash reserve ratio on banks, loan rates mushroomed to over 50%. With penalty rates as high as 100%, the seeds of nonperforming loans were sown. In a traditionally high inflation environment (averaging 20.6% per annum over the past 26 years, 29.2% over the last 9 years), with little variety of investment vehicles and a small stock market, real estate was the preferred hedge. Whether the real estate was linked to life company marketing profile or to interests in tourism, the timing of these investments in the early 1990s was unfortunate. With currency depreciation, the levels of capital invested were too high, and the resulting cash flows too low. With the consumer market in a frenzy over high interest rates, competition for the investment dollar intensified between life companies and banks. Consumers wanted investment policies with liberal withdrawal options and competitive returns. At the same time, inflationary pressures to grant large wage increases pushed administrative expenses out of line; competitive pressures for product support pushed the installation of state-of-the-art computer systems at a high cost of capital; competitive pressure for market share allowed 12 month projected commissions, high first-year commissions, and high bonuses as standard agent compensation. Additionally, companies aggressively pursued strategies to capitalize existing banks or other life operations and acquire new entities. The end result is companies had to borrow substantial amounts at a high cost to finance their operations.

The economy worsened, and loan rates remained high over many years. In 1993 the stock market plummeted and unit-linked policyholders withdrew massive amounts of funds. Disposable income declined, policyholders exercised withdrawal options or surrendered their policies, lapse rates rose, interest costs rose, wage demands increased, interest credits to interest sensitive policies remained high to prevent disintermediation, and investment losses increased.

Yet, due to the transfer into earnings of unrealized capital appreciation on real estate, companies continued to report profits and pay dividends, and so in 1993 the government increased the taxes on the industry. By the middle 1990s, the real estate market began to decline. No longer could companies

adjust book values upwards; in fact, property values began to fall. Finally, they recognized the threat to dynamic solvency and most started to restructure.

Although efforts to reduce administrative expenses and, to a lesser extent, marketing acquisition expenses were successful, the disposition of unsuitable assets, in particular real estate, was close to impossible. The decline in the economy had left a soft real estate market and a great deal of vacant office space. The decline in rental returns and investment income reduced portfolio returns below interest credited to policy-holders funds. Policyholders continued to withdraw funds with increasing regularity and companies had to keep borrowing. As the banking crises began to emerge, subsidiary losses due to non-performing loans further weakened company surplus levels. New banking regulations placed additional capital strain on parent life companies that were obliged to recapitalize their ailing subsidiaries. By 1996 many life com-panies were barely solvent if at all, hence the industry leaders' appeal to the government and the resulting formation of Finsac in 1997.

## Finsac

A total of JA$12.4 billion was channeled to four companies in the life insurance sector for the main purpose of repaying high-cost, short-term debt. Stock life companies gave 26.5% equity ownership to Finsac with the rest of the funding in five-to-seven year cumulative redeemable preference shares at a rate of 12.5%. A total of seven companies (out of 13) are either fully or partially owned by Finsac.

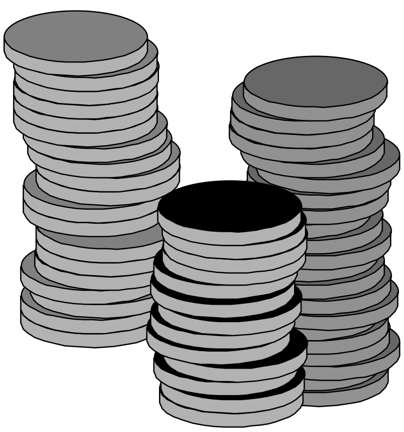
Finsac's mandate is to operate in three phases—intervention, rehabilitation and divestment. It is expected that through Finsac the financial sector will see a number of mergers/acquisitions. In addition, Finsac has adopted a temporary regulatory role as it helps to reorganize and retool the Office of the Superintendent of Insurance, which lacks the human and technical resources to effectively monitor the industry. Tech-nocrats at Finsac are also reviewing and making recommendations to update the Insurance Act, the law under

*(continued on page 9, column 1)*

which the general and life insurance companies are governed.

### The Life Insurance Sector Now

None of the Finsac-supported companies continues to have an interest in commercial banking, although many are still dogged by real estate. Options of demutualization and merger have been discussed with four of the companies, but no definite decisions have been made. One of the Finsac-supported companies has reported profits.



In the meantime, at least one new life insurance company, owned by one of the larger banks, has opened its doors. With its captive client base and well-capitalized parent, the new company may pose a considerable competitive challenge.

The new face of the life insurance industry is still emerging. One thing is sure, it will never look the same again.

*Janet Sharp, FSA, is Assistant Vice President for Island Life Insurance Company, Ltd. in Kingston, Jamaica, and the SOA Ambassador in Jamaica.*

**Chairperson's Corner**

*continued from page 1*

contributions of the Section to its members. I urge all of you to contribute articles, or to recruit authors, when you become aware of something that you believe would be of interest to the Section membership.

2. The Section has sponsored or co-sponsored over a dozen programs at Society meetings. Under Mike Gabon's and Bob Lyle's leadership, the Section sponsored and recruited for several concurrent sessions, with active participation by section members as speakers.In addition, at the Annual Meeting in New York we hosted a reception and an International Section breakfast.

3. The Section web page is maintained, providing easy access to International Section newsletters. We are investigating the possibility of adding hotlinks to websites that would be of interest to other internationally active actuaries.

4. The SOA Ambassador Program continues to operate under the direction of the International Section Council. Josh Bank has provided great leadership there, with strong support from the Society staff. The Section Council continues to recruit new and replacement Ambassadors, and to provide direction and support for their activities. The Society staff plays a strong role in this as well.

In addition to these recurring activities, a number of special activities have been undertaken by the council in the past year or are planned for the following year. A summary of these follows:

1. The Product Development CD-ROM was distributed to SOA Ambassadors, a project jointly sponsored with the Product Development Section. The intended use is to help spread knowledge about U.S approaches to product development and the actuary's role in the process.

2. We have co-sponsored with the Financial Reporting Section seminars outside the United States on financial reporting topics. The first of these was in Asia, and subsequent sessions have taken place in Latin America and the Caribbean. Future sessions are planned for Eastern Europe. Section members have played an active role in these, in addition to the financial support provided.

3. This year the Section will investigate whether to sponsor a special seminar to serve its members in the United States. One potential topic would be financial management of multi-national life insurance operations. We would appreciate your feedback on what type of topics you believe should be covered in such a seminar. Angelica Michail is coordinating this, and you can send your suggestions to her.

4. In October, the Society of Actuaries reorganized and strengthened its committee structure dealing with international issues. The International Section will work to accommodate that new organization and to make sure we work together smoothly.

5. We are investigating ways to more widely distribute the Section newsletter. Section Council member Ronald Poon-Affat is looking into the financial viability of having it translated into Portuguese and distributed to the Brazilian actuarial community. Once that is done, we will explore other markets.

*(continued on page 15, column 3)*