

**Insurance  
Latin America  
Special Report****Latin American Insurance Review  
and Outlook 2010: Good Growth  
Prospects with Challenges Ahead****Analysts**

Maria Fernanda Lopez (Argentina)  
+54 11 5235-8130  
[mariafernanda.lopez@fitchratings.com](mailto:mariafernanda.lopez@fitchratings.com)

Maria R. Goncalves (Brazil)  
+55 21 4503-2621  
[rita.goncalves@fitchratings.com](mailto:rita.goncalves@fitchratings.com)

Rene Ibarra (Mexico)  
+52 81 8399-9100  
[rene.ibarra@fitchratings.com](mailto:rene.ibarra@fitchratings.com)

Rodrigo Salas (Chile and Bolivia)  
+562 499-3309  
[rodrigo.salas@fitchratings.com](mailto:rodrigo.salas@fitchratings.com)

Milena Carrizosa (Colombia)  
+57 1 326-9999  
[milena.carrizosa@fitchratings.com](mailto:milena.carrizosa@fitchratings.com)

Eduardo Recinos (Central America)  
+503 2516-6606  
[eduardo.recinos@fitchratings.com](mailto:eduardo.recinos@fitchratings.com)

Sebastian Baus (Ecuador)  
+593 2 222-2323  
[sebastian.baus@bankwatchratings.com](mailto:sebastian.baus@bankwatchratings.com)

Hugo Cussato (Peru)  
+51 1 444-5588  
[hugo.cussato@aai.com.pe](mailto:hugo.cussato@aai.com.pe)

Pedro El Khaouli (Venezuela and  
Dominican Republic)  
+58 212 286-3232  
[pedro.elkhaouli@fitchratings.com](mailto:pedro.elkhaouli@fitchratings.com)

Franklin Santarelli (Latin America)  
+1 212 908-0739  
[franklin.santarelli@fitchratings.com](mailto:franklin.santarelli@fitchratings.com)

**Executive Summary**

After several years of economic growth, more vigorous banking activity, and the successful conversion of public pension funds into privately managed comprehensive social security frameworks, the Latin American insurance market has expanded its economic activity and paved the way for significant future growth. Being a region where the average penetration of insurance activities is still below 3% of its GDP, growth is the only way to move forward. Nonetheless, this expansion will still be dependent on the overall trend of the economy and the number of individuals and companies that can access financial services in a broader sense.

Contrary to what was seen in the developed world, 2009 was a relatively good year for the Latin American insurance industry. Despite lower growth and an increase in claims, the region was free from the negative effects of troubled assets and chargeoffs in investment portfolios. With most Latin American countries expecting to see economic activity rebounding due to the demand for insurance coverage, 2010 looks promising. However, performance will be contingent on the preservation of underwriting advances seen in the last few years and the need to move on from price wars in countries where they still prevail. To note, not all of the countries' prospects are so bright. For example, the insurance markets in Argentina, Venezuela, Ecuador, and, to a certain extent, Bolivia, have to deal with the volatility of the operating environment and government intervention.

Fitch Ratings has been covering the Latin American insurance market since the early 1980s through its extensive network of local offices in the region, assigning mostly national and international scale insurance financial strength (IFS) ratings in the largest insurance markets in the region. Currently, Fitch rates 122 insurance companies in Argentina, Bolivia, Brazil, Colombia, Costa Rica, Chile, the Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, and Venezuela, covering around 30% of total collected premiums in the entire region.

In general, the IFS ratings are based on the intrinsic financial profile of each individual company, and, given the significant penetration of international insurance groups in the region, some ratings have benefited from the expected support of their parent company as described in the criteria report, "Fitch's Approach to Rating Insurance Groups," dated March 24, 2010.

During 2009, the majority of IFS ratings (national and international) held very well, with a limited number of negative rating actions. Some of the negative rating actions were driven by particular issues of individual companies and others resulting from changes in the rating of parent companies and/or issues with the operating environment in their own countries (e.g. Honduras). Given the growth prospects, adequate or at least sufficient capitalization in most of the markets, and the improved recent financial results, Fitch expects that the universe of IFS ratings in the region should remain stable during 2010.

The comments made in this report are based on public figures provided by the insurance regulators and, in some cases, by individual companies.

## The Latin American Insurance Industry

### General Comments

Even with 2009 total collected premiums of about USD120 billion from Argentina, Brazil, Bolivia, Colombia, Costa Rica, Chile, Ecuador, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru, and Venezuela, the size of the industry is still small compared with more developed markets. It is roughly half of the volume managed by the Asian region. As expected, overall insurance penetration is low (around 2.46% of GDP on average). Of the more than 520 million inhabitants of the region, only a very small fraction of the population has at least one insurance product in their portfolio.

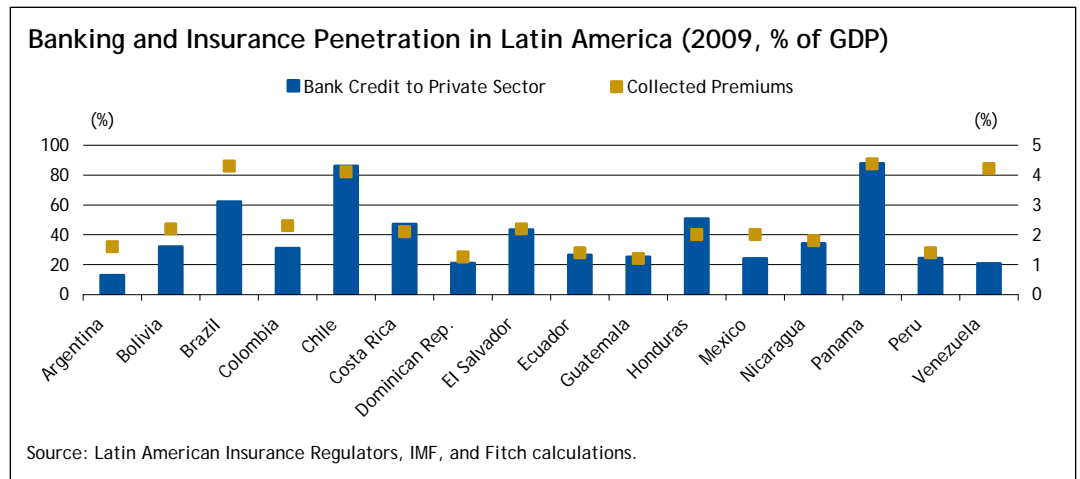
Given the differences in development levels among the economies of the region, results per individual country can be quite different, while the significant asymmetries in terms of the regulatory environment may be a source of deeper differences. With a concentrated insured portfolio in sectors such as auto, third-party liability for automobiles (in many countries compulsory by law), and health, the actual use of other forms of insurance is fairly limited in many countries. Nevertheless, the largest bulk of the growth of new business in the last decade has been annuities- and protections-related, with the implementation of private pension funds resulting in a steady redistribution of the insured portfolio.

Countries where private pension schemes have failed or have not been implemented tend to have less penetration and more concentrated insured portfolios, as is the case with Venezuela, Argentina, Guatemala, and, to a certain extent, other Central American countries. Conversely, countries such as Chile, Peru, Mexico, and Colombia have seen significant growth in the life insurance business, which has opened the door for cross-selling opportunities of other products, mostly through the bank assurance channel. Lastly, Brazil, the largest insurance market in the region (around 50% of total collected premiums for the region), has overcome the lack of private pension funds and successfully utilized the bank assurance channel to expand its share of life insurance products.

Currently, most insurance industries in the region are focused on expanding their cross-selling techniques, although considering the income limitations of the population, cross-selling opportunities in Latin America could be limited. Other players are trying to reach the largest portion of the population (the lower income population) through the creation of low-ticket products distributed through mass channels. The expansion possibilities are enormous, but challenging.

The typical budget of a Latin American family is primarily used to cover basic needs such as food, health, and housing. As a result, discretionary spending is very limited to other kinds of expenses, even when the benefit is as evident as the protection of assets or the security of a family after a catastrophic event such as the death of a loved one. Therefore, the actual speed of expansion of the sector has been lower than expected.

The annual hurricane season that affects at least one country in the Caribbean and/or Central America almost every year and the recent, dramatic telluric movements in Haiti, Chile, and Peru a few years ago, have raised public awareness of the benefits of insurance protection in the region. The successful development of the private pension funds and its extensive use of insurance protection should be leveraged by the sector as a way to raise the tangible value of insurance products. As such, appropriate pricing and strong business ethics should be reinforced in order to enhance the financial profile of the sector and help it take on the new business.



The need to overhaul the regulatory system in many countries in order to provide a constructive and business-oriented operating environment is another hurdle the sector faces. In jurisdictions where the regulation of the advertising of insurance products is more important than the monitoring of the financial health of the insurance companies, the expected growth will be limited even further. Since the insurance market has acted as the custodian of the population's retirement savings since the era of private pension funds, there is growing importance for appropriate regulation to avoid insurance company failures and losses in the working population's savings.

In general, insurance penetration varies by country (see the chart above). The highest penetration levels are seen in Brazil and Chile, with approximately 4% of GDP (Venezuela's figure can be overestimated due to the existence of a dual-exchange regime that can distort the real figures of collected premium and GDP), while Guatemala, Ecuador, and Peru (around 1.3% of the GDP) have the lowest levels. Those numbers should be viewed with a great deal of caution. Although the U.S. and Western Europe have insurance penetration numbers around 8.5% of their GDP, the fact is that those countries yield a significantly higher banking penetration compared with Latin America and, in general, insurance penetration tends to lag banking penetration. For example, a person without a bank account is very unlikely to have an insurance product in his or her portfolio, while the opposite is not necessarily true, it is at least almost always a prerequisite. The larger the banking sector, the greater the prospect for insurance protection.

As presented in the chart above, insurance penetration is highly correlated to banking penetration (measured as bank credit to the private sector as percentage of GDP). It is not a surprise that Chile, Brazil, and Panama (with the highest banking penetration ratios of above 60% of GDP), show the highest insurance penetration, whereas the Dominican Republic, Ecuador, Guatemala, Peru, and Mexico (with an average ratio of approximately 24% of GDP), are the countries with the lowest insurance penetration. As a comparison, the U.S. and countries in Western Europe show levels of banking penetration above 150%, with a ratio of insurance premiums to GDP of around 8.5%. On a positive note, banking penetration is steadily growing in most Latin American countries, and therefore, growth of the insurance business can also be expected. The successful use of the bank assurance model in the region bodes well for rapidly expanding the insurance industry footprint. Therefore, taking advantage of larger banking penetration and using other channels as microfinance institutions (rapidly growing in the region and tapping probably the largest part of the population: low income segments) and other mass channels would be part of this expansion.

High business concentration levels are also common in the region (excluding Argentina where the largest 10 companies manage 40% of the market and operate more than 178 companies), and, in some cases, they can hinder competition and the rapid expansion of the sector. Insurance companies related to the largest financial groups are normally the market leaders: Bradesco and Itau/Unibanco in Brazil; Pacifico and Rimac in Peru; Suramericana in Colombia; Lafise in Nicaragua; Mundial in Panama; G&T in Guatemala; and Popular in the Dominican Republic. Nonetheless, some independent companies, such as Sul America in Brazil or International de Seguros in Panama, are successful cases where adequate market share has been achieved.

The second-largest group of companies is represented by the extensive and long-standing share of foreign companies in the region including: Mapfre, Chartis (formerly American International Group [AIG]), Alico (in process of being sold to MetLife), Liberty, ACE, and ING in the Netherlands.

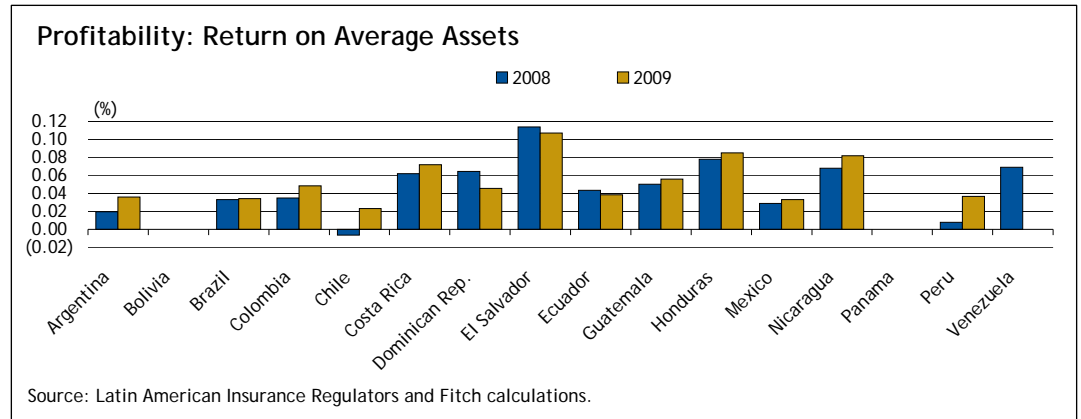
A possible third, distant group — but growing fast — is insurance companies related to international banking groups: HSBC, Citibank, and Santander. After a significant expansion of their banking businesses in Central America and Mexico, these banks currently manage several insurance companies that provide additional products to its banking clientele. Regional insurance groups are less common, but some groups — Mundial in Panama (recently associated with Mapfre) and Lafise in Nicaragua — have made their successful debut on regional grounds. Specialized or niche insurance companies such as Cesce, Coface, and Atradious, also operate in the region. Government-owned insurance companies are not frequent but in the cases where they exist, they tend to be important or even dominant players in their markets. The following are examples of dominant government-owned Latin American banks: Instituto Nacional de Seguros in Costa Rica (until 2008 a monopolistic market); Instituto Nicaraguense de Seguros y Reaseguros in Nicaragua (35% of the market); Seguros Banreservas in the Dominican Republic (21%), the emerging insurance operations of subsidiaries and partnerships by Banco do Brasil in Brazil; Seguros Sucre in Ecuador; and the group of recently seized insurance companies in Venezuela.

As mentioned before, the expansion of foreign investment in the insurance sector has been widespread within the region, with some countries more “internacionalized” than others. In El Salvador, 81% of its premiums are underwritten by foreign players, whereas Costa Rica had a state-owned monopoly until late 2008. However, a growing number of insurance licenses have been approved by the new regulator.

Additional expansion of foreign direct investment is still possible but contingent on the positive evolution of the operating environments in some countries (e.g. Venezuela, Ecuador, Bolivia). The expansion into some specialty niches where large local players are not actively participating is the case in the Brazilian reinsurance market and some business lines for primary insurance in that country, as well as the successful breakup of the Costa Rican insurance market. However, the smaller size of some countries (Nicaragua and the Dominican Republic) and the significant concentration of other markets (Peru or Panama) will result in slower advances in this respect.

### Financial Performance

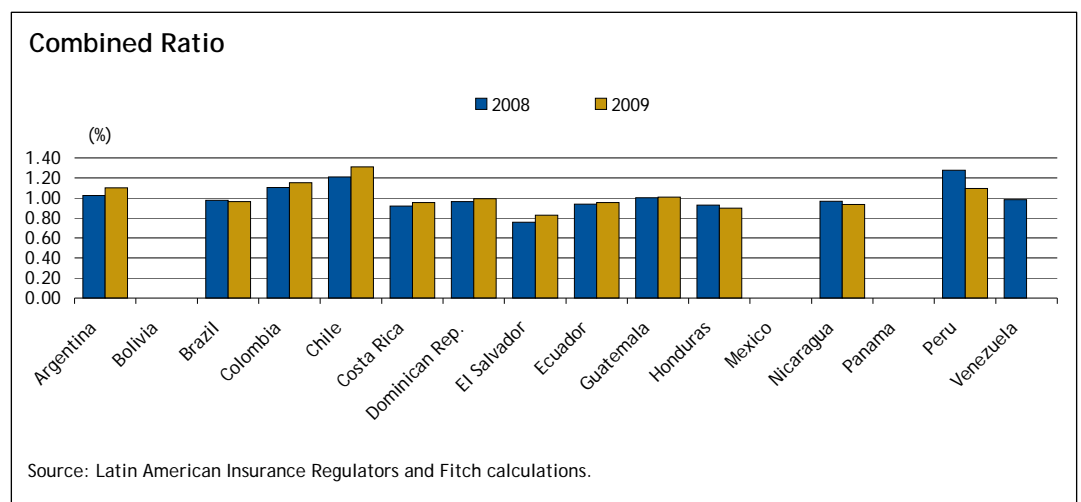
The Latin American insurance sector has been able to post relatively strong results in the last three years despite somewhat volatile underwriting results. As such, the return on average assets (ROAA) has been close to 5%. Nevertheless, there are significant differences between countries and regions (*see the chart on the top of the next page*). For example, the Central American region (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama) appears to be the most profitable group with an average ROAA of almost 7% for the 2008–2009 period, while



the average ROAA of the South American countries (Argentina, Brazil, Bolivia, Colombia, Chile, Ecuador, Peru, and Venezuela) was just barely above 3%.

This difference is primarily explained by a relatively higher claims ratio that undermines the combined ratio of the South American sample (*see the chart below*), the larger than proportional participation of life insurance (and hence the relative larger share of financial income that was more volatile during such period), and some accounting differences that result in heavier reserving charges in countries such as Chile and Peru and less stringent ones in countries (e.g. El Salvador) where the risk associated with the private pension funds business are not required to hold any technical reserves. Also, countries where the insurance market is more developed, and therefore, more competitive, have seen a steady decrease in margins. For example, Chile is one of the few countries where the ROAA has been consistently below 2%.

Price wars, especially in the auto and health sectors, have been a constant in the region (excluding Costa Rica, which was a closed company monopoly until 2008). Technical losses in these lines of business have followed. After several events of sizable losses due to improper pricing, many insurance companies — and even insurance markets in the region — have refined their outdated pricing techniques and, more importantly, improved claims cost control techniques. Extensive plans to achieve preferred (and lower) pricing from the largest vendors of the industry (body parts, auto part wholesaler, and hospitals) have been created, while detailed protocols in terms of



procedures and controls are necessary in the region. Limitations for expensive medical procedures and fraud detections have helped as well.

Nevertheless, and despite the evident advances in claims control and its overall benefit on the claims ratio, operating expenses are still high. This should be a focal point of the Latin American insurance industry in order for it to compete in times when operating margins may decrease due to competition and/or lower expected financial income.

### Investment Portfolios

Despite the turmoil of the international capital markets and insurance companies in the U.S. and Europe, the majority of investment portfolios of the Latin American insurance companies have held well during the turbulent economic environment. This successful outcome for Latin American insurance companies is mostly explained by the prevalence of closed investment regimes (most of the time with regulations that limit, or even prohibit, investments in securities issued by foreign entities) and the relative simplicity of the portfolio's profile. Typically, the vast majority of insurance companies' investment portfolios are highly concentrated in local government debt (denominated in local currency or U.S. dollars), local bank deposits, and, to a lesser extent, securities issued in the local capital markets (possibly excluding Chile, Colombia, and Peru).

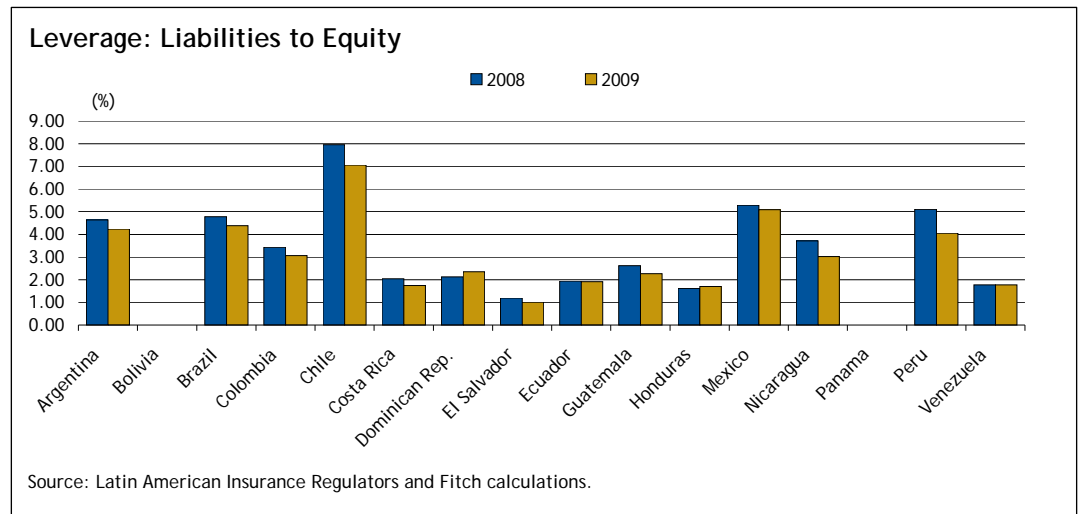
Investments in structured finance securities, collateralized securities, and even speculative positions in stock markets are fairly limited. The volatility of the prices of sovereign debt in many cases are covered by accounting regimes that do not require full mark-to-market of the positions and/or the use of such securities to hedge long-term commitments, such as annuities, which are not required to be recorded at market values. Changes in local capital markets and/or changes in the investment regime in many countries, may lead to alterations in investment allocation. However, any changes will take time to dilute the preponderance of government securities in the investment portfolio.

The sustained recovery of the value of government securities since mid-2009 has mitigated concerns about unrealized losses, even when the concentration issue remains a concern. In the region, economic cycles and volatility may affect several countries from time to time. Despite the temporal benefits of such simple and closed investment regimes, the growing need of adequate assets to hedge the different profile of liabilities as new products are developed. This creates the need for more proactive management and regulation.

### Capitalization and Leverage

Leverage has slightly increased in recent years due to the expansion of the market and the sometimes onerous reserve scheme for individual life insurance products (especially annuities). Also, the expansion into new distribution channels, such as bank assurance, among others, tends to undermine short-term profitability due to the initial cost of marketing and sizable commissions to attract distribution. Such mass channels are characterized by, but not limited to, retailers, utilities, and, in general, a wide spectrum of entities that reach a vast number of regular clients and can provide sales points and efficient, low-cost collection services.





As such, total retained premium to equity has remained close to 1.96x, with the South American countries at the higher end of the average (around 2.2x) and Central American countries with 1.7x on average. Again, this is explained by the larger participation of life insurance products in the former group of countries, normally with high retention levels. The total-liabilities-to-equity ratio is higher in both groups (around 3.25x for the whole region — 2.6x for Central America and 3.9x for South America), due to the burden of the annuities product in most countries and its effect on the required levels of technical reserves.

It is worth mentioning that the annuities business in South America is almost entirely represented by fixed yield annuities (the penetration of annuities in Central America is negligible) that, in most cases, are properly hedged in terms of tenor and yield (some restrictions apply), while traditional financial leverage is almost zero for most of the companies. Future changes in solvency rules for some countries (e.g. Mexico, Colombia, and Chile), and the recent change in Brazil, should result in the preservation of the capitalization of the market (*see the chart above*).

### Reinsurance Protection and Exposure to Catastrophic Events

Given the lack of critical mass in each country and the significant catastrophic exposure in most countries (Brazil, Argentina, and Panama to a lesser extent), regulatory limitations in terms of maximum retention and minimum protection are observed in most of the countries. In many cases, the overall small capital base of individual companies results in low retention levels and sufficient reinsurance coverage for business lines except auto, life, and health. Maximum exposure per event and/or catastrophe is limited to a small fraction (usually lower than 5% in South America and even lower in Central America) of the equity of each company and is primarily backed by a pool of well-rated international players, even when, in many cases, the pool is highly concentrated in a few reinsurance companies. Local and regional reinsurance companies based in Latin America are limited, with few regional players offering reinsurance coverage in the region. The lack of appropriate insurance coverage for a significant portion of the population (as proven in the January 2010 Haiti earthquake and the heavy rains that affected Rio de Janeiro in April 2010), and the overall low retention levels explain the long history of favorable net claims ratios in the region despite the occurrence of large catastrophic events such as hurricanes, earthquakes, and tsunamis.

On the downside, the region is exposed to the changes in the pricing conditions of the international reinsurance market and to sudden movements of international reinsurers in the region, as has been the case in recent years. The expansion of each market and the regionalization trend seen in some Central American countries may help build a larger business and, therefore, improve its negotiating power, although it will not be seen for several years to come.

### **Individual Performance by Country**

#### **Argentina: The Volatility of the Operating Environment Does Not Bode Well**

Like any other sector in Argentina, the insurance market has not been isolated from the recurring stress situations and sudden changes in economic climate in the country. The uncertainties related to the future performance of the economy are tied to the trend of agricultural commodities prices, fiscal policy and government debt management, political turmoil, and consistently high levels of inflation.

The fifth-largest insurance market in the region operates under this scenario and is possibly more fragmented in terms of market share. Despite its currently low penetration level (2.54% of GDP in 2009), the Argentine insurance sector still fares better than the average for the region, even when considering its relatively smaller share of life insurance products compared with other countries. The life sector was hurt by the 2002 economic debacle and the fall of the private pension fund scheme. During 2009, premiums only grew 3.9% (adjusted by inflation), less than half of what was recorded in 2008. The current uncertainty about the economic activity in the country and the overall operating environment limits the ability to provide a clear forecast on the trend for the sector in the short term. However, some growth should be seen, given the expected economic rebound, and prices could possibly increase with mounting inflation and the negative technical results of the previous years.

Despite the regulatory requirement of balanced technical results in every line of business since 2008, the claims ratio increased to 64% for 2009 compared with 59% in 2008, and operating expenses were 51% of retained premiums in 2009 compared with 48% in 2008. Higher claims due to increased inflation, some upturn in claims' frequency and lawsuits, and aggressive pricing, have resulted in a deterioration of the combined ratio to 110% in 2009 (100% in 2007). Favorable investment income has helped cover these negative technical results, but results are still volatile and below the regional average (ROAA 2007–2009: 2.7%). It is worth mentioning that the volatility of the investment results is primarily due to the constant changes in the valuation of the investment portfolio (highly concentrated in Argentine government debt) and securities issued by local banks and corporates. Favorably, no materials losses were recorded as a result of the international financial crisis. Given the expected inflation pressures and a meager organic growth trend, overall profitability of the sector will remain volatile and possibly below the average for the region in the short term.

Leverage, measured by the liabilities-to-equity ratio, remains above average for the region (4.4x for 2007–2009 compared with approximately 3.0x for the region), especially considering the significantly lower share of annuities and saving-related products on its balance sheet. The short-term trend for profitability and the uncertainties in the operating environment may limit the potential of further capital injections in the sector and a related decline in leverage.

Recent changes in the regulatory framework related to workers' compensation protection (20% of total collected premiums in 2009), which increased minimum compensation and lifted the caps on maximum compensation, negatively affected the sector's claim ratio in 2009. Without repricing, this regulatory change will limit claim



ratio improvement for the sector in 2010.

Despite the challenges of the operating environment, and supported by the good performance and prospects for most of the insurance companies with National Scale IFS ratings in Argentina, Fitch expects that most of the ratings should hold during 2010. However, sudden changes in the operating environment could result in a revision of the Outlook and ratings assigned to Argentine insurance companies.

### **Bolivia: Small but Aligned with Regional Trends**

Despite being the second-smallest insurance market in the region, with collected premiums of around USD228 million, Bolivia's insurance penetration is fairly aligned with the average penetration of the region (2.2% of GDP compared with an average of 2.46%). While growth had been strong in recent years, a significant change in the private pension scheme in 2007 resulted in a plunge in collected premiums for life segments for that year. In a market of just 14 insurance companies (eight property and casualty [P&C] and six life), concentration levels are expected, with the largest four insurance companies managing 87% of total collected premiums for the P&C business. Concentration levels for the life business are more balanced, especially given that not all of the companies actively participate in every market segment.

As per local regulations, life and nonlife businesses have to be managed through separate companies (in many cases linked to same shareholders), while foreign participation is relatively small (19% of total collected premium) and the bank assurance model lags the level of development of other Latin American countries. In the short and medium term, the current structure of the industry is not expected to change. Government intervention in the insurance business has increased but is still less aggressive than Venezuela and, to a lesser extent, Ecuador. However, there is still a chance that the government may consider the creation of a state-owned insurance company, which would alter the competitive structure of the insurance industry over the longer term.

Similar to other Latin American countries, the P&C market (around 87% of total collected premiums) is driven by auto (20% of the total), fire (22%), and compulsory insurance protections such as third-party liability for auto (8%). The life insurance business breakdown is comprised of life insurance policies related to mortgages (38%), traditional individual life (24%), annuities related to the private pension funds scheme (12% in 2009 versus 69% in 2004) and health insurance (11%).

With an underdeveloped capital market and some limitations on foreign investments, life insurance companies in Bolivia have a larger asset/liability mismatch profile. Current regulation is not as stringent as seen in Chile, Peru, or Mexico, resulting in a relevant reinvestment risk for the life industry that, so far, has been managed "ad hoc" by allocating a larger amount of investments to back up those obligations. However, this solution may prove to be insufficient in time. In general, the regulation of the Bolivian insurance market incorporates some of the best practices outlined in more developed Latin American markets, but still needs fine tuning to oversee the different kinds of risk in the market. This was illustrated recently by the regulatory seizure of a midsize insurance company, which violated regulatory requirements for some years and presented inaccurate financial information to the market.

Leverage is relatively in line with the average for the region, with a liabilities-to-equity ratio below 2.0x (but growing since 2007) for P&C companies and 4.0x for life insurance companies (decreasing due the reduction of the market since 2007). Adequate profitability levels (around 4% in the 2008–2009 period) and moderate cash dividends should help maintain leverage ratios at current levels.

With a relatively controlled net claims ratio (around 45% in the last five years), the combined ratio for the P&C segment has been below 90% for a number of years. Although expense levels are high — more than 40% for life insurance companies — the significant burden of the existing stock of annuities distorts the analysis of the ratio. In addition, the operating ratio, which incorporates the effect of the net financial income as well as underwriting results, has been quite volatile.

During 2009 and the first quarter of 2010, the national scale IFS ratings assigned to insurance companies in Bolivia have remained fairly stable. This trend is expected to continue for the remainder of the year given the rebound (although limited) in economic activity and demand for insurance protection.

### **Brazil: Well-Positioned to Deal with Expected Growth**

Signs of Brazilian economic recovery, which have become more evident since the second half of 2009, combined with the expectation of return to higher capital investments (mainly in infrastructure over the next few years), have rekindled premium growth projections in the Brazilian insurance market for 2010.

In view of this scenario, market projections are that premiums should return to higher, double-digit growth rate, closer to historical averages, at around 15%–20% per annum, above 2009. The estimates point to a total premium above BRL100 billion in 2009 (BRL96.2 billion in 2008), maintaining a significant share in auto, life, and private pension lines above 50% in the sector mix of premiums.

Despite the low market penetration of insurance products and regulatory transition, the Brazilian insurance market continues to be the largest in Latin America, with an estimated share around a stable 4% of GDP. In addition, the industry tends to benefit from consistent investment and economic growth over the long term, which basically leads to an increase in population income. Fitch further emphasizes that, notwithstanding the important moves related to industry concentration in the largest companies of the sector in 2009 and higher competition, it does not anticipate significant changes over the short term.

The bank assurance model has been predominant in the market, particularly in lines such as auto, health, and life, which rely on the strong presence of large national financial conglomerates with relevant participation from the major foreign insurance and reinsurance groups operating in the country. In Fitch's opinion, the advancements in the regulatory framework should gradually follow market evolution and international best practices, bringing more significant benefits over the medium and long term. The agency notes that the major Brazilian insurance companies have accelerated their search for higher operating efficiency by reorganizing their main portfolios and processes, as well as supplier cost controls, in addition to improving their subscription models. This has also contributed to recent market changes and improvements in loss ratios in 2009 (still close to 60%) and in combined and operating indicators, which were slightly lower than in 2008. Given the large number of insurance companies in Brazil with limited market share and weak competitive advantages, further merger and acquisitions should be expected in the short and medium term.

In terms of profitability, the economic recovery should minimize the impact of tighter financial earnings since historical profitability has recorded an ROA close to 3% for the largest sector companies. Sector leverage also tends to increase slightly as a result of business growth (the same as in 2009), while the average liabilities-to-equity ratio was estimated at around 5.5x–6.0x at the end of 2009.

Brazilian IFS ratings remained stable during 2009, reflecting cyclical behavior through a

sharp, but short downturn in the local economy. Brazilian insurers' ratings vary widely. The national scale IFS ratings portfolio ranges from 'AAA(bra)' to 'A-(bra)'. Many of the highest ratings are benefited by well-rated parents. This is likely to continue in 2010, although sudden changes in the profile of the market and/or specific companies may result in rating changes.

### Colombia: Underwriting Results still Under Pressure

Colombia was one of the countries in Latin America that experienced minor effects of the global financial crisis, registering a slight increase in GDP during 2009 (+0.4%). Historically, the growth rate of the insurance industry has been closely related to GDP movements. However, in 2009, the sector had a satisfactory performance with an important increase in premium volumes (+9%). This remarkable performance was led by some specific lines, such as surety bonds (+52.5%), given the extraordinary dynamism in infrastructure. The Life group (+35.2%) grew at a good pace after the positive dynamic of mortgage lending (+11.1%), driven by significant reductions in interest rates (-600 bps). Workers' compensation (+32%) and annuities (+29%) also showed adequate growth rates. In 2010, Fitch expects a modest growth of real GDP in Colombia (+2.5%) that will generate a positive impact on the insurance industry, pushing forward key business lines such as surety bonds, life group, and annuities, although significant challenges in terms of the underwriting results are still on the table.

In 2009, the insurance sector increased its technical losses, resulting in a deterioration of the combined ratio (115% in 2009 and 111% in 2008). This change was a result of a higher combined ratio in the life insurance sector (127% in December 2009 and 116% in December 2008) due to the inclusion of the government's workers' compensation portfolio into the insurance system, which is characterized by high claim rates. Another factor that affected the combined ratio of the life insurance sector was the growth of annuity lines (18%), which require high levels of reserves. Notwithstanding, nonlife insurance companies improved their combined ratio to 102% (2009) from 105% (2008) due to an increase in premiums and a reduction in claims.

Despite the negative technical results, net profits in 2009 from the insurance industry had an important dynamic (+76.2% December 2008/2009) given the outstanding results from investment portfolios. This performance was a result of the continuous reductions in interest rates determined by the Central Bank (-600 bps), causing sizable valuation gains. Fitch believes that such profits reached by the industry are temporary and not sustainable in the future, bearing in mind that interest rate volatility is expected to decrease significantly. Fitch believes the insurance sector in Colombia must focus on the enhancement of its underwriting result based on effective claim and operating costs control, as well as improvements on its pricing techniques, which are highly driven by a fierce price war on the largest business lines, especially P&C.

Over the past year, the Colombian insurance industry did not experience significant changes in its configuration in terms of market participants. However, the workers' compensation business line experienced an extraordinary growth rate over the past two years (26% on average), driven by its inclusion in the system of the premiums from the Government Workers' Compensation Institute (Government WC Institution). This operation was taken over by a public equity insurance company called La Previsora Vida, which later changed its name to Positiva. Previously, the Government WC Institution was not regulated by the Superintendencia Financiera, and its financial information was not consolidated with the entire industry's information reported by the regulatory entity. At the end of 2008, the Government WC Institution's figures were included in the industry information after the former institution transferred all of its premiums to

the new company Positiva. Fitch does not expect important changes in the composition of the insurance sector for 2010.

The premium breakdown of the Colombian insurance industry is 80% concentrated in nine lines of business; five of these represent 65% of total production: social security (workers' compensation and pension annuities), auto, group life, compulsory third-party liabilities (locally known as SOAT), and health. The insurance penetration in the Colombian market is only 2.3% of GDP, and the growth trend is primarily led by auto and life lines, particularly those related to social security lines.

At the present time, the Ministry of Finance is reviewing different aspects that regulate the insurance business in Colombia. The process includes changes to the solvency rule by trying to mimic the recent trends seen in Europe with Solvency II. In addition, an enhancement of the asset and liability management guidelines are expected in order to better allocate assets for the long-term liabilities derived from the annuities business and other products with long-tail characteristics. Finally, the local association of insurance companies (Fasecolda) and the regulator are conducting a detailed study of the technical reserves regime in order to be aligned with international standards. The government's intention is to issue a new regulatory framework with all of these proposals by the end of the first half of 2010. Given this scenario, Fitch expects a more robust capitalization regime and a possible increase in capital and reserves for the insurance industry. Nevertheless, the speed and final scope of the regulatory change is yet to be seen.

In general, Fitch does not expect changes to the national scale IFS ratings assigned to insurance companies in Colombia, which in most of the cases include a mix of its stand-alone financial strength, and, in some cases, the subsidiaries of some international financial groups incorporate some degree of support of its ratings. Fitch also believes that the nonlife insurance sector could improve its technical performance in 2010 if the loss ratio remains under control and premium growth continues the trend registered during the last year. The challenge of the life insurance sector is to achieve a better matching of assets and liabilities, reduce the loss ratio in some business lines, and boost growth in premiums.

### **Chile: Adequate Expected Results despite the Catastrophe**

Despite being the most mature insurance market in the region — and the one with the greatest penetration (4.2% of the GDP) — the size of its market still ranks sixth in terms of collected premiums during 2009. Despite the increase in collected premiums in terms of U.S. dollars (+20.5% for the overall market) supported by the significant appreciation of the Chilean peso, the 1.5% economic contraction in 2009 resulted in an overall decrease of collected premiums measured in local currency (–2.2% for the P&C segments and –1.4% for life insurance companies). Rivalry levels are high, as the market is moderately concentrated (the five largest insurance groups with 32% of total premiums) and the participation of foreign players is sizable (53% of collected premiums).

The short-term projection for 2010 indicates a recovery in terms of collected premiums (measured in local currency) of about 5%–6%. Nevertheless, this assumption could be affected by the earthquake and tsunami that hit the country in late February. Currently, the ultimate impact of this event is not clear, although prices may increase due to the expected pressure on the cost of catastrophe reinsurance prices and the normal increase of demand for insurance protection after a catastrophic event, which could possibly result in a double-digit increase for premiums. Nevertheless, those assumptions will rely on the overall performance of the economic activity in the country, which may or may not follow an expected increase in government spending.

Considering the aforementioned, Fitch believes that despite the expectation of very large gross losses, the current body of national scale IFS ratings assigned to P&C companies in Chile may not be significantly affected. Current leverage levels are relatively lower than other markets in the region, implying good capital reserves adequacy. However, Fitch expects at least an increase in the industry's leverage ratios in the short term, but they will be limited by the maximum regulatory level of 5.0x.

The sluggish activity in terms of premiums for 2009 resulted in an increase in the claims and expense ratio, pressuring the combined ratio to 110% and above the previous average of 100%. This increase in the claims ratio was mainly related to a poor performance of auto and surety lines, which were affected by a lower premium base and relatively stable claims. Other branches, such as fire and third-party liability sustained adequate results. Similar to other markets in the region, auto insurance remains the largest retained risk (38.9% and another 6.0% if compulsory third-party liability is included), although fire and other insurance lines provide a better portfolio diversification compared with other countries where auto and third-party liability can represent up to 70% of total retained premiums for the P&C industry.

After a drop in 2008, the rebound of the investment portfolio yield tied with the effects of the financial crisis on the valuation of the portfolio (although the actual losses related to defaults on some international issuers were very limited) aided overall profits, with the ROAA ratio increasing to 3.6% from less than 2% in 2008. The prospects of the sector in terms of profits in 2010 are not as promising. The final costs of the February 2010 earthquake and tsunami, even when moderate in terms of actual retention, will pose a burden for the current year's results considering the retained portion of claims, the reinstallation costs associated to the reinsurance protections, and the expected increase in the price of the reinsurance protection that may not necessarily be passed through 100% to the final customer — at least in the early stages. However, financial income should remain steady.

In regard to the life insurance market (65% of the overall market in terms of premiums but 94% of the assets under management), recent results have been encouraging despite the lower premium demand and have been primarily aided by the improved financial income in 2009. Even when the bulk of the business still comes from the annuities business (36.9% of total premium), traditional life protection products (individual and group life) are rapidly increasing their share in the total, becoming the focus of growth in most of the companies in the country. Bank assurance products are a more vigorous commercialization of individual life protection, and some alternative products, such as health coverage, complement the current protection provided by the scheme of health protection in the workers' protection program (locally known as ISAPRES) and have become the cornerstone of growth for several large players.

Operating results benefited from the investment income despite an increase in claims (partially affected by the surrenders propelled by the economic crisis, recorded as claims per local regulatory standards) and some operating cost pressures, which were normal given the steady shift of the insured portfolio mix from the low distribution costs of annuities to other lines that require a better remuneration of the commercialization channel. As such, the ROAA ratio for the life market improved to a high 2.1% (a loss of 0.8% in 2008), above the average of the last five years, but still below the overall average for the region given its more mature stage, the burden of the conservative reserve requirement of the annuities business, and a less volatile operating environment where margins tend to be narrower.

In general, the ratings assigned by Fitch to the body of life insurance companies in Chile have a stable outlook, while rating changes during the past year were mostly limited to



changes in the financial profile of some shareholders that affected the support benefit provided to the rating of its subsidiaries. For 2010, improved financial returns and the stability of the overall financial performance of the vast number of rated companies should result in a stability of ratings, being that the effects of the 2010 Chile earthquake are deemed to be marginal.

Leverage ratios remain the highest in the region but are significantly affected by the burden of the annuities business and conservative reserving policies. As such, the liabilities-to-equity ratio for the whole market has remained around 7.3x in the last three years, but a closer look identifies that most of the leverage comes from the life insurance market, where the average leverage ratio is around 7.9x. For companies concentrated in the annuities business, the leverage ratio can be higher than 12.0x. The average leverage of the P&C segment is around 2.4x, below the trend in the region.

It is worth mentioning that the forefront position of the Chilean regulatory framework results in adequate reserving policies, close control of the quality of the investment portfolio, good asset and liability management (in terms of yield and tenors) and, in general, a constructive operating environment. Despite the former, current regulatory trends as Solvency II and the final implementation of IFRS accounting standards are a challenge for the sector in the short and medium term.

#### Costa Rica: Checking the Field in 2010

Net premiums amounted to CRC353 billion at year-end 2009 (USD617 million), recording 5% growth in local currency with respect to 2008 (3% in terms of U.S. dollars). Premium growth was mainly due to an increase in P&C lines (including other nonlife and noncompulsory insurance), as they increased by 17.8% with respect to 2008, and the increase of the voluntary auto insurance line (+9.1%), two of the primary business areas subscribed in the country. This growth was partially offset by a decrease in the compulsory insurance (-16.7%) due to the economic recession that has its effects on lower employment figures and lower car sales (the two largest drivers of compulsory insurance in the country).

The insurance sector in Costa Rica is, for the first time, no longer dominated by compulsory insurance (workers' compensation and liability for auto insurance lines). At year-end 2009, they represented approximately 27.1% of total premiums written, slightly below the 27.6% participation of P&C insurance (including other nonlife and noncompulsory lines). Life and health insurance continued to represent a smaller percentage of the total (14.1%), primarily due to the fact that a large portion of these products are offered by unregistered insurers, but also because of the limited use of "bancassurance" and other nontraditional channels.

It is worth mentioning that net earnings in the industry grew by 34.6% (31.6% in U.S. dollars) due to lower expenses related to the financing of the company's owned hospital and considerably lower reserves burden, given the decrease in the premiums growth. Despite this trend, the net loss ratio kept its upward trend (65.6% in 2009 compared with 59.7% in 2008). The higher loss ratio was mainly due to a lower participation from the market's most profitable business line, compulsory insurance, by a higher frequency of claims in auto and a higher loss ratio in the P&C lines, which was affected by claims related to the earthquake that occurred in 2008 that were registered in 2009. Despite the higher loss ratio, the market's operating result grew by 38.5% compared with 2008, reflecting a greater net financial result due to the combined effect of a wider reserves base, mainly as a result of the growth in life insurance and high local interest rates (given the vast majority of the investment portfolio is represented by investment in government debt and deposits in local banks). As a result, the ROAA grew to 7.2% from 6.2% in 2008, while ROE grew to 19.2% from



18.9% in 2008.

The 2010 economic growth recovery projected by Fitch for Costa Rica (2.9%) should boost premium growth in most of the business lines, particularly in P&C and auto insurance. Additionally, the sector may continue expanding at a rapid rate in the life insurance segment, as most of the competitors, including Instituto Nacional de Seguros (INS), expect to grow in this segment by increasing penetration through the development of new mass products and distribution channels (e.g. bancassurance) and other nontraditional channels. In the past, life products were largely offered by unregistered insurers, but after the regulatory reforms undertaken in 2008, this type of activity has been explicitly prohibited, with local companies expected to fill at least part of this void.

In regard to the opening of the market with the new insurance law of 2008, it is worth mentioning that four new insurance companies were granted the authorization to operate during 2009: Seguros del Magisterio, Aseguradora Mundial-Mapfre, Alico, and Assa. All but one company is funded with foreign capital. A number of additional foreign companies have already started the filing process for new licenses.

During 2009, Fitch started its formal coverage of the Costa Rican insurance sector, assigning an international and national IFS rating to the state-owned insurance company, INS. INS is one of the largest insurance companies in the Central American region and the only operating insurance company at the time. INS' long-term IFS rating of 'BB+' and national scale IFS rating of 'AAA(cri)' have a Stable Outlook.

### **Dominican Republic: Strong Headwind Ahead?**

For a second year in a row, the Dominican insurance industry has been negatively affected by the economic downturn. This is reflected in a lower premium demand, a continuous increase in the net claims ratio since 2007, few advances in efficiency levels, and a slight but sustained deterioration of its combined ratio (more than 95% in the last four years), being that net financial income has not been able to compensate this trend given the low interest rate environment and the burden of an above-average premium receivable rotation.

Despite the fact that the economic slowdown in the Dominican Republic has been less pronounced compared with other Latin American countries, and the sustained demand of insurance protection from private pension funds remains relatively steady, fierce price competition (particularly in auto and other P&C businesses) has outlined the limited expansion on premiums. This trend that may continue in 2010 given the modest recovery expectations around the economy. The downturn observed in local interest rates since early 2009 will result in more challenges for the sector to achieve incremental financial results to cope with its increasing combined ratio. It is worth mentioning that the significant concentration of the market (the six largest insurance companies control more than 90% of total premium) makes the competitive environment even more complicated in times when prices should go up to enhance the profitability of the market. This is because, in the short term, an appropriate management of the investment portfolio and the reduction of premium receivables will be the main focus point for the Dominican Republic insurance market, under the absence of a real increase on premium demand or an upside on its pricing trends. Also, the weaker profitability and expansion expectations around the market should result in more incentives to continue with the consolidation process among small players, a trend that has proven all over Latin America to be less proactive than the economic rationale suggest.

Nonlife insurance lines kept their higher weight of total premiums written, whereas auto insurance has remained the most important, although it has lost participation due to a significant drop in car sales. Life products, in part rediscovered after the

introduction of the private pension fund scheme in 2002, can be further benefited if some initiatives in regard to a tax regulation scheme are approved. The current low penetration level of life insurance in the Dominican Republic — even compared with the region average — implies a very bright future if the income of the population maintains a steady increase and adequate products are offered to the market.

Due to its geographic location and small size, the Dominican Republic is highly susceptible to catastrophic damage, as has been the case in the last 30 years, resulting in a heavy dependence on reinsurance programs, which, so far, have resulted in adequate protection to the results and equity of the sector. Proportional reinsurance policies have not been completely substituted — a trend that has generally been observed throughout the region. Despite its obvious benefits, the heavy dependence on catastrophe protection exposed the industry to the sudden change in the price environment because the significant increase in the number and size of catastrophes since early 2010 and the expected hurricane season (forecast to be more active than the 2009 season) could result in some price increase. This could lead to another source of profit constraints in the industry if those increases cannot be properly reflected in higher premium prices.

Even when leverage ratios are in line with the media of the region — and the Dominican Republic is not even within the group of the most leveraged industries in the region — capitalization presents significant opportunities for its improvement, especially considering the significant expansion possibilities of the industry, given its low penetration levels. Decreasing profitability and high sizable cash dividends could hinder this need in the short and medium term, as has been the case since 2005. The sizable participation of fixed assets (few of them income generators) and the need to better align its technical reserves, compared with best practices in Latin America, suggest that current leverage ratios are slightly underestimated, signifying an even more conservative capital position.

Given the environment of lower profits, a relatively large holding of fixed assets, and a low premium receivable turnover, liquidity ratios for the industry have been tight for a number of years. Significant changes in that trend will be mostly contingent on better premium collection schemes and a decrease on fixed asset holdings. The former is a real challenge for an industry where the distribution channel (independent brokers and large brokerage dealers) has a significant impact on customer management, comparable to the rigidities seen in Panama.

National scale IFS ratings of Dominican insurance companies remained stable during 2009, although less favorable economic conditions in 2010 could pressure the risk profile of some companies, resulting in some negative actions under the absence of a real profitability recovery or sizable capital injections.

#### **El Salvador: Growth Challenged in 2010**

At the end of 2009, net written premium growth in the Salvadoran insurance industry was close to zero (0.4%) given the decline in the country's GDP (–3.0% according to Fitch's estimates). Furthermore, the industry growth rate was far from the two-digit average in the last three years.

The product mix is almost equally diversified into life and nonlife lines, but life is predominant in those insurance companies that are members of financial groups. It is worth mentioning that nearly 80% of net premiums in the industry are subscribed by insurance companies controlled by foreign groups, which in Fitch's opinion, leaves a limited probability of entrance for new players.

In terms of concentration, underwritten premiums in the top five insurance companies represent almost 79% of the total net written premiums in 2009. The market share of companies not directly related to financial groups is relatively limited. The pricing competition is still aggressive, primarily in auto lines (around 12% of total collected premiums), and participation in life and fire coverage is almost 20% for each.

Net income grew 6% due to lower reserve expenses and improved financial results. On the other hand, the net loss ratio increased to 49.9% (45.8% in 2008) as a result of higher claims frequency in the health business, the overall increase of the average claims cost, some high value claims related to Hurricane Ida, and the maturity of the insurance related to the survivor and disability policies in the industry. Nevertheless, the industry's net loss ratio still compares favorably with the average recorded by the insurance sectors of other Central American countries (67.3% in Guatemala, 57.3% in Honduras, and just above 45.6% in Nicaragua). The industry also faced some pressures on its operating costs ratio due to its anemic premium growth and higher burden of commercialization costs from mass channels, with net expenses representing a bigger proportion of the total retained premiums (32.8% in 2009 and 29.8% in 2008).

As a result, the combined ratio reached 82.8% in 2009, but it is still one of the lowest in the region. As a caveat, it is important to address that local regulatory rules lag behind many countries on the continent due to the lack of reserves for the provisional business, resulting in an underestimation of the extremely low combined and leverage ratios of the industry. The industry's financial performance still recorded high profitability ratios. The average ROA was 10.7% and ROE was 22.5%.

Fitch believes that the environment for the industry will remain challenged in 2010 considering the weak economic outlook (GDP growth of 0.2% according to Fitch). Recent changes in the tax rule for reinsurance activities in El Salvador could pressure prices and reduce the demand of insurance protection. However, Fitch's outlook for the industry remains stable overall, given the strong capital and liquidity position presented at the end of 2009; the underwriting orientation towards life lines; the contribution of the financial results linked to the limited volatility in the investments portfolio, particularly concentrated in fixed-income instruments; and the reasonable catastrophe and risk loss exposures to capital for the majority of the insurance companies.

Despite the challenging operating environment, and the support provided by its institutional shareholders (incorporated in the national scale IFS ratings of the incumbent participants), Fitch expects that the current set of national scale IFS ratings assigned to El Salvador should continue in 2010, while upside potential for the ratings is generally limited.

#### **Ecuador: Expansion of the State-Owned Insurance Company?**

Despite weaker economic activity (GDP growth of just 0.4%) and a significant increase in premiums in 2008 due to the introduction of the compulsory third-party liability insurance for vehicles (locally known as SOAT) that resulted in a significant increase on premiums (+30% on total collected premiums), 2009 was a good year in terms of premium growth (+6.6%). Although, it was below the training average of 17% for the last five years.

The outlook for 2010 is still promising due to the expected increase in government investment in the electrical sector and the expected expansion of the banking business, which may drive the demand for insurance coverage (especially on loans granted to individuals). However, the volatile operating environment and the threats of government intervention in the financial sector are factors that may undermine the performance of the sector. Despite the increase in operating costs, a relatively

controlled claims ratio and stable financial income resulted in just a slight decrease in the overall profitability for the sector (2009 ROAA: 3.8%; 2008 ROAA: 4.3%), although underwriting results were still reasonable (combined ratio of 95%). Should no dramatic changes in the operating environment occur, the results of the market should hold during 2010, especially given the expected growth and the significant protection provided by one of the few proportional reinsurance programs in the region (some exceptions apply to individual companies).

Auto and group health are the largest lines of business in the Ecuadorian insurance sector, accounting for 41% of retained earnings due to the fact that both lines registered relevant growth of 11% compared with their 2008 levels. Also, other lines, such as those related to large risks related to government activities (oil and other investment projects), registered two-digit growth. On the other hand, the recently introduced SOAT registered a 35% plunge in its premium levels due to the mandatory reduction of its prices and some caps on the protection offered to the insured portfolio (both conditions regulated by the government), a negative trend that will continue during 2010 while the renewal process of the insured portfolio occurs.

Currently, 43 insurance companies operate in the Ecuadorian insurance market (23 composite insurers, seven life insurance companies, and 13 P&C). During 2009, the regulator approved the incorporation of two new insurance companies and forced the liquidation of one small company. Concentration levels are relatively low, with the 10 largest company's collecting around 54% of total premiums. This is one of the lowest concentration levels in the region after Argentina. Even after no merger and acquisition activity was recorded in 2009, the recent request from the government to migrate all of its insurance protection to the state-owned insurance company (Seguros Sucre) resulted in a significant increase of almost 160% (currently manages 6% of the market). This expansion will continue into 2010 after all private sector companies complete the renewal process of all the premiums. Also, this is due to the expected larger than proportional increase on premium demand from the government compared with the private sector demand. This change in the dynamic where a government-owned insurance company will experience a new expanded size could result in an asymmetric performance between private sector companies and Seguros Sucre, as is the case in Nicaragua, Costa Rica and Venezuela.

Ecuador's insurance penetration is still below the average of the region (1.82% of GDP), and the country ranks ninth overall. As previously mentioned, despite the significant difference in penetration compared with other countries, the fact that the Ecuadorian financial sector is relatively smaller as a percentage of GDP and lacks significant life insurance products (annuities and other life saving products), the real growth potential of the market cannot be as promising in the medium term until the aforementioned factors and the overall volatility of the operating environment are controlled. Fitch currently does not assign IFS ratings to entities in Ecuador.

#### Guatemala: Operating Results still Negative

Despite lower economic activity (GDP growth of 0.5% in 2009 according to Fitch), net written premium growth in the insurance industry was similar to the previous year (9%), which is mainly explained by the increase in P&C and accident and health premiums, which have largely increased in terms of insured portfolio and prices.

The industry's premium breakdown is primarily concentrated in auto (26% of underwritten premiums) as well as the accident and health business (23%), with a lower participation in life lines (19%), fire and earthquake (17%), and other insurance lines (15%). However, nonlife lines represent the most with 58% of the total subscribed premiums.

Net income during 2009 grew by almost 23% due to an important increase in financial income (almost 15%). On the other hand, technical results deteriorated even further compared with 2008 because of an increase in the net loss ratio to 67.3% in 2009 from 66.4% in 2008. This ratio compares unfavorably with the average recorded by the insurance industries of other Central American countries (57.3% in Honduras, 49.9% in El Salvador, and just above 45.6% of Nicaragua). As such, the industry once again posted a combined ratio above 100%, the highest compared with the averages of the other Central American countries (82.8% in El Salvador, 89.7% in Honduras, and 90.7% in Nicaragua). Nevertheless, the Guatemalan insurance industry registered acceptable profitability ratios (ROA of 5.6% and ROE of 19.2%) as a result of the contribution of the financial results (8.7% of the total premiums earned).

Unlike the trends in other Central American countries, just 28% of net premiums are underwritten by foreign-owned insurance groups. Industry concentration is relevant, because five insurance companies managed 69% of total premiums (58% for the largest three). In Fitch's opinion, this means that the possibility of new entrants is low, especially considering the aggressive pricing, primarily in auto insurance.

Ongoing regulatory changes associated with the introduction of a new insurance law will result in new reserve requirements for the sector. The largest changes will be related to the P&C business. As a consequence, those insurance companies heavily weighted in such lines would present a major deficiency in reserves, causing mid-term pressure on their results. Despite the former, Fitch acknowledges the benefits of the revamped regulatory piece that may enhance the profile of the sector, especially in regard to its investment portfolio and leverage. Despite the evident reserve insufficiency of the sector compared with regional best practices, leverage ratios are still higher than in other Central American countries, with a liability-to-equity ratio of 2.3x and the highest ratio of net earned premium to equity of the Latin American region (2.3x, only matched by Nicaragua).

Fitch believes that the industry's performance in 2010 would benefit from the positive economic outlook and credit conditions in Guatemala (GDP growth projections of 2.0% according to Fitch) as long as the industry moves away from its fierce price competition. Fitch also believes that it is important to reduce the level of operating leverage and show a stronger capital position.

The current set of national scale IFS ratings assigned to insurance companies in Guatemala are a mix of stand-alone ratings. Some companies benefited from the support provided by their institutional shareholders, being that all of the ratings currently have a Stable Outlook. This trend should continue under the absence of sudden changes in their financial profiles. The imminent approval of the insurance law in 2009 should have a positive effect on the Guatemalan market, as it will require greater technical reserves and capital levels.

#### **Honduras: Strong Performance despite the Operating Environment**

The turmoil that affected the Honduran economy during the second half of 2009, characterized by political instability and a slowdown in economic activity, resulted in a stagnation of premium volumes, but the sector was still able to post adequate results. As a consequence of the GDP slowdown (-0.2% estimated), net collected premium growth was close to zero (0.2%) at the end of 2009, well below the growth of the previous year (14.3%).

The industry's premium breakdown is relatively diversified: life (28%), accident and health (19%), auto (21%), fire and earthquake (21%), and other insurance lines (11%). Additionally, the distribution of premiums is well-balanced between nonlife (53%) and life lines (47%), with the latter increasing its share.



During 2009, earnings in the industry grew by almost 25%, influenced by an increase in the operating results (75%), particularly lower reserve needs due to limited premium growth, controlled claims and expense ratios, and an increase in financial income contribution. The top five insurance companies collected 76% of the total premiums in 2009, experiencing an overall decrease of 4%, while the remaining six companies achieved an increase of 14%. This mixed trend in growth has resulted in some expansion of the market share in small and midsize companies, while the conservative position of the five largest companies resulted in some loss of their share.

The net loss ratio slightly increased to 57% (55.6% in 2008) due to greater P&C and life claims and retained losses related to the 2009 earthquake that struck the northern area of the country, which led to higher crime rates. The auto insurance lines also registered higher loss ratios due to the decrease in sales and the increase in thefts and repair costs (auto parts and labor). However, the average loss ratio in Honduras still compares favorably due to its relatively lower concentration in auto insurance. The combined ratio in 2009 of 89.7% was below 92.9% in 2008, as a result of the improvement in the net expenses to earned premiums ratio. Consequently, the industry recorded acceptable profitability ratios (ROA of 8.5% and ROE of 22.7%).

In Fitch's view, the positive economic outlook (GDP growth projections of 2.0% according to FMI) will benefit the operating performance of the industry, which has remained solid even after the political crisis in 2009. The change in government may create more stability in the operating environment. This could also minimize the impact of tighter financial results due to a fluctuation in the exchange rate.

During 2009, Fitch took negative rating actions on several Honduran financial entities (banks and insurance companies) based on the overall deterioration of the operating environment and the possibility of reduced foreign investor support. However, it is still too early to judge the structural change of those factors. Further changes in the current set of national scale IFS ratings will be contingent on a more stable and sustainable operating environment and/or changes in the intrinsic financial profile of individual insurance companies.

### **Mexico: Growth Opportunities Challenged by Current Economic Conditions**

Despite the signs of a gradual recovery in the Mexican economy for 2010, Mexico's GDP is expected to grow 3.5%–4%, and collected premiums growth is expected to remain below 2009's results. Collected premiums have sustained an adequate rate of growth (2004–2008 average of 10.6%), although the past economic turmoil affected the auto insurance sector (20.2% of total premiums in 2009) due to decreasing auto sales. Therefore, premium growth was positively driven by other P&C lines, especially in the large risks arena (e.g. Pemex's risk coverage, which is Mexico's largest policy and is distributed among the sector). Therefore, expected growth for 2010 is expected to be around 8%–9% (13.4% in 2009). According to the local insurance regulator (Comisión Nacional de Seguros y Finanzas), the insurance portfolio mix remains stable and is composed of life products (40.7% of total premiums); casualty (other P&C business in addition to auto, 20.5%); auto (20.2%); health (14.8%); and pensions (3.8%).

The Mexican insurance sector is slightly more concentrated than the region average but still well below Peru and other markets. The largest five companies (out of 98) managed 52.5% of direct premiums during 2009 (50.1% in 2008). It is important to consider that more than 50% of Mexican insurance companies (57 of the 98) are owned by foreign financial groups or insurers and have made their way into the Mexican market through acquisitions or mergers. In 2008, the most relevant acquisition was AXA Seguros purchase of ING's insurance business portfolio (10.8% market share in 2009).



In line with regional trends, and despite being the second-largest insurance market in the region, penetration is still low. As of 2009, collected premiums represented 2.0% of GDP (2004–2008 average of 1.6%). This trend has been positively affected by higher income levels, an increase in banking penetration, and the expansion of the underwriting of large risks that were previously contracted abroad (e.g. Pemex). Fitch believes this trend will continue over the longer term, although it is only expected to make a modest contribution to Mexico's economy in the short term since only 5% of the Mexican population has health/life insurance.

Since most insurers in Mexico are multisector (e.g. life, nonlife, health), combined ratios are relatively high when compared with Latin American standards. Historically, the industry's combined ratio has remained somewhat pressured (over 100%), affected mainly by high claims ratios. In 2009, the claims ratio reached 73%. Significant change is not expected in the short term given the challenges of the market in terms of claims control, price competition, and modest overall expected growth. Similar to other markets in the region, the enhancement of the underwriting result is a must for the sector in order to sustain adequate growth. A more intensive use of the bank assurance channel, as seen in Chile, Peru, and Brazil, will benefit the expansion trend of the sector in business lines that tend to be less driven by price and with good underwriting results.

In 2009, the sector's ROA reached a reasonable 3.3%, while the ROE stood at 19.7%. The ROE is expected to remain relatively stable in the foreseeable future, depending mostly on the stability of life products. Despite weak trading earnings in 2009, the insurance sector has been primarily dependent on financial income to boost net earnings given that technical and operational results have remained somewhat weak. The expected reduction in the capital market's volatility will aid the sector in protecting and/or boosting its financial income during 2010. Leverage ratios vary widely across companies. Insurers linked to financial groups (not necessarily bank assurers) present higher leverage ratios due to their focus on life saving products, while nonlife-oriented insurers show higher capitalization ratios. However, the sector's liabilities-to-capital ratio remains between 4.0x and 5.0x, which is better than markets with wider life insurance penetration (e.g. Brazil and Chile). Life saving products account for 21.4% of total life written premiums. Fitch believes life savings products will continue to represent a small share of total premiums. Therefore, the Mexican insurance sector is expected to remain less leveraged than other more developed markets in this segment.

#### Nicaragua: Low Claims but Inefficient

The Nicaraguan insurance industry reported a 7.9% increase in net written premiums during 2009 to NIO2.25 billion (USD108 million) compared with 2008 (2.7% in U.S. dollars). This growth was mainly due to the expansion observed in P&C lines (+15.2%), which represented 46.5% of the overall increase in premiums, followed by mandatory automobile insurance (+23.8%), which contributed 31.5% to overall growth. It is worth mentioning that the voluntary auto insurance line decreased by 3.1% as a consequence of the contraction of financial institutions' consumer loan portfolios and the decline in auto sales in the country.

Thus, the insurance sector in Nicaragua is, for the first time, no longer dominated by voluntary auto insurance as it represented approximately 23% of total premiums at year-end 2009 (36% in 2008), below the 26% participation of P&C insurance (24% in 2008). Life insurance continued to represent the third-largest insurance segment in the Nicaraguan market (16% of total premiums), while the other personal line, health insurance, represented 10% of the total premiums profile. Mandatory automobile insurance (locally known as SOA) and other minor lines comprised as "others" represented 12% and 11%, respectively. Surety bonds represented only 2.5% of total premiums. The state-owned Instituto Nicaragüense de Seguros y Reaseguros (INISER) maintained its 35% participation in

2009 with the remainder of market share being distributed among four private insurance companies: Seguros América (27%), Metropolitana de Seguros and Seguros Lafise (both with 15%), and Aseguradora Mundial (7.7%).

The combined ratio, which reflects the underwriting operating profit/loss of the Nicaraguan market, improved to 93.5% in 2009 from 96.8% in 2008 as a result of favorable claims experience (loss ratio declined to 48.6% from 51.2% of premiums earned). Loss ratios have benefited from the enormous efforts made by the private insurers. Almost all of these private insurers belong to foreign multinational financial groups, which have introduced more efficient technical tariff and risk selection procedures, as well as better claims control methods, particularly in the auto insurance segment. The Nicaraguan loss ratio remains the lowest in the region, benefiting from the absence of natural catastrophes in 2009 and the relatively low criminality rates. The loss ratio is nonetheless partially offset by the relatively high operating costs ratio (highly affected by the high operating costs in the INISER), although the latter recorded a slight improvement to 44.9% in 2009 from 45.6% in 2008.

Net earnings grew by 65.6% due to a decreasing loss ratio and an increase in net financial income given the significant increase in capitalization and reserves levels in the market, especially by the private foreign insurers. Due to the fact that INISER and Seguros Lafise, which together represent 50% of the market's total premiums written, use nonproportional reinsurance coverage, the overall premium retention level in Nicaragua is relatively high (60%) compared with other Central American markets, but below the average in Latin America. This translates into a high reserves coverage, a wide investment base, and a relatively high financial income contribution (12% of premiums earned). As a result, the average ROA grew to 8.2% from 6.8% in 2008, while ROE grew to 11.1% from 7.3% in 2008.

Although Fitch believes that the industry will remain challenged in 2010 given the weak economic outlook, Fitch's rating outlook for the industry remains stable. This is due to the adequate liquidity position presented at the end of 2009 and the strong operating profitability driven by relatively low loss ratios and good investment results. This contributed to the high capitalization and reserves coverage in the market. In Fitch's opinion, the increasing participation of highly rated multinationals, such as the recent joint venture of Aseguradora Mundial and MAPFRE, should lead to improved financial strength in the local market.

### **Panama: Ready to Grow and Improve Its Results in 2010**

The Panamanian insurance industry endured the recent global financial crisis and slowdown in the Panamanian economy reasonably well. Panamanian insurance industry grew 9.5% in 2009 after a very vigorous increase in 2008 (+47.3%) as total collected premium reached USD847.17 million. This increase reflects growth in personal consumer lines (life and health insurance) new business from both established and new distribution channels, including bancassurance and P&C lines, price increases to the risks insured in the Colón Free Zone and the recently completed high-rise buildings that require this type of insurance coverage. Net premiums written for personal consumer lines increased due to new business in individual life insurance and health insurance; as well as group life insurance. Net premiums written for P&C, automobile, liability, surety bond, and other general lines also increased in 2009, reflecting the recovery of the economy compared with 2008, which was partially offset by declines in transportation lines, as well as rate decreases, and increased market competition, especially in auto insurance.

The 2009 total gross loss ratio decreased more than three points to 36.9% of premiums written compared with 2008, despite the more moderate premium growth. The loss ratio decreased to 14% from 21% in the individual life line, and to 32.6% from 80.6% in

the P&C lines. In the latter case, the decrease was due to the absence of the various severe, noncatastrophic losses registered in the Colón Free Zone in 2008. The overall retained loss ratio decrease was partially offset by the higher frequency of car accidents, higher auto parts costs, and rate decreases in auto insurance, which increased its loss ratio by eight points to 53% from 45%.

The Panamanian Association of Insurers recently suggested an amendment to Law 59 dated July 29, 1996 that regulates the activities of insurance and reinsurance companies in the country. Current regulation is viewed by the industry as outdated. The proposal includes several important provisions, including the adoption of IFRS accounting regime, the creation of an ombudsman for the insured, and tightening of controls for the prevention of money laundering. Other changes promote the further development of the sector, incorporating new technology tools, and also providing greater guarantees to companies and insured individuals. The proposal also includes new investment and reserve regulations as well as requirements for submission of updated financial information.

Fitch considers that the 9.5% growth registered by the market is a cyclical low and will recover in the coming years due to Panama's high public investment and major infrastructure projects. Strategic alliances, name changes, better prices, and increased product and service offerings are just some of the actions that have been implemented to help insurance companies in the market grow and be more competitive in the near future.

The Panamanian insurance market has experienced globalization and expansion beyond its borders. This led to the creation of multinational coverage with the corresponding dispersion of risks and cheaper prices. While the new expanded size should benefit operating costs as economies of scale develop, it has also allowed the entry of new players into the market. The Panamanian insurance sector increased to 27 companies at year-end 2009 from 17 companies two years earlier. Recently, Aseguradora Mundial, the largest company in terms of premiums written (with USD85.6 million), sold 65% of its shares to the Spanish insurer Mapfre. This entity also includes all the subsidiaries that are a part of the Panamanian group in Central America (Nicaragua, Honduras, El Salvador, Guatemala, and most recently Costa Rica). According to Fitch, the positive economic prospects of the country, the entry of new multinational players, and the changes to the insurance law will bring the Panamanian market better insurance products and services, as well as a quantitative and qualitative transformation of the market.

During 2009, the set of national scale IFS ratings assigned to insurance companies in Panama remained stable thanks to its good financial performance and the support benefits incorporated by incumbent institutional investors that act as the majority shareholders in some companies. Fitch expects this trend to continue in 2010.

### **Peru: Despite Its Concentration, Competition Remains Strong**

After a period of sustained deterioration in its technical results (2004–2008) due to fierce price competition, the Peruvian insurance market is finally on its way to post improved results in the short and medium term. Peru has the most concentrated insurance market in the region with the three largest insurance companies representing more than 70% of total collected premiums. This market has been characterized by high rivalry levels despite the sustained growth provided by a vigorous economic activity and the expansion of the insured universe in the country (12.4% average premium growth during the 2004–2009 period).

During the 2004–2008 period, competition was driven by price reductions, while the

average cost of claims (and its frequency) increased. This was in part due to less than proportional growth in the providers of goods and services to the insurance market and the overall outdated transportation grid in the country. In addition, the occurrence of some high value claims in 2007 and 2008 resulted in a deterioration of the claims ratio. Therefore, the net loss ratio increased to a peak of 81% in 2007 (from 68% in 2003), while net operating costs were still sizable around 40%. With that in mind, the Peruvian insurance market has posted combined ratios well above 100% from 2004 until 2008 (126% average). The industry has taken a more cautious approach to pricing since late 2008 helped by advances in claims cost control, and slight, but still limited advances in operating costs. This resulted in the first combined ratio below 110% in 2009. This trend may continue in 2010 due to price discipline, the overall expected growth of the economy, and better subscription and claims control techniques.

Despite the recent incursion of foreign players in the market, Peru is still detached from the internationalization trend of the insurance sector seen in other countries of the region. This can be mainly explained by the very dominant position of the three largest players, which are controlled by local financial conglomerates. However, foreign participation is expected to increase as the new players incorporated in the last five years continue with their expansion strategies.

Similar to most of the countries in the region, asset quality was slightly affected by the international financial crisis due to the conservative investment policies followed by the market, controls over foreign investments, large allocation to Peruvian government debt, and, to a lesser extent, investments in the shallow local capital market. Accordingly, financial income has remained stable, excluding some nonrecurring gains recorded in 2006 and 2007 by some companies. Going forward, financial income may be challenged by low interest rates as some companies have started the process of exploring other investment alternatives, such as commercial real estate investments. This has been seen in Peru's neighboring country, Chile. Overall, profitability has been somewhat volatile in the 2004–2009 period, with an average ROAA of 3%, a maximum ROA of 4.3% in 2006, and a minimum ROA of 0.8% in 2008.

Similar to the Chilean insurance market and, to a lesser extent the Brazilian market, the significant and growing share of life insurance (annuities related to the private pension fund scheme as the largest driver of such growth) results in a steady increase in the liabilities-to-equity ratio (average of 4.5x during the 2005–2009 period) but are still well below the levels seen in Chile, which is a more mature industry. Despite the former, a relatively conservative dividend payout ratio has helped mitigate that trend, a policy that may be expected to continue in the short and medium term given the bright growth prospects of the sector for 2010 and 2011.

The sustained and relatively balanced expansion of the Peruvian economy, combined with the current and very low penetration level of insurance protection in the country (1.37% of GDP in 2009), and the introduction of value-added products and low-cost products for the lower income classes are key factors for the performance of the market. In addition, the level of competition and the benefits of a steadily improving regulation framework should materialize into sustainable and profitable growth in the short and medium term, assuming the preservation of technically adequate pricing.

Given the relative stability of the environment and the improvement of the financial results of some of the insurance companies, the international IFS ratings assigned to three Peruvian insurance companies in Peru were affirmed, while the good growth and results prospects in the short and medium term could result in some positive actions in the future.

### Venezuela: Fast Growth Years Are Gone

The Venezuelan insurance industry has been negatively affected by the economic downturn in 2009, exhibiting a slowdown in premium growth and deterioration in the net loss ratio. Positively, the net financial income was still capable of contributing to the industry profitability ratios, which remain at adequate levels similar to previous years. Weak economic activity for 2010 (and a possible GDP contraction), increased pricing competition (particularly in auto), and stalled auto sales will limit premium growth during the present year. Also, a higher than expected claims ratio; the expected maturity of an expanded business base after several years of strong growth; high inflationary pressures; and weak efficiency ratios will result in significant challenges for the combined ratio and overall profitability during 2010. To a certain degree, the net financial income is expected to make up for some of the increase in the combined ratio. As a result, net profits could show a slightly negative trend in 2010.

In addition to the aforementioned challenges — common to any insurance industry in times of reduced premium demand — the Venezuelan insurance industry also faces several challenges related to the management of public sector policies. These have been a significant driver of premium demand in the last five years. The potential changes in health coverage for public sector employees and the recent creation of a state-owned insurance company could cause a significant migration of premiums and/or an overall decline in public sector insurance protection. The takeover by the government of a large insurance company in 2009 sped up this process. As of year-end 2009, approximately 17% of total collected premiums went to state-owned insurance companies, while independent estimates suggest that slightly less than 50% of the total market is comprised of premium from government entities.

Industry concentration of the top 10 companies has remained fairly stable at around 65% over the last few years. Most of insurance premium in Venezuela is written by privately owned insurance companies. Nevertheless, the expansion of the aforementioned state-owned insurance company could result in evolutionary changes to the sector and could also affect pricing levels. Auto and health coverages represent most of the business in the Venezuelan insurance sector (around 70% in terms of collected premiums and even higher in terms of retained business). Therefore, Venezuela is among the least diversified insurance markets in Latin America.

With companies facing stronger competition, higher government intervention in the business, and its own participation in the underwriting business, industry results could be negatively affected in 2010. The financial viability of many small and midsize insurers will be tested, which leads to the belief that a consolidation may occur. However, consolidation has been resisted in the Latin American region. While new insurance laws are currently under discussion in Congress, any new regulatory framework should not have a great effect on the insurance market, at least in the short term. Some new requirements outlined by other regulatory parties within the financial sector could result in the creation of compulsory premium schemes, such as mandatory agribusiness protection (with help from a new insurance fund to be created by the government). Changes in the way the government manages its own insurance protection demand will be more challenging to the sector, at least in the short term.

A number of national scale IFS ratings in Venezuela were downgraded in 2009. These actions were concentrated in the local reinsurance market. The current challenges may pose more downward rating pressure for the insurance universe in Venezuela.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://www.fitchratings.com). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE.

Copyright © 2010 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. All of the information contained herein is based on information obtained from issuers, other obligors, underwriters, and other sources which Fitch believes to be reliable. Fitch does not audit or verify the truth or accuracy of any such information. As a result, the information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed, suspended, or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from USD1,000 to USD750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from USD10,000 to USD1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of Great Britain, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.