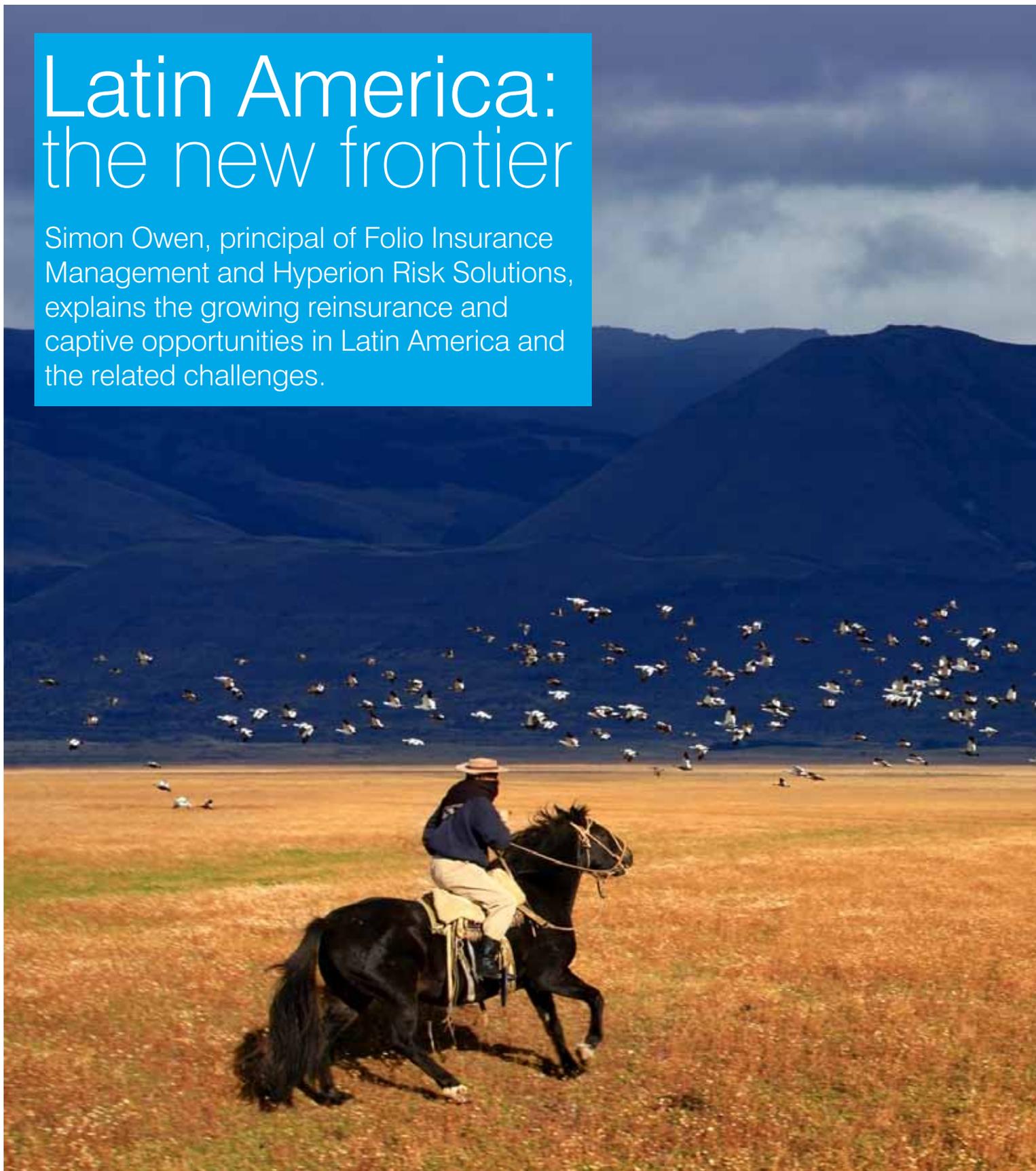


Latin America: the new frontier

Simon Owen, principal of Folio Insurance Management and Hyperion Risk Solutions, explains the growing reinsurance and captive opportunities in Latin America and the related challenges.





Emerging Markets

Contrary to what certain factions of the industry might lead you to believe, the insurance world is not as complicated and as enigmatic as it may seem. As is the case in most business sectors, the application of common-sense, intuition and experience generally provide the basis of opportunity. The associated complexities follow thereafter.

Basic economic principles and trends surrounding the commercial insurance industry are inextricably linked to the reinsurance and captive industries and often indicate where future opportunities will arise.

For example, over the past decade North America and many parts of Europe have rapidly matured to become what can be fairly described as a saturated market. Despite the participants being arguably some of the most innovative globally, the lack of natural consumer growth dictates that the commonly applied growth strategy is purely the acquisition of greater market share.

In a similar vein, the reinsurance industry in the West continues to stagnate. This is particularly apparent in the area of property catastrophe reinsurance, which has effectively become a commoditised product. In fact, it may not be too long before we see traditional reinsurers replaced by a dedicated derivatives market.

As a consequence, reinsurers and reinsurance brokers alike are visibly shifting their focus to emerging markets such as Asia and Latin America. Both regions offer huge opportunities for growth, both at a consumer and reinsurance level, primarily as a result of a rapidly expanding middle-class and an increasing demand for more sophisticated insurance products.

While these trends do not directly correlate to captive opportunities (as there is obviously huge scope for further captive use in those markets), there are clear overlaps in the logic behind the resulting new business acquisition strategies.

Focus on Latin America

From a strategic growth viewpoint, Latin America is very much on the radar of both reinsurers and the offshore captive industries. Given that the predominant forces of both industries have a significant presence in the Caribbean, Latin America's close proximity makes it an extremely attractive proposition as a potential source of future business.

So, now we reach the complicated piece.

When trying to successfully penetrate new markets, it is imperative to fully understand them, their nuances, their needs and their problems. Only then can we offer truly effective products and solutions.

From my own experiences, Latin America ("LatAm") might be aptly likened to a rose. It is incredibly alluring, yet alarmingly thorny.

In insurance terms, this "thorniness" is a fitting way to illustrate the many overly-elaborate licensing requirements and excessively complicated taxation systems that apply in many parts of Latin America. While there are similarities in licensing and tax requirements in certain countries, the only truly consistent feature of a diverse region, is unprecedented legislative complexity.

“THE OTHER MAJOR CHALLENGE IN LATAM IS THE POTENTIALLY PROHIBITIVE COSTS, ESPECIALLY IN THOSE INSTANCES WHERE BOTH INSURANCE AND REINSURANCE FRONTING ARE REQUIRED.”

Brazil provides a good example in this regard. It is the largest economy in Latin America (the seventh largest in the world). Its insurance market is equally dominant from a statistical standpoint, accounting for over 40% of the region's total non-life premiums. However, it is also the World Economic Forum's worst performer in terms of the “burden of government regulation”, a fact that becomes immediately apparent when considering the cumbersome and restrictive laws in relation to reinsurance cessions.

In summary, Brazil has strict licensing laws in relation to insurance. Admitted paper is always required, meaning that insurance fronting for captives is a pre-requisite. This is proliferated by the fact that a minimum of 40 percent of all reinsurance cessions must be placed with a “Local Reinsurer”. The remaining 60 percent (or less) must be placed with “Admitted” (locally represented) reinsurers, or “Occasional” (overseas) reinsurers (subject to a 10 percent maximum of the ceded portfolio). Just to further confuse matters, a maximum total cession of 50 percent to any one reinsurer is applicable across the board, plus there is a stipulation that approved reinsurers cannot retrocede more than 20 percent out to affiliated entities.

Therefore, because captives are not generally licensed by the local regulators (SUSEP), they are not able to directly assume a Brazilian retrocession, effectively meaning that captive involvement in Brazilian risks is only possible when the related risks have been fronted at both the insurance and reinsurance level.

A similar process would apply in Argentina, where the regulators seem to consistently frustrate the country's local insurance market with cumbersome, confusing and restrictive requirements.

To give some more examples, Colombia's laws are less complex, but they also dictate that dual fronting is required. In Panama, no such requirement is currently in place, but it is scheduled to come into force in early 2013. Other countries are arguably far more straightforward and open to unlicensed reinsurers and captives, but whether they will stay that way remains to be seen.

With all of the above in mind, the question then becomes; how do we address these issues to make captives a viable proposition in the region?

Innovative Captive Solutions

As a captive management practice with an existing presence in the region, Folio is firmly committed to understanding Latin American needs and requirements. To give just one example, we have recently formed a Segregated Portfolio Company (‘SPC’) structure for a large Latin American financial services group. This vehicle was purposely domiciled in the Cayman Islands, a leading financial services jurisdiction, and has been assigned a financial strength rating of A-(Excellent) and an issuer credit rating of “a-”.

The intent is to afford the SPC's clients, based in certain Latin American countries, with risk participation opportunities. This will include the provision of dual fronting services that have been approved by the respective authorities in the jurisdiction of the underlying risks. This alone can effectively resolve one of the key regional challenges facing reinsurers and captive owners alike.

With specific regard to captives, the other major challenge in LatAm is the potentially prohibitive costs, especially in those instances where both insurance and reinsurance fronting are required. Coupled with a continually changing local regulatory environment, it becomes immediately apparent why most Latin American captive owners have chosen to domicile in flexible and pro-active offshore jurisdictions.

Why Offshore?

Firstly, the fact that most offshore jurisdictions have low or zero corporate, dividend, premium and other tax rates, make them immediately appealing. Furthermore, there are certain offshore jurisdictions that already have the benefit of Double Taxation Agreements (‘DTAs’) and Bilateral Investment Treaties (‘BITs’).

Many others are actively seeking to sign Tax Information Exchange Agreements (‘TIEAs’) with a numerous Latin American countries. By reinforcing the offshore world's commitment to cross-border cooperation and its commitment to transparency, many of the subscribing jurisdictions may even be afforded some tax treaty-style benefits that will further increase their appeal.

Finally, and probably most importantly, many offshore regulators have played a significant role in the success of many domiciles thanks to their pragmatic, yet flexible, approach to regulation. Their rare willingness to assist the private sector and captive owners in finding solutions to problems created by legislative changes in other parts of the world is extremely refreshing.

In conclusion, the constantly changing regulatory environment in Latin America and other parts of the world adds yet another noteworthy reason for prospective captive owners to seriously consider offshore jurisdictions when choosing a captive domicile. The overwhelming majority of captive owners already have. ●

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