STRATEGIC ISSUES FACING THE CARIBBEAN INSURANCE INDUSTRY

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CONTEXT: GLOBAL ECONOMY

- The recovery of the global economy following the financial crisis of 2007-2009 is slow and faltering as governments struggle with the overhang of public sector debt, which reached crisis proportions in Ireland and Greece within the Eurozone.
- Notwithstanding the developments last week, a ‘double-dip’ recession in the USA is still unlikely, but the Eurozone could slip into recession (UK has now had two successive quarters of negative growth);
- It will be 1½ to 2 years before strong and sustained economic growth with low inflation re-emerges. The IMF has lowered its growth projections for the global economy for 2012 and 2013, but has largely maintained its growth projections for the period 2014 through 2017.

CONTEXT: REGIONAL ECONOMY

- Regional economies remain weak:
- Jamaica – weak but positive growth in the context of IMF programme; exchange rate holding steady with inflation around 7.5% but foreign exchange reserves have been declining.
- Trinidad and Tobago – third successive year of decline in real GDP; oil production at lowest level since mid 1950s; markets for natural gas endangered over the medium term.
- Barbados – weak tourism sector causing higher unemployment, high debt levels and no growth.
- Guyana- positive fairly strong economic growth.
- OECS – weak economic activity; St Kitts debt restructuring and bank failures in Antigua have reinforced negative sentiment on the sub-region.

GLOBAL AND REGIONAL INSURANCE MARKETS

- The high incidence of natural and man-made catastrophes around the world over the last few years has implications for the cost and availability of reinsurance in the years ahead. The tsunami and nuclear accident at Fukushima in 2011 contributed to the second highest economic losses from natural and man-made catastrophes of US$370 billion.
- These catastrophes also adversely affected the results of the two largest insurance groups – Guardian Holdings Limited and Sagicor Financial – through their Lloyds associates and subsidiaries.
- Investment returns have been seriously affected by historically low bond yields and the weak performance of equity markets since the financial crisis.
- However, Swiss Re reports that insurance premium growth rebounded somewhat in 2010 with (real) non-life premium in emerging markets growing by 8.8% cf. 0.7% in the industrialized countries, while life premium income grew by 11% in emerging markets cf. 1.7% in industrialized countries

GLOBAL AND REGIONAL INSURANCE MARKETS

- The attempts at the resolution of the financial crisis by governments and international institutions has engendered a slew of regulatory reforms directed at all financial institutions, not just banks and shadow banks. Regulators worldwide and here in the Caribbean are moving to tighten the regulatory regime for insurance companies focusing on solvency and capital adequacy requirements as well as governance structures within individual operating companies.
- Within the Caribbean region, the collapse of Colonial Life Insurance Company (CLICO) and its sibling British American Insurance Company (BAICO), as well as the sale of ALICO and ALGICO to MetLife consequent on the restructuring of AIG, has changed the landscape of the Life and Health Insurance business. It has also adversely impacted household net worth across the region, affected government fiscal operations and contributed to the slowdown in economic activity since 2009.
- PALIG, which writes business in Central America, acquired the Caribbean business of ALICO and ALGICO from MetLife in November 2011

- Over the next five (5) years, we can expect to witness
  - (i) slow top line growth;
  - (ii) higher operating costs, arising in part from higher costs of compliance;
  - (iii) reduced capacity to write property business as reinsurance capacity available to the region becomes more expensive and restricted; and
  - (iv) greater scrutiny from the public, the media, customers, regulators and reinsurers in the wake of the collapse of CLICO and BAICO.
- The question then is how are companies to deal with this ‘state of the world’? What (generic) strategies are appropriate?

Industry Structure Analysis: The Starting Point of Strategy

- The development and articulation of strategy must begin with an understanding of the structure of the market(s) within which the company operates.
- Industry market structure and market dynamics define and delimit the company's 'room for manoeuvre'.

Industry Structure in Life and Non-Life Insurance in the Caribbean

- Our estimate of the size of the Caribbean industry in 2010 was about US$3.6 billion of which about US$1.9 billion (55%) was Life business and US$1.6 billion (45%) was Non-Life Business.
- Over the period 2007 – 2010, the industry has been profitable.
- The biggest markets are Trinidad and Tobago, The Bahamas and Jamaica. The relative shares by country are estimated to be:
  - Trinidad and Tobago 33%
  - The Bahamas 21%
  - Jamaica 14%
  - Barbados 12%

Industry Structure in Life and Non-Life Insurance in the Caribbean

Growth of Gross Premiums			
	2003 - 2006	2006-2009	2003-2009
Life Business	6.6%	3.1%	4.8%
Non-Life Business	7.2%	4.0%	5.6%
Total Business	6.9%	3.5%	5.2%
Source: Various – Regulator reports; Swiss Re Sigma World Insurance publications; Central Bank reports			

- Industry growth slowed over the period 2006 to 2009 consistent with global trends.
- Industry profitability has been variable; the two largest Life companies have experienced fluctuating profitability owing to losses on overseas businesses, though their regional franchises have performed quite well.
- The hurricane seasons in recent years have been relatively benign and non-life companies have performed well.

Industry Structure in Life and Non-Life Insurance in the Caribbean

- There are over 200 operating companies whether incorporated or branches. The majority of these (80%) are in the Non-Life segment of the industry. There are four times as many Non-Life companies/branches as there are Life companies/branches. Several companies operate branches or agencies in more than one territory.
- However, identifying those groups which have over US$100 million in assets and the foreign-owned groups, there are nine (9) groups of companies which dominate the regional industry:
  - Sagicor Financial
  - Guardian Holdings
  - Island Heritage
  - CL Financial/CLICO
  - United Insurance
  - PALIG
  - New India
  - TATIL
  - Scotiabank

Industry Structure in Life and Non-Life Insurance in the Caribbean

- Most of the ‘independent’ companies, that is companies operating in one territory which are not part of a regional or international financial services group, are to be found in the Non-Life segment of the industry where the barriers to entry have historically been easier and the technical requirements for operation easier to surmount. These requirements include access to reinsurance, insurance accounting and claims management services.
- The Non-Life segment is highly competitive in all the territories of the region as there are no territories where there are less than 10 companies writing property and casualty business.
- By contrast, the Life segment is now dominated by two companies Sagicor and Guardian Life, given that CLICO is being wound up (The Bahamas and Guyana) or under judicial management (Barbados) or has effectively stopped writing business (Trinidad and Tobago).

Generic Strategies

- Driving Operational Excellence in order to lower costs and gain market share.
- Training, Education and Human Resource Development initiatives which increase capacity of management and boards of directors to cope with a challenging trading environment.
- Consolidation, that is, seeking mergers or acquisitions which might enable companies to better meet the demands for increased capital and better governance processes.
- Risk Management, that is, the careful selection of risks, sophisticated claims management and superior management of investments.
- Capital Enhancement, increasing available capital to meet tougher regulatory requirements and possible reduction and higher cost of reinsurance.

Driving Operational Excellence

- Strictly speaking, Operational Excellence is not strategy. It is something that companies must do, whatever strategy they may be pursuing. It is a ‘hygiene’ factor.
- However, failure to pursue and achieve operational excellence results in:
  - Lower return to shareholders (though this may not be a critical factor for family owned companies)
  - Company may become a potential takeover target (this may also be different for family-owned businesses).
- However, the less efficient the market, the greater the scope for relatively inefficient companies to survive and even thrive.
- Efficiency is a function of:
  - Informed customers
  - Regulation and other barriers to entry
  - Reinsurance arrangements (which should minimise mis-pricing of risks)
- The structure of ownership of companies in the Non-Life segment of the industry explains the slow evolution of the market in this regard; this may begin to accelerate if regulators impose and enforce demands for greater capital.

Training, Education and Human Resource Development

- The cliché that “People Matter” happens to be true in the Insurance, an industry whose output is a service based on a promise to pay, and where the customer pays upfront.
- Training and education need to focus on:
  - Risk Management
  - Reinsurance Negotiation
  - Claims Management
  - Regulatory Compliance

Consolidation

- Slow economic growth, customers shifting to quality, and higher costs of compliance will put pressure on companies, especially the smaller independent companies in the Non-Life segment of the industry.
- Those companies which are unable to adapt will face either suspension and eventual closure by the regulators or acquisition by larger rivals.
- It is difficult to predict the pace and extent of consolidation in any industry. Family-owned firms may resist acquisition in order to preserve family employment. Firms which are part of groups of companies, financial or non-financial, may be able to divert capital to the insurance business.

Risk Management

- On the Life side, it appears that the HIV/AIDS epidemic may have peaked; however population growth has slowed markedly over the last few decades and the region's population is aging, with implications for health care costs, and how those costs are allocated between the public and private sectors.
- On the Non-Life side, the projected higher incidence of natural disasters arising from climate change will alter the risk landscape for general insurance companies over the next decade.
- Insurance companies may have to pay much greater attention to conformity with building codes and wind and earthquake resistance, but will require government reinforcement of the promulgation and enforcement of the standards. The public relations consequences of declining cover for properties located in certain areas which might be or become flood-prone or buildings which do not conform to code would need to be handled on an industry-wide basis.

Capital Enhancement

- There is still ongoing debate on the calculation of required capital within and between the accounting and actuarial associations, and among the regulators.
- Risk-based capital approach is being adopted by regulators
- It is clear that companies – life and non-life – will need to hold more capital and will be subjected to periodic on-site supervision (Pillar 2).
- However companies have been given an (unintended) reprieve by the slow pace of regulatory reform, notwithstanding the CLICO debacle.

CONCLUSIONS

- The Caribbean insurance industry is waiting … on regulatory reform to be implemented which will have implications for capital requirements, and governance and compliance requirements; and on the global economic slowdown to turnaround and growth to resume. While waiting, insurance companies are well-advised to address:
  - Operational Excellence
  - Training and Development
  - Consolidation
  - Improved Risk Management
  - Capital Enhancement
- The IAC, in conjunction with the regional regulatory bodies, needs to mount a project to collect accurate and comprehensive data on the industry across the region and to maintain the data on a consistent basis.