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Historical Factors That Have Influenced the Life Insurance Market in Colombia

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It is well documented that the property and casualty, or general insurance market is typically influenced by the evolution of macroeconomic variables, such as the growth in gross domestic product (GDP). For instance, the growth in GDP of BRICS countries (Brazil, Russia, India, China and South Africa) has promised to lift millions of people into the middle class, allowing them to acquire goods and services which creates demand to insure their newly acquired assets (e.g., homes, automobiles). Recent analyses and published papers, attempt to show the impact that macroeconomic factors (such as financial development, inflation levels, private saving rates, local interest rates), demographic factors (such as social security expenditures, income growth, young dependency ratio, life expectancy) and geographic factors have on the sprouting of the life insurance market. Some of these factors are different than the factors that influence the growth of general insurance due to the nature of the liabilities and investment strategies inherent to the long-term concept of life insurance in general. Similar evidence regarding the dependency of Latin American (LATAM) insurance markets to macro economic variables has been published lately; however these articles do not ponder the effect of historic variables.

How do all of these findings relate specifically to Colombia and why do other countries have a significantly larger level of life insurance activity when measured as a percentage of GDP? Notwithstanding the fact that Colombia has always been characterized by an intense internal conflict that puts pressure on its economic and financial markets, it has been one of the few LATAM countries that has never defaulted on its debt obligations and avoided hyperinflation (low income countries tend to rely in the export of

goods such that a tough devaluation of the currency due to hyperinflation causes a countries' earnings to be very unstable), whereas countries such as Brazil and Argentina have defaulted in the past and suffered extended periods of hyperinflation. The internal conflict was born in the 1950s as a peasant movement looking to protect the rights of the poor and to provide social justice. Years later, it became a business financed through extortion, kidnapping and drug-trafficking. The twenty-first century in Colombia has featured strong antidrug and antiterrorism policies and also lately, President Santos has started activities towards a peace process with insurgency groups that would put an end to one of the longest internal armed conflicts in the history of modern civilization. There were similar attempts to provide Colombia with long lasting peace at the beginning of this new millennium but President Pastrana's government was too lax and gave the terrorist groups enough rope to keep committing crimes.

On the other hand, regarding social and economic policies, the Colombian congress recently passed laws that allow the poorest to access free health care, reduced taxes for imports and exports originating from businesses where free trade agreements are in place, and introduced strong macroeconomic policies that increase the country's revenue and stimulate foreign investment. Due to this political assertiveness, the country is enjoying exceptional growth rates, which are supported by soaring foreign investments (15 percent increase year on year) that are being reported in the most renowned publications including *Financial Times, The Economist and The Wall Street Journal.* This thriving economic and political environment should provide fertile ground for life insurance market growth, although this hardly explains the behavior up until now since most of the changes have occurred in the latest decade.

Colombia is one of the biggest LATAM countries in terms of population and size, but a significant portion of its territory remains relatively isolated due to the lack of roads and communication infrastructure. This is mainly due to its geography as mountains and rainforests cover more than 50 percent of the territory and some areas are by any means, impenetrable. Colombia possesses strategic points (places that if supported by a robust infrastructure would have the greatest impact in terms of economic growth, social uplift and sustainability), relatively unconnected that can only be accessed by rudimentary means. Similar middle-income countries such as Chile and Argentina have five and 25 times the number of rail line kilometers available for use than Colombia, respectively. Even though Colombia is rich in natural resources such as gold, petroleum, emeralds, gems, nickel, and coal, the location of the mines and deposits are such that the costs of extraction and transportation increase the price that the consumer has to pay. Most of the industries complain that it is cheaper to transport goods to Hong Kong or Europe than within Colombia. During the last three centuries there has been no efficient means to reach the final consumer and therefore, economic growth and with it the growth in insurance demand has been lethargic.

The life insurance industry landscape in LATAM is better in some respects than in mature markets such as Europe and the United States because the young dependency ratio is much higher (and thus the size of the target market population). That is, LATAM populations are relatively young. These individuals are much more likely to acquire life insurance protection because their asset and salary growth outlook is larger than in older populations. On average, there are six individuals per each senior in Latin American countries whereas in European countries this ratio is just three individuals per each senior. Since life insurance policies are used to provide protection on income, another way to look at this phenomenon is assessing future market size determined by the proportion of the population under 15 years old. By this measure, Latin America almost doubles Europe's future workforce (25 percent compared to 14 percent, respectively).

The Colombian life insurance industry needs to take a big leap forward by overcoming significant challenges to increase insurance penetration to comparable South American levels. The average penetration for South America is 1.11 percent whilst Colombia's is 0.686 percent (the lowest among the high growth countries which include Mexico, Brazil, Colombia and Chile). Some of the biggest challenges are broadening post-secondary education, reducing the operating costs to make it more attractive for investors, deregulating economic markets, and improving financial literacy and awareness.

Access to higher education and beyond, has been one of the main reasons why Colombia falls back to very similar countries like Chile and Mexico. In the 1960s, more than half of the populations in Mexico and Chile were below their poverty line, but postsecondary school education enrollment allowed them to enter the middle class and as of now, are responsible for the vast

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growth in consumption. It was not until the late 1970s that the Colombian government took over the costs associated with educating its people. In spite of recent improvements in the volume of citizens attending college or universities, it is below the average proportion in the LATAM region. Educated people become one of the main factors for the success of the life insurance industry because these people have a better quality of life and thus greater necessity to protect their current state than uneducated people.

Reducing operating costs presents a two-fold challenge in Colombia: technology use and high labor costs. In the United States, insurance companies were some of the first to harness the power of computing in the 1950s, which was required to administer large number of policies. However, the biggest players in Colombia (e.g., Grupo Sura and Seguros Bolivar) had always been locally owned, until recently since their initial public offering were less than five years ago, and therefore were less exposed to information technology trends and thus, slower to adopt better technology. On the other hand, while running an enterprise in Colombia is cheaper in terms of taxes than in some European countries (28 percent of profit taxes compared to close to 50 percent) it is more expensive when it comes to hiring employees because welfare expenses increase costs an additional 50 percent reducing profit margins and thus, making it less attractive for investors. The result is that due to substantial operating costs most of the life insurance products are still inaccessible for a broad economic section of the population.

Significant government efforts to stop drug trafficking, reduce corruption, and improve security coupled with business friendly policies have resulted in a vast influx of foreign investments since the country's risk diminished significantly. Also, liberalization of the markets in the early 1990s lifted restrictions in most of the economic sectors and provided equal treatment for local and foreign investors. All of these facts, which coupled with better ratings on the international Corruption, Heritage Economic Freedom and World Bank Doing Business indices, enhanced the investment climate such that the foreign direct investment (FDI) has been growing exponentially in the last two decades. Nonetheless, Colombia has lagged behind comparable countries such as Mexico and Chile for two decades, as these countries had free trade agreements in place with the United States and Europe since the beginning of the 1990s. This meant the growing local presence of worldwide insurance and banking companies that brought with them knowhow and expertise, resulting in a healthy competitive market that drove down costs and increased innovation to satisfy Colombians' needs.

Financial market penetration (*Bancarización* as referred to in Spanish) may very well be the most substantial challenge to increase insurance penetration. In the early decades of the last century, means to save in rural populations were almost nonexistent since the government owned banks did not have any material presence in these low population areas. This resulted in a lack of knowledge of the financial world and the role of insurance products. As seen in Bangladesh and India, micro insurance and loans products can reduce poverty by offering financial stability and increasing awareness. NGOs (Non-governmental organizations) and government agencies should focus their efforts in proliferating appreciation of the financial markets in rural areas so their use becomes more common. Recent studies show a significant increase in the penetration of financial products, which reaches almost 65 percent of the population with at least one financial product. Unfortunately this does not imply broadened insurance use since its growth, while positively correlated, is not as large because insuring life (in other words, securing means of living for your family in a predominantly male working society) is not deemed necessary possibly due to the lack of knowledge, as well as perhaps longstanding family traditions. This amelioration would also create robust vehicles for the sales and administration of insurance policies

that would in turn, reduce transaction and operating costs.

As a conclusion to this article, we can assert that although Colombia has taken big steps towards the modernization of the financial services industry and particularly the insurance industry, some pressing problems remain unsolved. Access to education should be extensive regardless of the degree of urbanization and enrollment to science related careers should be encouraged to be aligned with worldwide market trends. Access to financial services should be nationwide and the growth of its penetration depends on teaching people to save by participating in the financial markets while creating confidence on the system. These actions should ease the burden on payment processing for the sales of insurance policies. Finally, lifting tariffs and restrictions to protected markets (e.g., oil & gas and infrastructure), and concluding the peace process successfully shall bestow investors with a safe and sound economic environment.

In some cases, economic policies are indeed very difficult to implement. As we have seen, experience in similar middle-income countries can be leveraged to streamline the innovation of economic markets. □