

# 2014 EY Latin America insurance outlook

Significant opportunities and challenges  
in a highly competitive environment



## Market summary

The Latin American region presents rich growth potential to competitively astute multinational and regional insurers in 2014, particularly for companies that pursue specific market niches. Overall, insurance penetration rates still remain low in many Latin American countries, particularly on the life insurance side despite continuing economic growth and reduced poverty levels. Nevertheless, growing risks include significant regulatory and fiscal reform, inflation, substantial catastrophe exposures and volatility in currency exchange rates. Insurers that efficiently manage these complexities, focus intensely on the markets in which they compete and achieve positive changes in their operating environments are highly favored to prosper. These factors may also drive consolidation in the market as larger insurers are potentially better placed to deliver the change required.

An understanding of the external forces at play in the region can help shape strategic and operating priorities. These forces demand increased attention in 2014 and must be prioritized organizationally.



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## External forces in 2014

Technology changes	Customer expectations	Regulations and taxes	Catastrophes	Capacity and competition	Inflation risk and currency FX	Economic factors
						
Pace of change accelerating	Demanding value, new approaches	Steady increase, volatile	Substantial but stable	Capital buildup ahead of premiums	Volatile	Pockets of demand

### Successful insurers assessing these forces to improve profitability in Latin America in 2014 will seek to:

- ▶ Focus on niches with expanding market opportunities
- ▶ Respond to competitive environments
- ▶ Develop efficient distribution alternatives
- ▶ Enhance and embed risk and capital management frameworks
- ▶ Develop and support insurance talent
- ▶ Advance data quality and precision



## Focus on niches with expanding market opportunities

Rich growth opportunities continue to draw insurers to launch operations or expand their presence in Latin American markets. Since 2012, on average, insurance premiums have grown at a double-digit pace across the region, well above the rate of most other global regions. This pace will continue through 2014, compelled by strong regional growth in small business and the modernization of mature industries and infrastructure, which drive demand for insurance protection.

In this heightened competitive environment, insurers can accelerate premium growth by targeting the rapidly growing market clusters within the region. While economic volatility and inefficiencies in Brazil's infrastructure, for example, have tempered recent enthusiasm to some degree, insurance premiums nonetheless continue to grow at a robust pace. Total direct premium in Brazil increased 14% in 2013, higher than the 10% nominal increase in GNP. Total insurance in Mexico grew at 11% (excluding the impact of a Pemex multiyear property renewal) and is well above the country's 7.5% nominal GDP. The trend of robust premium growth continues in other Latin American countries: Colombia's premium growth was 8% in 2013, while total insurance premiums in Peru grew 16%.

This high demand for insurance exceeds Latin America's overall economic growth. Specific insurance products and market segments with high growth potential include personal lines and especially life insurance, given the improved economic conditions in many countries and the growing need for insurance.

Increasing insurance penetration of the consumer sector is another growth factor, with life insurance emerging as a dominant channel for savings in Brazil. Individual life premiums in the country rose 29% in 2013, following a 66% increase in 2012. In Mexico, individual life premiums were up 23% in 2013, on top of a 19% increase in 2012.

Rising entrepreneurship, the growing small business segment and the expanding global needs of more mature businesses in many regions are propelling significant increases in commercial insurance premiums. In Brazil, these factors contributed to an 18% rise in 2013 in direct premium for *Compreensivo Empresarial*, a commercial multi-peril insurance product. The Brazilian government supports entrepreneurial growth and has passed special laws and introduced tax breaks for micro-enterprises known as "simples." Consequently, parts of Brazil's informal economy are migrating into its more formal economy. Mexico also has built a strong policy framework to support small- and medium-sized businesses, expanding the national loan guarantee program and facilitating more simplified regulations. Colombia has similarly reformed its regulatory processes involving permit applications, taxes and cross-border trading to increase the ease of doing business for small companies.

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More mature Latin American companies are poised to expand significantly within Latin America and outside the region. The best of these Multilatina businesses are becoming world-class global leaders in their industries. As they expand globally, they are implementing far-flung global supply chains, which introduce a range of credit, business interruption and other financial exposures. Many Latin American insurers also are structurally part of larger corporate families. These various complexities require more targeted risk management and risk transfer solutions. Additional challenges emerging across the region include currency exchange restriction risks, as seen most acutely in Venezuela. To expand capital market access, Chile, Peru and Colombia are integrating their stock markets.

By targeting high premium growth clusters in smaller markets, insurers can achieve significant growth potential. Peru's steady economic growth and expanding middle class, for instance, have strengthened Peruvian businesses that are now expanding into foreign markets. Middle class consumers, small business development and Multilatina maturity throughout the region offer significantly high near-term growth opportunities for both multinational and regional insurers.

### **Respond to competitive environments**

Insurance capacity across the region is expected to continue to increase in 2014. This is especially the case in Brazil, where double-digit decreases in premiums are anticipated across many low-hazard markets. Successful insurers will redouble their efforts to find profitable opportunities in this environment of diminishing premium rate adequacy and reduced margins.

These insurers must not only identify opportunities for superior top line and bottom line growth. They also need to execute effective strategies to better serve these segments relative to their competitors. This requires developing a customer-centric business culture focused on customers' distinctive needs and expectations.

A critical challenge is consumers' general reluctance to purchase insurance products other than those they are mandated to buy by law. In such low penetration market segments, insurers and the industry must build necessary product awareness and instill customer trust. Collaborative endeavors undertaken by industry participants in Latin America are not nearly at the same level of cooperation of North America and Europe. Insurers need to share data capabilities and interact with governments through trade associations to achieve positive regulatory change, while obstructing more burdensome regulations. A vibrant insurance marketplace with robust risk protection for growing consumer and business economies requires stronger industry and government and private and public partnerships.

Insurers also must tailor their products to the cultural expectations and economic suitability of targeted market segments. For instance, products and services should demonstrate a better value proposition to middle class consumer segments, by simplifying the policy terms, reducing overhead and distribution costs and enhancing options for premium payment and loss reimbursement. Yet, many insurers remain insulated from their customers, beset by weak data capabilities and minimal market information, other than that supplied by agents. Companies need to invest in more sophisticated information systems and processes to achieve a better understanding of the customer base, leveraging this insight to establish more direct relationships and improve customer retention.

Wider use of advanced analytics and technology in a few Latin American countries is contributing to enhanced market segmentation capabilities and improved pricing granularity. Leading auto insurers in Brazil, for instance, are using predictive modeling to price risk by the insured peril. Conversely, virtually no Latin American market utilizes consumer profile information to advance ratemaking and customer persistency modeling. This practice is of increasing interest to leading insurers, due to the cross-selling and upselling strategies based on the digital analysis it presents. Increasing competition will pressure insurers to develop data capabilities that track market potential, penetration and performance, as well as customer satisfaction and loyalty.

## **Develop efficient distribution alternatives**

Insurance distribution in Latin America has conformed to traditional systems such as brokers and bancassurance, as cash collection is critical to success. Insurers with owned or partnered distribution channels have thus enjoyed an advantage. Nevertheless, these traditional sales channels generally are not growing in line with expanding populations or addressing more demanding consumer expectations.

Latin American consumers seek demonstrated value when buying insurance, which competes with other purchases such as a new television or a vacation. Insurance sales and service offerings also must address consumer expectations. Across the region, consumers widely use the internet and mobile technology to shop and transact business, which is generally shaping price, information and transaction expectations. Traditional insurance distribution in Latin America has not evolved to keep pace with this changing marketplace. Dramatic changes in insurance distribution appear inevitable and may be the primary basis of differentiation in the evolving insurance marketplace.

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Many insurers, for example, are exploiting multiple distribution channels, leveraging social networks and mobile technology to distribute products and provide education and services to customers when and where it is most efficient for them to engage in these interactions. Multi-distribution channels present the potential to improve competitive advantage and market reach, as well as increase insurance sales to middle class consumers.

A one-size-fits-all distribution strategy, on the other hand, has not been effective in Latin America. Current market share by distribution channel varies by insurance product and by country. Eighty percent of life insurance premiums, for instance, are secured through the bancassurance channel in Brazil, while Mexican life insurance distribution is 40% bancassurance, 33% traditional agent and 26% payroll deduction. Personal lines general insurance is distributed predominantly through traditional intermediaries, which can constrain penetration of new and expanding markets.

Latin America consumers are highly engaged users of social networks and mobile technologies. They are very comfortable interacting online and are open to transacting business with online service and product providers. These factors have yet to fully influence the insurance distribution environment, but rapid evolution appears inevitable. Leading distribution innovators are likely to achieve significant market share gains, as they revise their sales and services strategies.

Aside from lower premiums, consumers want insurance products and services delivered as easily and efficiently as other types of online transactions. This remains a key challenge for insurers, requiring that they exploit advanced digital capabilities to drive efficiencies in bancassurance and insurance brokerage, while expanding both online and direct channels. To generate profitable growth, successful insurers will manage distribution strategies across markets via coordinated channel alternatives.

Expanding shop-assurance channels, for instance, provide consumer insurance products to consumers at local markets, e.g., insurance associated with durable good purchases. Mobile applications and social networking, which are growing regionally and by product sector, offer similar opportunities. Changing lifestyles and buying preferences will drive new distribution channel development. Finally, by applying innovative approaches to distribution, insurers increase their opportunities to communicate with customers, thereby extending insurer-consumer touch points that increase the possibility of additional sales.

Critical challenges hindering the development of the Latin American insurance market include a pronounced lack of insurance product awareness and questions over the perceived value among potential customers. To successfully address these issues, insurers must provide targeted financial education, develop online communities for knowledge transfer purposes and support the use of advanced analytics to identify prospects for more personalized communications.

## Enhance and embed risk and capital management frameworks

Insurance regulation in Latin America is evolving toward more sophisticated risk-based capital approaches to solvency assessment. This is in line with European and US regulatory trends and more open markets in the Pacific Alliance countries of Chile, Mexico, Peru and Colombia. Having set a 2015 compliance date for a Solvency II-style capital requirement framework, Mexico's legislation is the most advanced and is likely to be implemented ahead of the rest of the region.

Chile is implementing similar rules required to manage each risk category individually. Solvency regulations are under review in Brazil and Colombia, but both markets are likely headed toward more complex risk-based capital assessments. While the rate of regulatory change differs by country, the direction is clear.

The challenge is that most insurers in the region generally are not technically prepared for this level of risk and capital management. Those that develop sophisticated data analytics and other systems and processes to enhance risk measurement and management along the lines of global standards will secure an advantage over competitors in compliance and capital efficiency. While a significant challenge, successful insurers will develop and leverage more precise measurement of risk into increased capital efficiency and profitability.

Many Latin American countries, such as Argentina, Colombia, Chile, Mexico and Peru, have recently implemented significant tax reforms. These changes include an increase in corporate income tax rates, a withholding tax on dividend distribution and a capital gains tax on the transfer of stock. As these complex revisions and reforms evolve, they suggest substantial consequences, involving deductions for expenses paid to subsidiaries, dividends paid to foreign investors and the calculation of goodwill in a merger. This complexity increases as governments redefine margins and revise tax structures that are outside of international financial reporting standards.

New anti-avoidance rules limiting transactions that may be considered abusive have also been widely adopted. Significant audit activity is now focused on transfer pricing, and in certain cases, taxpayers are required to demonstrate that a given transaction has not been carried out solely for tax purposes. If this is deemed the case, tax authorities can re-characterize the transaction.



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The operational complexity foisted on the industry by the regulatory and tax changes insists on more sophisticated structures for management, information and capital systems. Multinationals that have experience with sophisticated solvency regulation have a slight advantage over insurers that lack this experience. Local carriers with complex conglomerate structures comprising businesses besides insurance may find it difficult to expeditiously adapt to the changes. Multinationals also may have greater access to capital to satisfy the emerging capital requirements. All insurers in the region, however, suffer from inadequate access to reliable data. Developing broad, high-quality data on customers and risks would be a prudent first step for the industry to take. For many insurers, such progress is hindered by legacy systems, making access to customer information difficult. Limited analytic capabilities and access to intellectual capital further hinder risk analysis.

### **Develop and support insurance talent**

In addition to the high demand for analytic skills, carriers in Latin America also are in the market for underwriting talent. Both skill sets are in short supply. A key factor in the hunt for underwriting talent is the opening of the reinsurance market less than a decade ago, which fostered profound changes in how insurers underwrite business. As the demand for underwriting talent grows and brokers and insurers compete intensely for these skills, costs are rising.

Insurance competition overall continues to narrow average profit margins in the industry. To drive higher top line and bottom line results, superior underwriting capabilities have become a critical differentiator among insurers. Ensuring underwriting talent on top of evolving technical skill needs is another challenge. For example, new process structures require the management of multiple product offerings and distribution channels.

Increasing these demands on underwriters is the need to develop high quality, high value insurance products at competitive prices. In turn, this compels insurers to recruit underwriters of significant intellectual capital from universities and other industries, and effectively train these individuals. One source of this external talent may derive from the strong use of the bancassurance model in the region.

For the most part, insurers in Latin America have lacked a widespread appreciation for recruiting top intellectual capital, and only a few universities have risk management degree programs. Successful companies will need to solve these problems through enhanced internal training and development, an increased focus on talent retention and successful recruitment from outside the industry and the region.

## Advance data quality and precision

As competition in Latin American markets intensifies and solvency regulation moves toward European structures, expect increasing sophistication among insurance competitors. Preparing for digital enhanced competition and risk management requires that insurers overcome legacy insurance technology to “rewire” their processes and enterprise business intelligence. Technology investments must focus on enhanced underwriting capabilities and innovations in distribution that involve a customer-facing experience.

Insurers in the region are beginning to leverage data analytics and related algorithms to determine pricing models. Consequently, data availability and quality are critical challenges to market development and profitability; i.e., limited customer profile information hampers such advanced ratemaking and customer persistency modeling. Increasing the breadth and granularity of customer data for analytical purposes will enhance insurer-customer interactions for both life and general insurance. Sources for data mining include social media, mobile communications and telematics connected to automobile usage. Recognizing that intermediaries are also digital customers, insurers should support their agents’ digital strategies to reduce channel conflict.

Solvency regulation also compels the industry to consider wide use of advanced risk and capital management systems. These demands require technical analyses of risk based on customer behaviors, as well as more precise measurements of exposures.

Effective analytic capabilities in market segmentation and predictive modeling are critical to gaining digital success in 2014. Successful insurance companies will be highly digital, intensely focused on the customer and pursuing an enterprise-wide analytics approach that takes into account strategic, operational and cultural factors. Vigilant data stewardship also is required to assure internal and external data quality. Insurers also must incorporate technical talent needs with local market knowledge to assure quality analysis in a regional context.

Insurers are at different stages of development in their digital evolution. Challenges are significant, given the high demand for specialized technology talent and the dynamic underlying conditions. EY’s Global Digital Survey of industry players affirms that analytics capabilities is the skill set most in demand among insurers.

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## Latin American critical risks and opportunities

Regional focus	Risks	Opportunities	Emerging challenges
Latin America generally	<ul style="list-style-type: none"> <li>▶ Disparate regulatory</li> <li>▶ Inflation</li> <li>▶ Catastrophe</li> <li>▶ Consumer regulation</li> </ul>	<ul style="list-style-type: none"> <li>▶ Expanding middle class</li> <li>▶ Maturing industries</li> <li>▶ Opening markets</li> <li>▶ Risk modeling</li> </ul>	<ul style="list-style-type: none"> <li>▶ Consumer education</li> <li>▶ Distribution costs</li> <li>▶ Data quality</li> <li>▶ Customer segmentation</li> </ul>
Brazil	<ul style="list-style-type: none"> <li>▶ Increased regulation</li> <li>▶ Naive competition</li> </ul>	<ul style="list-style-type: none"> <li>▶ Modernizing infrastructure</li> <li>▶ Emerging small businesses</li> </ul>	<ul style="list-style-type: none"> <li>▶ Product differentiation</li> <li>▶ Market acceptance</li> </ul>
Colombia, Mexico	<ul style="list-style-type: none"> <li>▶ Transitioning regulatory</li> </ul>	<ul style="list-style-type: none"> <li>▶ Business sector reforms</li> </ul>	<ul style="list-style-type: none"> <li>▶ Expanded premium drivers</li> </ul>
Chile	<ul style="list-style-type: none"> <li>▶ Income disparity</li> </ul>	<ul style="list-style-type: none"> <li>▶ Ease of doing business</li> </ul>	<ul style="list-style-type: none"> <li>▶ Product expansion</li> </ul>
Argentina, Venezuela	<ul style="list-style-type: none"> <li>▶ Local protectionism</li> <li>▶ Political encroachment</li> </ul>	<ul style="list-style-type: none"> <li>▶ Rapid growth</li> </ul>	<ul style="list-style-type: none"> <li>▶ Flexible market participation</li> <li>▶ High inflation</li> </ul>
Peru, Ecuador	<ul style="list-style-type: none"> <li>▶ Volatility</li> </ul>	<ul style="list-style-type: none"> <li>▶ Rapid growth</li> </ul>	<ul style="list-style-type: none"> <li>▶ Small market size</li> </ul>

### Year over year change in total insurance premiums for selected Latin American countries

(Adjusted to US exchange rates as of 31 December each year\*)

	2007	2008	2009	2010	2011	2012	2013*	Average
Brazil	42%	-13%	49%	25%	5%	11%	4%	18%
Chile	23%	19%	-10%	33%	17%	17%	0%	14%
Colombia	22%	13%	16%	12%	17%	22%	2%	15%
Mexico	16%	-15%	21%	5%	2%	21%	18%	10%

**Brazil:** Superintendencia de Seguros Privados (SUSEP)

**Chile:** Asociation de Aseguradores de Chile A.G. (AACH)

**Colombia:** Superintendencia Financiera de Colombia

**Mexico:** Comision Nacional de Seguros y Fianzas (CNSF)

### Corporate income tax rates for insurance companies and general domestic withholding tax rates on dividend distributions

(Selected Latin American countries)

	Corporate income tax rate	Divided withholding tax
Argentina	35%	10%
Brazil	40%	0%
Chile	20%	35% (minus CIT credits)
Colombia	25% + 9% CREE tax	0%
Mexico	30%	10%
Peru	30%	4.1%

Worldwide corporate tax guide, EY, 2013.

## Most costly windstorms in Latin America (not also hitting the US)

Name	Damage US\$ billions	Year	Storm classification at peak intensity	Areas affected
Karl	\$5.60	2010	Category 3 hurricane	Belize, Mexico
Gilbert	\$5.00	1988	Category 5 hurricane	Venezuela, Central America, Hispaniola, Mexico
Stan	\$3.96	2005	Category 1 hurricane	Mexico, Central America
Matthew	\$2.60	2010	Tropical storm	Venezuela, Jamaica, Central America
Luis	\$2.50	1995	Category 4 hurricane	Leeward Islands, Puerto Rico, Bermuda
Michelle	\$2.15	2001	Category 4 hurricane	Central America, Jamaica, Cuba, The Bahamas
Joan	\$2.00	1988	Category 4 hurricane	Lesser Antilles, Colombia, Venezuela, Central America
Fifi	\$1.80	1974	Category 2 hurricane	Jamaica, Central America, Mexico
Dean	\$1.78	2007	Category 5 hurricane	The Caribbean, Central America
Marilyn	\$1.50	1995	Category 3 hurricane	The Caribbean, Bermuda

### Sources:

Economic Commission for Latin American and Caribbean and Interamerican Development Bank, 2000.

"Según cálculos de Kuri Grajales, Karl causó daños al estado por 12 mil mdp," La Jornada Veracruz, Fernando Ines Carmona, 19 September 2010.

"Atlantic Hurricane Season of 1988," *Monthly Weather Review (American Meteorological Society)*, Miles B. Lawrence, James M. Gross, 1 October 1989.

"Additional Disaster Data Resources", *Centre for Research on the Epidemiology of Disasters' Emergency Events Database EM-DAT*, <http://www.em-dat.net/links/disasterdbs.html>.

Fondo Nacional de Desastres Naturales: a fund for disaster relief in Mexico with contributions to Hurricane Karl relief.

"The Deadliest, Costliest, Most Intense United States Hurricanes Of This Century (And Other Frequently Requested Hurricane Facts)", Paul J. Hebert, WSFO, Miami, FL and Robert A. Case, NHC, Miami, FL, 1990.

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EYG No. EG0162  
1311-1167542 NY  
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