Article from:

The Actuary

February 1993 – Volume27, No. 2

States and Canada, and to a draft of standards of practice for pensions, life assurance, and general insurance. Each member association must establish disciplinary procedures to enforce the code.

Common problems

These strides in international actuarial cooperation point out the similarity of problems facing working actuaries around the world.

Declining birth rates and declining mortality rates are leading to populations with declining ratios of workers to support those beyond normal working age. In this issue, we print several contributions to the debate initiated by Robert Myers and Haeworth Robertson on the uncertain future of U.S. Social Security, an uncertainty partly due to the country's changing demographic profile. The U.S. problems are far from unique. In my country, the Canada Pension Plan faces similar difficulties. The French pay-as-you-go social security program faces future problems. The New Zealand social security system will have to be reorganized. The projected ratios of workers to retirees in Mexico make U.S. and Canadian planners wish they were so fortunate, but the ratios are far lower than those on which the Mexican system was designed.

The drop in asset quality and yield has contributed to insolvencies or strains on the adequacy of capital for U.S., U.K., and Canadian insurance companies. We are now entering the age of the appointed actuary. With the profession's increasing responsibilities in a volatile environment, the more we can learn from international give-and-take the better.

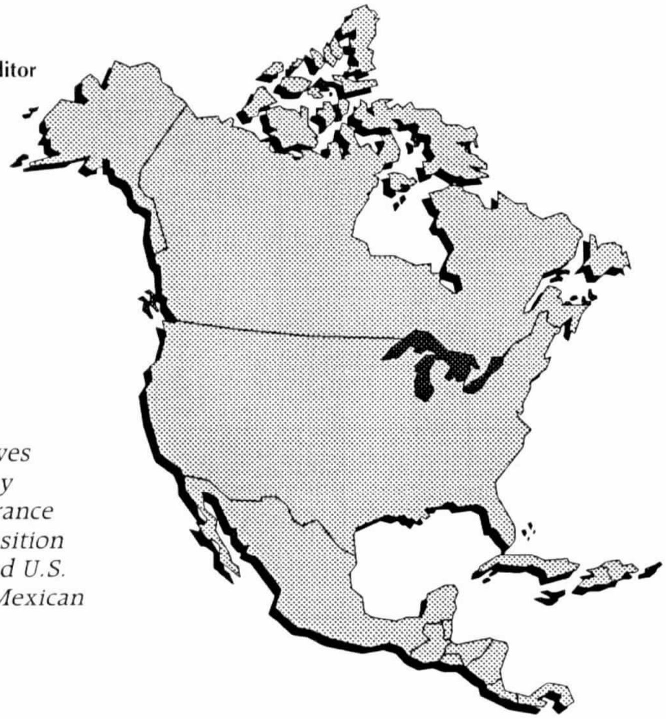
Shared solutions

What effect will all this have on the individual Society of Actuaries member? We can only benefit by learning how actuaries outside the United States and Canada solve similar problems. We may have to adapt to a slightly more restrictive working environment, but we can design it ourselves rather than have it imposed on us by legislators and regulators. We are justifiably proud of our education and examination system, but we cannot be blind to better ways that may have been developed elsewhere. Above all, we should grasp the opportunities that increasing international cooperation affords us.

Insurers to benefit from NAFTA

by Cecilia Green, Staff Editor

While some industries consider the vision of an expanded market under the North American Free Trade Agreement (NAFTA) merely a mirage, the insurance industry sees the potential for significant gains. The agreement as signed by Mexico, Canada, and the United States removes restrictions on foreign equity ownership of Mexican insurance companies over a short transition period. It gives Canadian and U.S. firms greater access to the Mexican insurance market.



Since the 1930s, the Mexican insurance market had been closed to foreign companies. In 1987, the government allowed foreign companies to be minority owners of Mexican insurance companies and to become joint ventures partners with Mexican insurers but did not let them set up wholly owned subsidiaries.

Under NAFTA, foreign companies will be permitted to build up their presence gradually. Faring the best will be a few companies that already owned 10% or more of a Mexican insurer as of July 1, 1992. They can buy out their affiliates by January 1, 1996. Companies with joint ventures formed before July 1, 1992, begin with a 30% ownership ceiling in 1994, building to 51% in 1998, and then 100% ownership on January 1, 2000. Insurers with no prior involvement in Mexico may establish wholly owned subsidiaries by January 1, 1994.

During the transition period of 1994-2000, subsidiaries will face limits on their Mexican market share. As a group, U.S. and Canadian wholly owned subsidiaries will be limited to 6% of the Mexican market. That ceiling rises to 12% by 1999. Individual subsidiaries will be restricted to 1.5% of the market share until January 1, 2000, when the caps will be lifted.

Intermediary and ancillary insurance service companies can set up subsidiaries with no limits on ownership or market share. Any acquisition with a purchase price of more than $25 million, however, requires approval from the Mexican government. The limit increases gradually over 10 years to $150 million, when all limits end.

NAFTA benefits depend on economic growth

"Entrance into the Mexican market should be viewed as a long-term investment," Camilo Salazar said at the Society of Actuaries October 1992 annual meeting session on NAFTA. Salazar was chief actuary for the American and Caribbean regions for the American Life Insurance Company, a member of the American International Group (AIG). AIG is one of the handful of foreign-controlled companies that is well positioned to benefit from NAFTA. It holds a 49% stake, the largest percentage allowed under current Mexican law, in La Interamericana, a commercial property and casualty company.

Salazar said the U.S. Department of Commerce estimates that Mexico's individual life premiums would benefit the most from NAFTA. By 1995, individual life premiums probably will be twice that of the 1991 level. Group

continued on page 4 column 1

NAFTA cont'd

premiums are estimated to increase also. These increments will be a result of new products and more efficient distribution, marketing, and administration methods introduced by new foreign players.

"Successful long-term growth of the life insurance market in Mexico will largely depend on the economic expansion of the manufacturing and industrial base," he said. "As the national economy grows, the middle class grows and begins to have the monetary means to insure its newly acquired and increasing wealth."

Market potential worth venture into Latin America

In the session, Salazar pointed out the life insurance market potential in Mexico. Of Mexico's 86 million people, 40 million are between the ages of 20 and 60, the typical range of life insurance buyers. Only about half of those live above poverty level, and 20%, or 8 million, are considered in the upper economic class that can afford life insurance.

"The approachable number of consumers in the Mexican market fluctuates somewhere between 8 and 20 million consumers," he said. "The Mexican market is underdeveloped by international standards. The ratio of total insurance premium to GDP is about 1%, whereas this ratio fluctuates between 4 and 5% in developed countries. Only 1.5 million people in Mexico today own individual life insurance."

Salazar sees NAFTA as the first step to a hemispheric trade zone that will continue down the road into the rest of Latin America. Argentina, Brazil, Chile, Colombia, and Venezuela represent an additional market of more than 250 million. Argentina is with Mexico at the forefront of economic change, he said, and Chile has signed an agreement with Mexico that could provide the basis for it to join NAFTA.

How NAFTA will affect actuaries

"NAFTA changes will be slow to emerge in terms of the impact on your day-to-day lives, but when the changes arrive, they will be fundamental and far-reaching," predicted W. Paul McCrossan, another speaker at the annual meeting session on NAFTA. McCrossan, a consulting actuary with Eckler Partners Ltd., was the 1991-92 president of the Canadian Institute of Actuaries. While a member of the Canadian Parliament, he worked on pension and insurance reforms.

"You have to understand that NAFTA is coming through on the fast track," McCrossan said. "The fast track chosen by both Mexico and Canada means the treaty cannot be amended in the U.S. Congress. We have a long history of trying to negotiate treaties and get them through Congress and the states. They have the 'Christmas tree ornament' effect: things keep getting added on."

McCrossan pointed out that professional mobility, or the ability to work in other countries, was an issue that emerged under the Canada/U.S. Free Trade Agreement (FTA), a predecessor to NAFTA, now in place for four years. NAFTA has created a new category of business visitors.

"Business visitors can move across borders to transact their business provided their business is international in scope and they do not intend to change their residence," McCrossan said. Under NAFTA, McCrossan said, professions are obligated to develop mutually acceptable professional standards and criteria and must develop licensing. The three Mexican actuarial organizations have been invited to attend the Council of Presidents, consisting of the presidents and presidents-elect of the six organizations representing actuaries in Canada and the United States.

The first working meeting of the presidents-elect of the Canadian, United States, and Mexican actuarial bodies took place in Washington, D.C., on December 16, 1992. The presidents-elect, together with their advisors on accreditation, will meet in Mexico on February 8-9, 1993, to examine mutual eligibility and accreditation issues.

Another new provision under NAFTA is a financial services committee that will consult on standards and rules for financial institutions. It provides for coordination of regulatory authorities in the three countries. It also creates a financial sector dispute settlement mechanism, drawing from a panel of 15 financial service experts from each country.

An important concession in NAFTA is that if the United States liberalizes its financial service structure, only Canadian and Mexican financial institutions automatically benefit. They also get "most favored nation status" in any financial service concessions the United States makes with any other country.

Actuarial preparation in Mexico

Two other speakers in the session, Oliva Sanchez-Garcia and Segundo Tascon, mentioned the differences between the North American and the Mexican actuarial educational process.

Sanchez-Garcia, director of the actuarial school at the Anáhuac University in Mexico City, said that to be an actuary in Mexico, one must receive an actuarial degree from an officially recognized Mexican university. The student must write a dissertation and defend it in front of an examination committee. The Ministry of Education grants the professional certification that is required of anyone signing an official document that needs an actuary's signature.

"If we compare our programs with the education curriculum of the Society of Actuaries," Sanchez-Garcia said, "we can see that about 50 to 60% of the courses account for about 175 of the 200 credits of the Society requirements at the Associate level. The rest of the Mexican curriculum covers material that corresponds to some of the requirements in the Fellowship level."

She said the university began in 1990 to encourage students to take the SOA exams. "With the eventual signing of NAFTA, we should start to learn about the way we operate in each other's country. It is important to realize that we have a different professional tradition. You have certification given by peer recognition, and our profession requires an academic degree and supervision of the civil authority."

Sanchez-Garcia urged establishing joint mechanisms of training and continuing education.

Segundo Tascon, a consulting actuary and manager of Wyatt Mexico, believes that NAFTA will be the motivation for reconstructing Mexican academic preparation to include actuarial exams.

Expanding professional unity

"There's no doubt in my mind that Mexican actuaries are actuaries in every sense of the word and meet the standards that we use to describe ourselves," McCrossan added in the session wrapup. "But we're faced with a different educational system. We're going to have to reconcile these two systems."

McCrossan also mentioned the

continued on page 9 column 3

Discussion cont'd

Fiasco," in the American Academy of Actuaries September 1992 *Actuarial Update* prompted a rebuttal from Myers, saying that his "doom and gloom" picture is incomplete. Myers says Robertson does not separate OASDI and Medicare. "OASDI provides cash benefits bearing measurable relationships to past earnings. Medicare provides reimbursement for health care services, which do not have precise utilization limits. Thus, . . . the real culprit is Medicare," he writes.

He further explains that the "fiasco of horrendous costs" about which Robertson warns us will not come overnight, so necessary changes can be made gradually as the experience develops.

Nothing new in the SS debate in 10 years

Edwin Hustead comments, "The Robertson-Myers debate on Social Security has not offered us anything new for a decade." The following edited paragraphs from his letter explain his views:

"Yes, Haeworth, we know that the total Social Security/Medicare tax rate falls far short of the future needs of the combined program. Yes, Bob, we know that the Social Security tax rate is almost adequate for the future needs of the Social Security program without Medicare. In that view, either unpredicted changes in the economy will balance the income and outgo, or minor adjustments will be made to taxes or benefits in the next millennium. We decide whether or not to include Medicare with Social Security and then march hand-in-hand with either Myers or Robertson. For the rest of this letter, I will simply refer to Social Security and let the reader decide if that includes Medicare or not.

"The issue that Myers raises in the November 1992 *Actuary* also is old, but it is much more complex than the rest of the argument. It is important for actuaries to understand and appreciate the political and economic implications of the Social Security trust fund investments. It is the real-world financing of Social Security, and not the artificial world of the trust funds financing, that has driven and will drive the debate on this issue.

"Perhaps Robertson's use of 'fallacious' in describing the trust funds is overly strong, but he is correct. Everyone who really understands the operations of the federal budget agrees with him. Social Security tax revenues are in fact spent when received, and current year benefits are in fact funded by current year taxes. The current excesses are spent on other federal programs. When Social Security outlays exceed revenues, the government will have to meet that year's Social Security deficit from other sources, such as increased taxes or reduced spending.

". . . The illusory nature of the trust funds explains the debate on Social Security benefits. If the trust funds had a real economic meaning, then no advantages to cutting Social Security benefits this year would exist. No one would propose cutting those benefits, and politicians would not fall all over each other swearing not to cut benefits. As Social Security payments make stronger . . . demands on the federal budget, the generational debate will center around how much can be paid each year out of that year's taxes. The size of the trust fund balance will be meaningless."

Din of inequity

Bill Sutton reminds us of the 1959 paper, "Misconceptions and Missing Perceptions in Our Social Security System (Actuarial Anesthesia)" by Ray M. Peterson (*TSA* XI, p. 812), that was on the examination syllabus for several years. Peterson believed that as employee contribution rates increased to an amount more than the value of employees' own future benefits, resistance to paying those rates would occur. As a result of this, he wrote, "There will truly arise a din of inequity."

Sutton commented, "My feeling is that Robertson, in his own way, is trying to create a modern version of Peterson's 'din of inequity' which never did arise."

More discussions by actuaries available

Session 86, "Worldwide Social Security Programs," at the Society of Actuaries October 1992 annual meeting in Washington, D.C., was moderated by Bob Myers. Panel members represented U.S. and other governmental agencies. They discussed social insurance systems in Canada, Latin America, Eastern Europe, and Asia. Audio tapes are available through Teach'em Inc., 1-800-225-3775, and the session will be printed in the Society's *Record*, to be published in late 1993.

Another discussion appears in "Sooner than You Think — the Coming Bankruptcy of Social Security," an article by SOA member Bruce D. Schobel published in the fall 1992 issue of *Policy Review.*

Nineteen ninety-three and the new administration should provide fertile new areas for continuing the Social Security discussion.

Cecilia Green is staff editor and Dick Bilisoly is education actuary at the Society of Actuaries. Mary Riebold is managing director of the William M. Mercer New York office, a member of the SOA Board of Governors, and the immediate past president of the Conference of Consulting Actuaries.

NAFTA cont'd

work done on developing a common code of conduct between Canada and the United States. How that code could be applied in Mexico, as well as what the current Mexican actuarial code of conduct offers, should be considered, he said.

The strong licensing and accreditation system present for Canadian and Mexican actuaries may make it easier for them than for the United States to join in a reciprocal accreditation package, McCrossan said.

"Whatever we design has to be expandable," McCrossan said. "NAFTA is an open-ended treaty. Any new entrants that apply can join if they accept the terms of the treaty. That means that whatever we decide not only has to work between Canada, Mexico, and the United States, it also has to be capable of expansion into Chile, Argentina, Brazil, Australia, and New Zealand, who have indicated some interest in joining NAFTA."

McCrossan also mentioned the professional issue of how involved actuaries in the three countries would be in leading governments through "the most difficult sociological problems they all face" — the problem of the aging population.

"This is a worldwide problem," he said, "and one where NAFTA and the professional cooperation among the three groups may offer something to their countries."