# Changes in the Rules of the Game: Future of the Insurance Business in Mexico

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**A revolution is taking place just south of the border of the United States. Tapen Sinha describes it.**

The insurance industry in Mexico is on the move. Until 1990, foreign companies were forbidden to enter the direct insurance business in Mexico. With the entry of Mexico to NAFTA in 1992, things are moving in the Mexican insurance industry (see the basic facts about the Mexican economy in Table 1).

**Table 1: Overall key economic indicators for the Mexican economy**

| Basic Facts about Mexican Economy | |
|---|---|
| Area(thousands of sq. km.) | 1958 |
| Population (1995) | 91.1 million |
| GDP (billions of US$) | 371.2 |
| GDP per capita (PPP adjusted in US$) | 7080 |
| Telephone main lines | 7,200,000 |
| Adult illiteracy rate | 10% |
| Infant mortality rate (per 1000) | 35 |
| Joined NAFTA | 1992 |
| Joined OECD | 1994 |

*Source: Various*

At present, the Mexican insurance industry is worth about US$3 billion. But, despite the peso crisis of 1994, the Mexican economy is growing. At present, the income level in Mexico is $7,080 (Purchasing Power Parity adjusted). Among the OCED countries (which Mexico joined in 1994), Mexico has a projected growth rate (OECD Forecast, November 1996) for 1997 of 4.5 per cent, and for 1998 of 5 per cent. For 1999 and 2000, the projected growth rates are 5.2 per cent and 5.6 per cent respectively (Informe Hacendario, Abril-Junio, 1997, page 47). The only OECD countries with a comparable projected growth rate in GDP are Ireland, Poland and Turkey.

## Why is the insurance industry in Mexico so interesting?

In the past six years, the insurance industry in Mexico has grown at the real rate of eight per cent. Compared with the US, it still represents a small percentage of GDP (compare 1.87 per cent in Mexico with 8.5 per cent in the United States). However, insurance penetration in a country depends on the stage of development.

**Table 2: Insurance growth: Direct premiums as a percentage of GDP**

| Year | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| Premium/GDP | 1.15 | 1.24 | 1.47 | 1.57 | 1.61 | 1.87 |

*Source: Comision Nacional de Seguros y Fianzas*

Researchers have noted that as the economy grows, so does the purchase of insurance. The relationship between the growth of income and the growth of insurance demand is not a linear one. Rather, as the per capita income level rises, from $500 to about $5,000, the insurance demand rises gradually. Then there is a rapid rise in demand for insurance until the economy matures and the per capita income reaches $15,000.[1] Mexico is right at that threshold now (see Table 2). If, over the next 10-15 years, the Mexican economy grows as expected, the current $3 billion industry will flourish into a $50 billion industry.

**Table 4: Foreign Ownership of Mexican insurance companies (end of 1995)**

| Institution | Nationality | Percentage |
|---|---|---|
| Atlas | American | 30 |
| Cigna | American | 49 |
| Chubb de Mexico | American | 30 |
| Genesis | American | 24.5 |
| | Spain | 24.5 |
| Geo New York Life | American | 30 |
| Interamericana | American | 49 |
| La Territorial | France | 32.5 |
| Monterrey Aetna | American | 44.5 |
| Principal International | American | 30 |
| Tepeyac | Spain | 49 |
| Veracruzana | American | 35 |
| Banamex | Holland | 49 |

*Source: Comision Nacional de Seguros y Fianzas*

## Changing market structure in the Mexican insurance industry

The market structure in Mexico is changing in two distinct ways: (1) deregulation is bringing in more foreign companies into Mexico; and (2) composition of the markets for different kinds of insurance is changing.

### Deregulation

There were at least three distinct impetuses for deregulation in the last decade. In 1988, Mexican Federal Government initiated a set of (mostly internal) deregulation processes. As a result, in 1990, a new Law of Insurance was passed. This law introduced a new solvency requirement for the insurance companies and introduced a new regime of investments by the insurance companies. In 1992, with NAFTA, a second wave of opening up of the insurance sector (mostly for the American and Canadian companies) took place. With Mexico joining the OECD, a third wave came in 1994.

At the end of 1990, there were 44 insurance companies operating in Mexico. By the end of 1995, six have merged with others. More than half of them changed their names to reflect either acquisition or merger or joint ownership with foreign partners (see Table 4).

Competition is also increasing. There are about 30 per cent more insurance companies operating in Mexico today than in 1990. One of the national companies has been privatised, another one is in the process of being privatised (Table 3). The figures for the insurance companies give a somewhat distorted picture because six or so companies have more than 90 per cent of all insurance business.

**Table 3: Number of Insurance Companies Authorised to Operate 1990-96**

| Year | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| Private | 36 | 36 | 36 | 38 | 41 | 49 | 54 |
| National | 3 | 3 | 3 | 2 | 2 | 2 | 2 |
| Mutual | 2 | 2 | 2 | 2 | 3 | 3 | 3 |
| Reinsurance | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Total | 43 | 43 | 43 | 44 | 48 | 49 | 61 |

*Source: Anurio Estadistico de Seguros, 1996 (Comision Nacional de Seguros y Fianzas)*

In addition to the large holding by foreign companies, a number of foreign companies hold smaller proportions in Mexican insurance companies.

### Composition of the market is changing

The most notable feature of the last decade in the Mexican insurance market is that the relative importance of different types of insurance is changing. Note the huge rise in the market share of accident and health insurance over the last decade.

**Table 5: Market share by the type of insurance**

| | 1986 | 1991 | 1995 | 1996 |
|---|---|---|---|---|
| Life | 28.99 | 35.57 | 33.80 | 34.50 |
| Accident and Health | 2.36 | 8.40 | 8.81 | 9.80 |
| Property and Casualty | 68.65 | 56.03 | 57.34 | 58.22 |
| Fire | 18.32 | 10.19 | 12.22 | 11.11 |
| Auto | 21.31 | 30.39 | 26.50 | 25.40 |
| Total | 100.00 | 100.00 | 100.00 | 100.00 |

*Source: Anurio Estadistico de Seguros, 1996 (Comision Nacional de Seguros y Fianzas)*

Note: Fire and Auto are part of Property and Casualty and therefore should not be counted separately

There are five areas in which the insurance industry is likely to grow over the next several decades: (1) health insurance; (2) annuities; (3) workers' compensation; (4) business insurance of small and medium enterprises; and (5) auto insurance. The reasons are discussed below:

*Health insurance*

IMSS guarantees basic healthcare for every Mexican working in the formal sector of the economy. However, only half of the economically active population is working in the formal sector. So, there is a great potential for the other half of Mexicans to buy private health insurance. Unfortunately, the population in the informal sector is also the poorer half. Hence, unless the economic growth accelerates, the potential cannot be realised.

*Annuities*

With the new laws for compulsory retirement saving,[2] the new (compulsory) individual retirement accounts are going to grow over the next few decades (the AFORES and the SIEFORES). This will inject a large amount of funds in the insurance industry. The current system of retirement is mainly a US style 'pay as you go' scheme. But, on 1 July 1997, new entrants into the workforce will not be allowed to get into the old schemes any more. They will be enrolled into the new compulsory private schemes. At present, there are 17 companies operating in this market. Many of these companies have foreign affiliates (mainly from the US but one has a Chilean affiliate).

*Workers' compensation*

This is another potentially big market that has not grown because laws were not in place to protect the workers in the workplace. However, with the new laws (NAFTA laws), at least in the organised sector, this will become a larger market over the next few years.

*Business insurance*

Small and medium enterprises are growing in Mexico but the owners of these businesses have not yet understood the benefits of business insurance. With education, the situation is slowly changing.

*Auto insurance*

Only about a quarter of all automobiles in Mexico have any kind of insurance (compared with more than 95 per cent in the United States). Compulsory auto insurance, which is common in the other OECD countries, is not compulsory in Mexico. However, at the beginning of July 1997, compulsory auto insurance laws came into effect in Mexico City. Other large urban areas will follow (some have already implemented them, but enforcement has not been widespread).

Mexico reserved its existing prohibitions and restrictions on cross-border trade in insurance services, which allow Mexican residents to come into the United States to purchase life and travel insurance from American/Canadian insurers. However, it did not reserve its existing restrictions on the ability of Mexican residents to purchase from cross-border insurance providers tourist insurance (including travel accident and motor vehicle insurance for non-resident tourists, but not insurance of risks of liability to third parties) for individuals, purchased without solicitation by Mexicans who come into the United States; cargo insurance to and from each country for goods in international transit, including insurance of vehicles used in transporting cargo; and reinsurance.[3] 'Cross-border' insurance means the providing of insurance: (a) from the territory of one Party to NAFTA into the territory of another Party; (b) in the territory of a Party by a person of that Party to a person of another Party; or (c) by a national of a Party into the territory of another Party. It does not include the sale of insurance in the territory of a Party by an investment in that territory.[4] (Executive Power Branch, Secretariat of the Treasury and Public Credit, 'Rules of Establishing Affiliates of Foreign Financial Institutions', 21 April 1994, Chapter I, Section One (I).)

## Rules of Forming Joint Venture and Subsidiaries: Advantage NAFTA

NAFTA has brought in further changes in the insurance business in Mexico. Tables 5(a) and 5(b) show how things are going to shape up after NAFTA rules are fully implemented at the turn of the century.

'Rules for Establishing Affiliates of Foreign Financial Institutions' were adopted by the Secretariat of the Treasury and Public Credit on 21 April 1994 (the 'Rules'). The Rules establish the conditions for the incorporation and operation of an 'affiliate' of a 'foreign financial institution' in Mexico as a subsidiary of an American/Canadian insurer, and the acquisition of over 50 per cent of the stock of an existing Mexican insurance company.[4] An 'affiliate' is defined as the Mexican corporation 'with majority participation in its capital by a Foreign Financial Institution or an Affiliate Holding Company' that is authorised to organise and operate under the General Law of Mutual Insurance Corporations and Institutions.[5]

An 'Affiliate Holding Corporation' is a Mexican corporation authorised to incorporate and operate as a holding company under the Law to Regulate Financial Groups, and which is majority-owned by a foreign financial institution The Rules are administered by the Secretariat of the Treasury and Public Credit (the 'Secretariat') and the Financial Liberalisation Committee.

These rules have recently been extended to companies originating in Chile. There is some discussion about extending them for companies from Argentina as well.

**Table 6(a) Forming Joint Ventures before NAFTA**

| Before NAFTA | |
|---|---|
| US/Canada | Other countries |
| Since 1996, become subsidiaries (no quota) | Only up to 49% |

*Source: Comision Nacional de Seguros y Fianzas*

**Table 6(b) Forming Joint Ventures after NAFTA**

| After NAFTA | US/Canada | Other |
|---|---|---|
| 1994 | 30% | They can hold |
| 1995 | 35 | up to 49% |
| 1996 | 40 | but no more |
| 1997 | 45 | than 20% per |
| 1998 | 51 | individual |
| 1999 | 75 | or company |
| 2000 | 100 | |

*Source: Comision Nacional de Seguros y Fianzas*

**Table 7 Subsidiaries after NAFTA with maximum capital**

| After NAFTA | US/Canada | Other |
|---|---|---|
| 1994 | 6% | No opening |
| 1995 | 8 | possible |
| 1996 | 9 | (except |
| 1997 | 10 | through the |
| 1998 | 11 | US and |
| 1999 | 12 | Canada) |
| 2000 | free | |

*Source: Comision Nacional de Seguros y Fianzas*

## Conclusions

Changes in the Mexican insurance industry will have far-reaching effects not just in Mexico but in other Central American countries. For example, Guatemala has already committed itself to a Mexican-style privatisation of its public pension system. It has also been letting in foreign companies to operate life and other kinds of insurance business. Costa Rica has taken similar steps. The new conservative government in Nicaragua is conducting a feasibility study of establishing a private pension market. Therefore what happens in Mexico not only affects the domestic market in Mexico but influences other countries in the region as well. ■

**Notes**

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1 See Sigma 9/96, Swiss Reinsurance Publication, 1996.

2 Ley del Seguro Social, IMSS, Mexico DF, 1996 December.

3 NAFTA Documents, Cross Border Trade in Services, Chapter 12.

4 Executive Power Branch, Secretariat of the Treasury and Public Credit, 'Rules of Establishing Affiliates of Foreign Financial Institutions', 21 April 1994, Chapter I, Section One (I).

5 Ley General de Instituciones y Sociedades Mutualistas de Seguros.

6 'Rules of Establishing Affiliates of Foreign Financial Institutions', Chapter II, Section Four.