NEW REGULATION IN THE MEXICAN INSURANCE MARKET

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Introduction

In recent months, Mexican law has suffered modifications in different sectors and one of them is the insurance market. The following presentation will briefly analyze some of the changes that will be implemented shortly.
Executive Summary

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Agenda

• **Current Panorama of Mexican Insurance Market**
  • Ley de Instituciones de Seguros y Fianzas
  • Compulsory car insurance
  • Conclusions
In the last years, Mexican Insurance Market has experienced a considerable growth.

In the past 12 years, the Direct Premium has grown more than 100%.

Source: Prepared by the author based on the database of CNSF and Banxico.
Current Panorama of Mexican Insurance market: Mexico VS USA and VS OECD average (2000-2012)

Insurance spending (% of GDP) – Mexico, USA and OECD average

- Insurance companies’ share of GDP in Mexico has remained stable.
- Although it is much lower than in the US.
- It is even lower than the OECD average.

Source: Prepared by the author based on the database of OECD (2014)
Current Panorama of Mexican Insurance market: Mexico VS Latin America (2005-2012)

Insurance spending (Total % of GDP) in Latin America

When compared with other Latin American countries the situation does not improve

Mexico ranks 11th in Latin American penetration levels (percentage of premiums VS GDP)

Note: No data of Brasil (2006 & 2008),

Source: Prepared by the autor based on data of ASSAL (2014) and of “The Latin American Insurance Market in 2012-2013” (by Fundación Mapfre)
Financial Inclusion in Mexico

People with any insurance

- With: 22%
- Without: 78%

Reasons for not having

- Cost: 42%
- Ignorance: 25%
- No one has offered them an insurance: 9%
- Distrust of insurance companies: 4%
- Other: 20%

Source: Encuesta Nacional de Inclusión Financiera (ENIF) 2012 by CNBV and INEGI

Insurance market emulates GDP’s behavior, but a year later

Insurance market growth falls less and raises more than GDP

Source: Prepared by the autor based on databases of CNSF and the database of the World Bank
If insurance market wants to keep growing in a financially stable way, it is necessary to implement a regulatory frame based on fair capital requirements. This is because demand for compulsory insurance would increase market penetration.

Mexican regulatory and supervisory framework considerably follows the best international practices.

Source: 1. Financial Stability Assessment Program (2011) by IMF
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On April 4th 2013, the new law about insurances and securities (Ley de Instituciones de Seguros y Fianzas, LISF) was published.

The LISF will enter into force on April 4th 2015.

Main objective of Solvency II: All insurance companies have the enough capital to financially meet any responsibility with the insured\(^1\).

LISF is not a direct implementation of Solvency II.

Mexico will implement a solvency system based on Solvency II (European framework) and the principles of the International Association of Insurance Supervisors (IAIS).

Source: 1. “¿Qué sabe usted acerca de Solvencia II?” by Swiss Re (Feb. 2013)
Update the solvency regime to strengthen the financial position of insurance companies, so the insured are protected.

Promote a healthy development of all the insurance market based on a risk-based solvency regime.

Induce a greater competition as a way to stimulate the innovation and the efficiency of the market.

Strengthen the protection of the users, based on a greater insurer information transparency, as well as a better market discipline.

Source: “Modernización a la regulación en materia de Seguros y Fianzas” by CNSF (Feb. 4, 2014)
Regulatory discipline.
Efficient and practical rules that reduce the probability of insolvency of financial entities

Self-discipline.
Rules that financial entities impose upon themselves through their governing bodies and a solid corporate governance

Market discipline.
The right incentives to operate the market review mechanisms and to improve financial entities

Source: “Modernización a la regulación en materia de Seguros y Fianzas” by CNSF (Feb. 4, 2014)
Ley de Instituciones de Seguros y Fianzas: Detailed description

Source: “Modernización a la regulación en materia de Seguros y Fianzas” by CNSF (Feb. 4, 2014)
Main changes introduced by the Circular Única de Seguros y Fianzas (CUSF)

- Establish internal controls such as audits and committees.
- Establish a general formula to calculate the Solvency Capital Requirement.
- Specific rules for the Dynamic Solvency Test, taking into account the Actuarial Standards of Practice.
- Regulatory issues for methods of constitution, increase and valuation of technical reserves.

Source: “Modernización a la regulación en materia de Seguros y Fianzas” by CNSF (Feb. 4, 2014)
Potential impact of the LISF

- Strengthen of capital levels
- Risk-based calculation of capital
- Regulation models focused on each company’s specific characteristics
- Company manages risk appropriately

It requires many internal changes

Create an attractive environment to boost the investment on the insurance market

It opens the market even more to foreign investment

Small companies might not be ready:
- Disappear
- Create conglomerates
- Merge with large ones*

Source: “Modernización a la regulación en materia de Seguros y Fianzas” by CNSF (Feb. 4, 2014)

* See Appendix
More side effects of LISG

- Insurance companies will need technical and technological resources to implement the models.
- Increase the number of hired people.
- Stimulate competitiveness and greater market efficiency.
- Create important challenges for the insurance companies and for the supervisors.
- Attract new talents to the companies.
- Insurance companies will need technical and technological resources to implement the models.
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Compulsory Car Insurance: Why is it needed?

Mexico is the only OECD country that does not require a compulsory insurance for car accidents.

- 28% of all cars are insured
- In 2013, there were 30,000 car accidents in Federal roads

Starting in September 2014

Reform of the Federal Roads, Bridges and Traffic act

Source: 1: AMIS' statistics
        2: Secretaría de Comunicaciones y Transporte’s statistics
Compulsory Car Insurance: A long way to go

Reform of the Federal Roads, Bridges and Traffic act

It establishes that all vehicles traveling on federal roads, highways and bridges must have third-party insurance.
Note: Local roads are not included

- Annual premium: $23 (US)
- Minimum insurance cover:
  - Material damage = $3,800 (US)
  - Personal injuries = $7,700 (US)
- People would become more familiar with insurance

Source: 1: AMIS’ statistics
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• Conclusions
Conclusions

1. Regulators need to keep an eye on what happens with the market because these changes will provoke learning and improvement.

2. Government needs to carefully follow the implementation of the LISF and of the compulsory insurance.

3. It is advised to develop mechanisms to protect small insurance companies.

4. It seems that Mexican Insurance Market’s future is promising because it is on the rise, so it will need enough capital to face such growth.
Final comment

“Overall, it seems likely that capital requirements under Solvency II will, in aggregate, lead to a risk reduction in the asset allocation of the insurance sector as a whole. This may to some extent be regarded as an intended consequence and legitimate goal of regulation, but one that has implications for financial markets and sectoral funding.”

Largest Insurance Companies (based on Direct Premiums)

- MetLife (USA) 14.2%
- AXA (France) 8.9%
- Banamex (USA) 5.7%
- Bancomer (Spain) 5.0%
- Monterrey NYL (USA) 5.0%
- Tepeyac (Spain) 3.3%
- GNP (Mexico) 11.3%
- Inbursa (Mexico) 6.9%
- Quálitas (Mexico) 4.4%
- Banorte (Mexico) 3.9%

Others 31.3%

Source: Prepared by the author based on “Participación en el Mercado – Seguros” by CNSF (Dec. 2013)
Lourdes Casanova, a Senior Lecturer and Academic Director of the Emerging Markets Institute at the Johnson School of Business at Cornell University, formerly at INSEAD, specializes in international business with a focus on emerging markets multinationals. A Fulbright Scholar with a Masters degree from the University of Southern California and a PhD from the University of Barcelona. Visiting professor at Haas School of Business at the University of California at Berkeley, Judge Business School at University of Cambridge and at the Latin American Centre at the University of Oxford, University of Zurich, and Universidad Autónoma de Barcelona and consultant of the Inter-American Development Bank. Taught, directed executive programs at INSEAD for senior managers from multinationals including Telefónica, BBVA and Cemex and the Brazilian Confederation of Industries. Co-author with Julian Kassum of: The Political Economy of an Emerging Global Power: In Search of the Brazil Dream, forthcoming in 2014 Palgrave Macmillan, author of ‘Global Latinas: Latin America’s emerging multinationals’ Palgrave Macmillan 2009, coauthor of Innovalatino, Fostering Innovation in Latin America, Ariel 2011 and articles in journals including Beijing Business Review, International Journal of Human Resource Management, Business and Politics and Foreign Affairs Latinoamérica.

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Alejandra Quintos Lima is an undergraduate senior at Universidad de las Américas Puebla (UDLAP) where she was awarded a full scholarship for studying the major in Actuarial Science. Born and raised in Puebla, Mexico. During spring 2014 she was an intern at the American Association for Marriage and Family Therapy where she could get an insight into American culture and rapport.

At Johnson, coached by Prof. Lourdes Casanova and Richard Coyle, she conducted a research about the new insurance law in Mexico. Upon graduation, Alejandra wants to pursue an actuarial career in the United States by becoming an Associate of the Society of Actuaries and by getting a Ph.D. in applied mathematics.

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