



Swiss Re



Global financial crisis and the impact on the Latin American insurance industry

Fasecolda – Convención Internacional de Seguros
Cartagena, Colombia

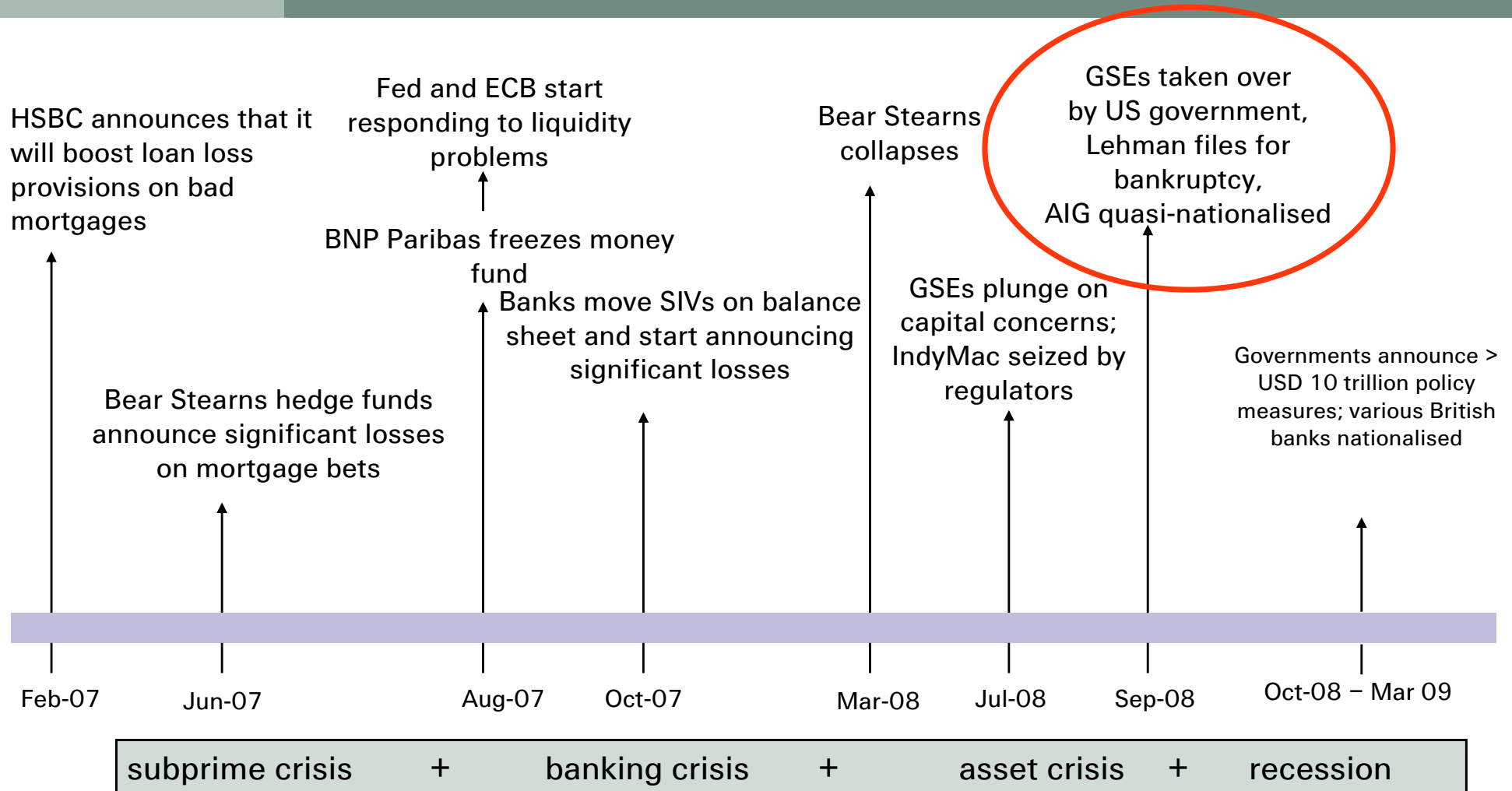
Thomas Holzheu
Economic Research and Consulting
Swiss Re

21 May 2009

RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES



Important milestones of the financial crisis



Sources: DB Global Markets Research, Swiss Re Economic Research & Consulting



How does the global financial and economic crisis spill over in to Latin America?

- Global meltdown of stock markets
- Blow-out of credit spreads
- Lower capital inflows
- Collapse of commodity prices
- Depreciation of currencies
- Lower exports
- Decline in tourism/remittances
- Decline in domestic demand

transmission via
financial markets

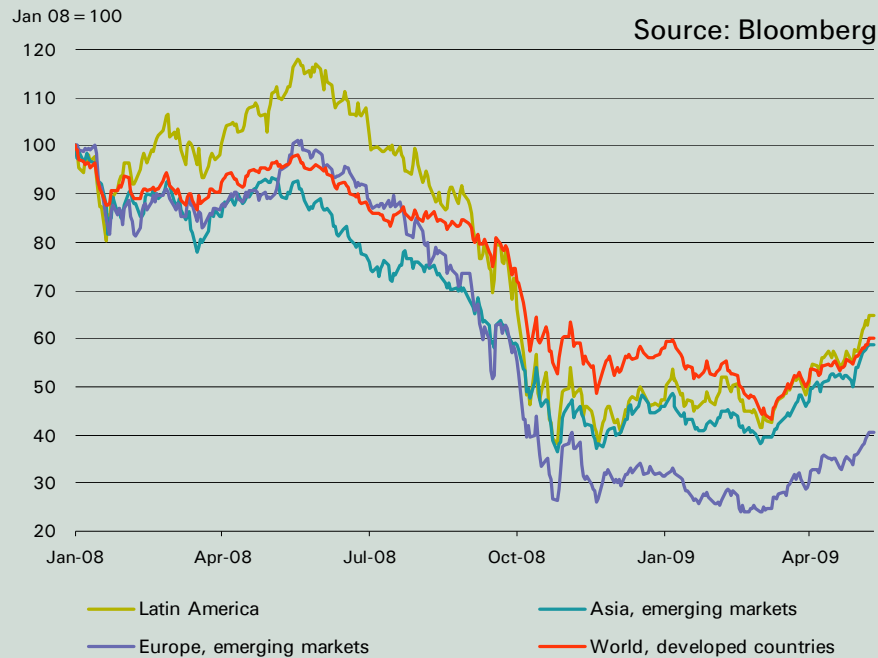
transmission via
"real economy"



Spillovers of the global financial crisis via stock markets and foreign exchange

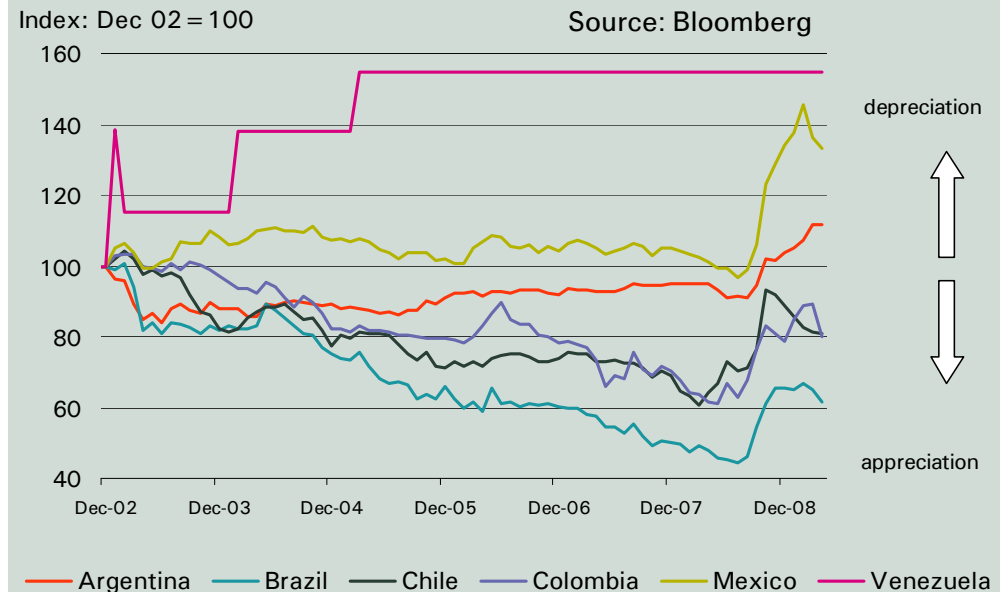
Stock markets are selling off

MSCI Indices



Currencies have depreciated recently

Nominal exchange rates vs. USD





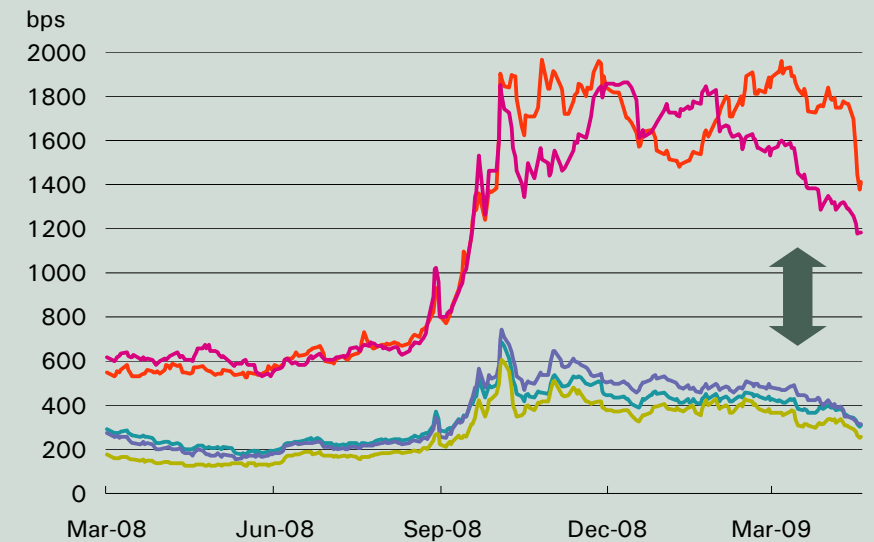
Global credit crisis drove up credit spreads in LA

5-year CDS spreads have been rising CDS spreads (bps)

	31 January 2008	11 May 2009
Argentina	483	2539
Venezuela	182	1387
Colombia	183	236
Mexico	113	225
Peru	148	218
Brazil	137	209
Chile	65	128

Source: Bloomberg

EMBI + spreads, monthly data



— EMBI + Argentina — EMBI + Brazil — EMBI + Colombia
— EMBI + Mexico — EMBI + Venezuela

Source: Bloomberg

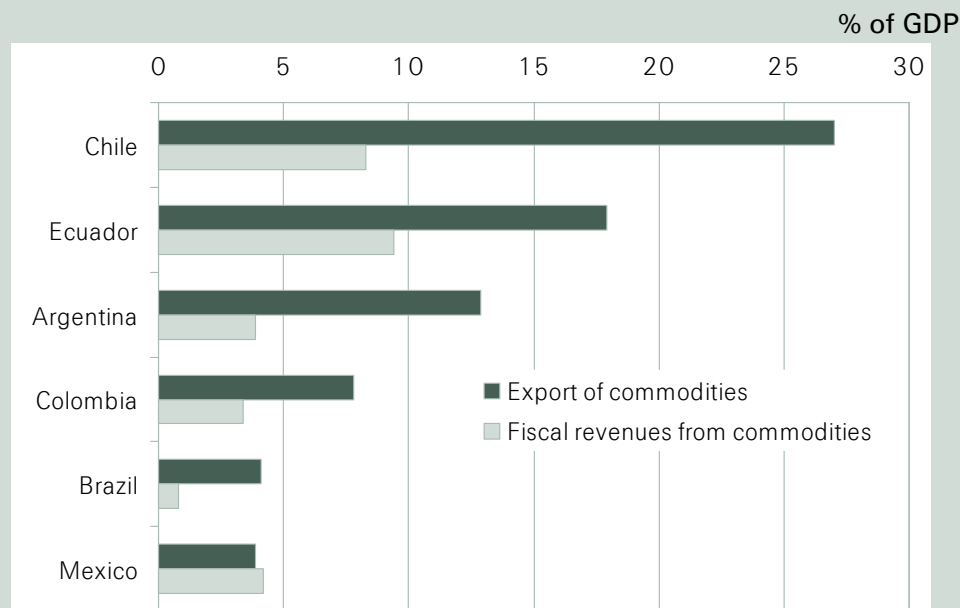
The availability of credit for Latin American companies is declining and the cost is increasing



Dependence on commodity markets

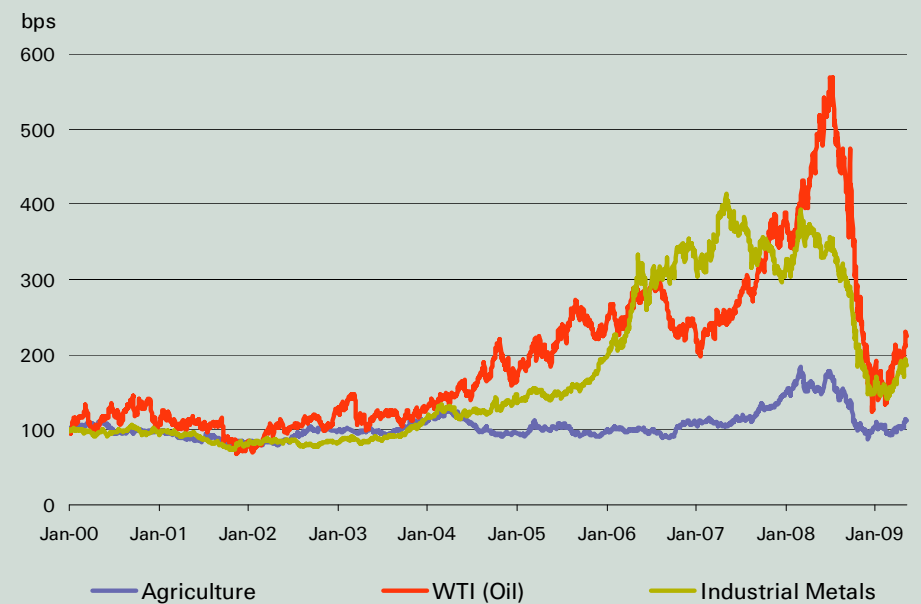
High dependency on commodity exports

Commodity participation in exports and fiscal revenues



Source: Deutsche Bank

Commodity prices have collapsed after a peak in 2008 (Index, January 2000=100)



Source: Bloomberg

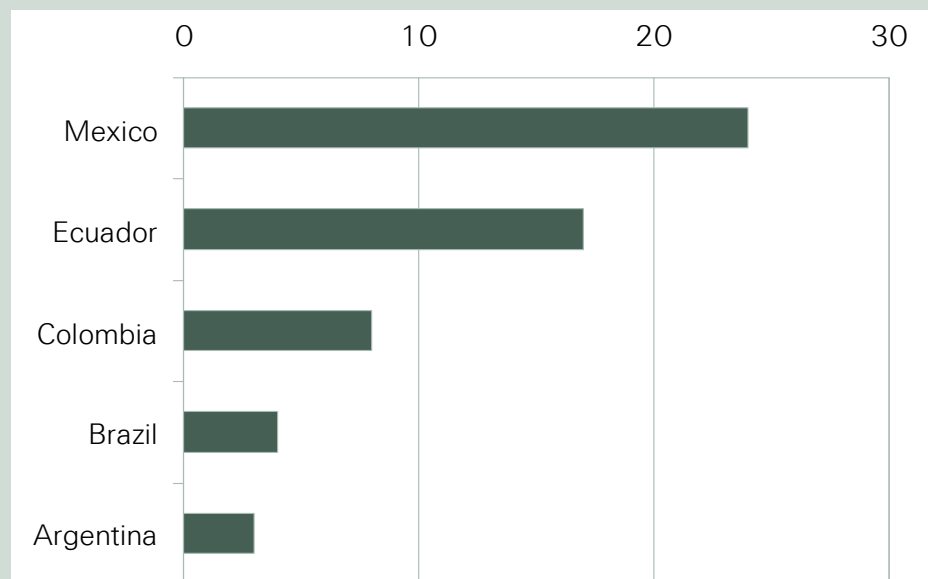
Latin American terms of trade have deteriorated sharply since mid 2008 as prices of the region's key commodities collapsed



Dependence on the US economy

High dependency on US economy

Exports to the US (% of GDP)



Source: Deutsche Bank

US economic outlook

In %	2008F	2009F	2010F
<i>Annual Averages:</i>			
Real GDP	1.1	-2.8	1.4
CPI	3.8	-1.3	0.9
Core CPI	2.3	1.4	1.2
<i>End-of-Period:</i>			
Fed Funds	0.25	0.25	1.0
10-yr T-note	2.3	3.0	3.6

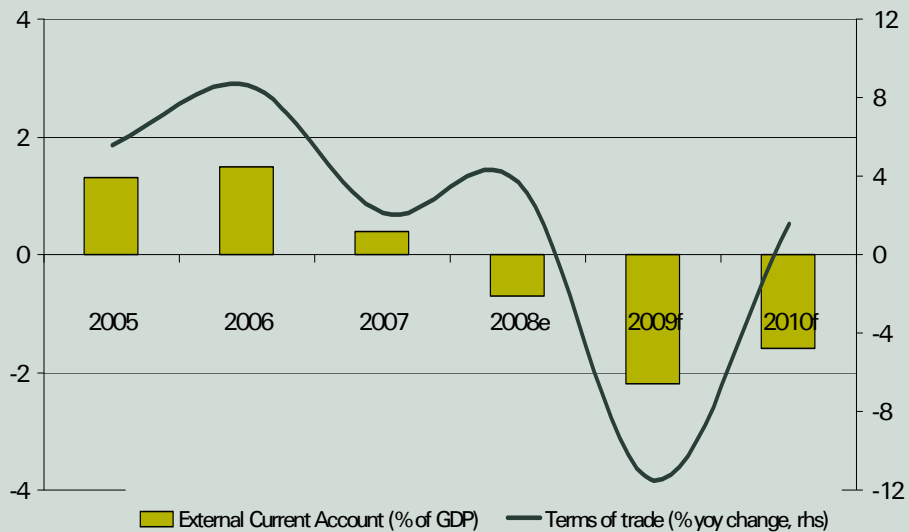
Source: Economic Research & Consulting

Exports to the US and other G3 countries are suffering from weak global demand



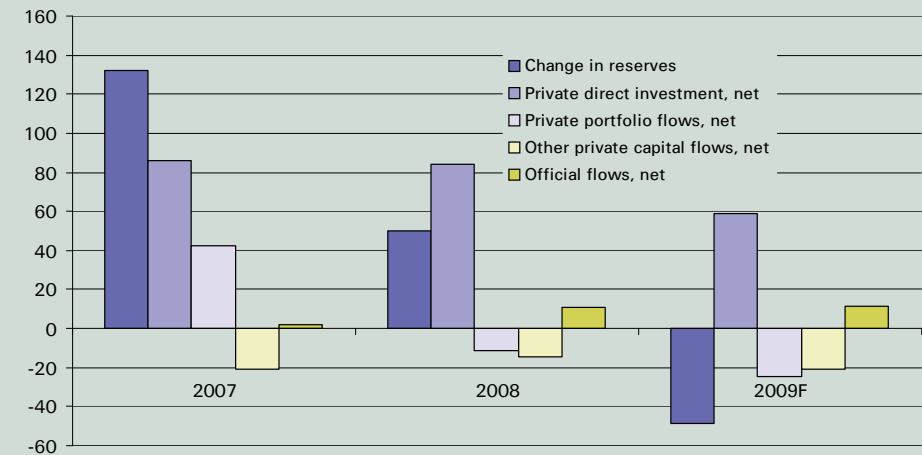
The current account turned into a deficit and external borrowing is drying up

The current account deficit is growing as terms of trade fall sharply



Source: IMF

Net capital inflows (in USD bn)



Source: IMF

Keeps interest rates high, allows for only modest countercyclical fiscal stimulus



GDP growth decelerated sharply in 4Q 08 as domestic and foreign demand fell

GDP is expected to contract this year, but less than G3

Source IIF, e = estimate, f = forecast

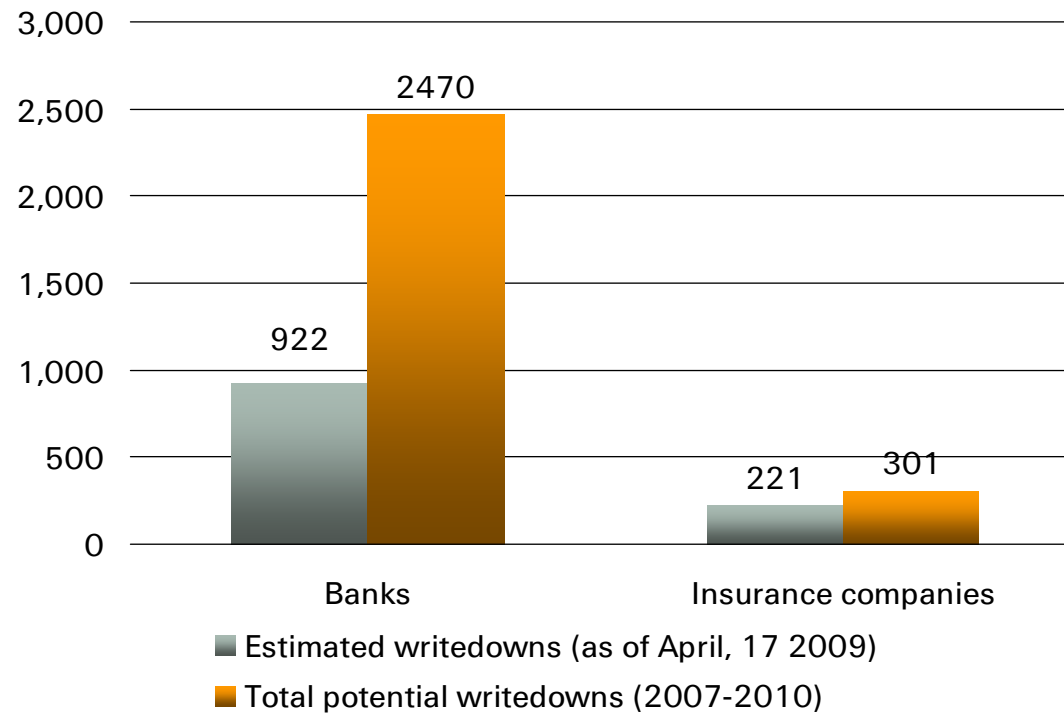
Real GDP growth in %	2006	2007	2008e	2009f
Latin America	5.4	5.5	4.1	-0.7
Argentina	8.5	8.7	7.0	-1.2
Brazil	4.0	5.7	5.1	-0.5
Chile	4.3	5.1	3.5	0.5
Colombia	6.9	7.6	3.1	1.6
Mexico	4.9	3.2	1.3	-2.5
Peru	7.7	8.9	9.2	3.0
Venezuela	10.3	8.4	4.9	0.3

RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES



Financial institutions are facing huge losses

Estimates of financial sector potential writedowns (2007-2010) as of April 2009



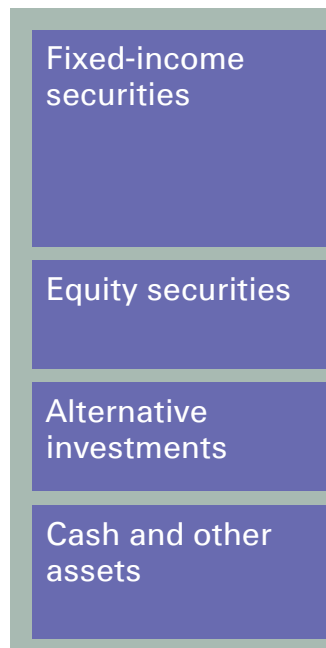
RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES

Source: IMF Global Financial Stability Report April 2009, Bloomberg



Insurance business is fundamentally different from banking

Assets



Liabilities



- **Insurance business is funded primarily by premiums received for providing insurance protection**
 - both premium flow and pay-outs are reasonably predictable
- **Pay-outs are triggered by hazardous events, and not by policyholders' will**
 - a 'run' on an P&C insurance company is virtually impossible and very unlikely for L&H company
- **Insurance hazards are typically uncorrelated**
 - the failure of one insurer does not necessarily predict failures of other companies*

* see G30 and FSF studies

-
- A dashed blue arrow originates from the bottom of the Assets column and points to the right, ending in a solid blue arrowhead.
- **Premiums received are invested in diversified classes with matching currency and cash flows**
 - insurers hold assets mostly until maturity and are therefore immune to short-term value fluctuations

Funding and risk management are more difficult and expensive for insurers due to the crisis



- Credit markets stop working

- Access to liquidity, access to hybrid and other alternative capital sources becomes difficult

- All asset classes except for government bonds are stressed

- Equity capital becomes expensive

- No country is unaffected

- Diversification cannot prevent drop in asset values

- Many markets show symptoms of fire sales, often few trades

- Hedging is very expensive given high volatility and unusually high counterparty risk

- Important risk management tools are more expensive and difficult to use

- Real economy becomes unstable

- Asset values are further destabilised



Key initiatives of insurers

Impact of the crisis on insurers

- Falling values of mortgage-related securities
- Eroding asset values in other asset classes
- Higher cost of capital
- Lower financial flexibility incl. alternative capacity
- Surging claims payments in some sectors (eg D&O/E&O)
- Declining demand for insurance

RE
DC
OF

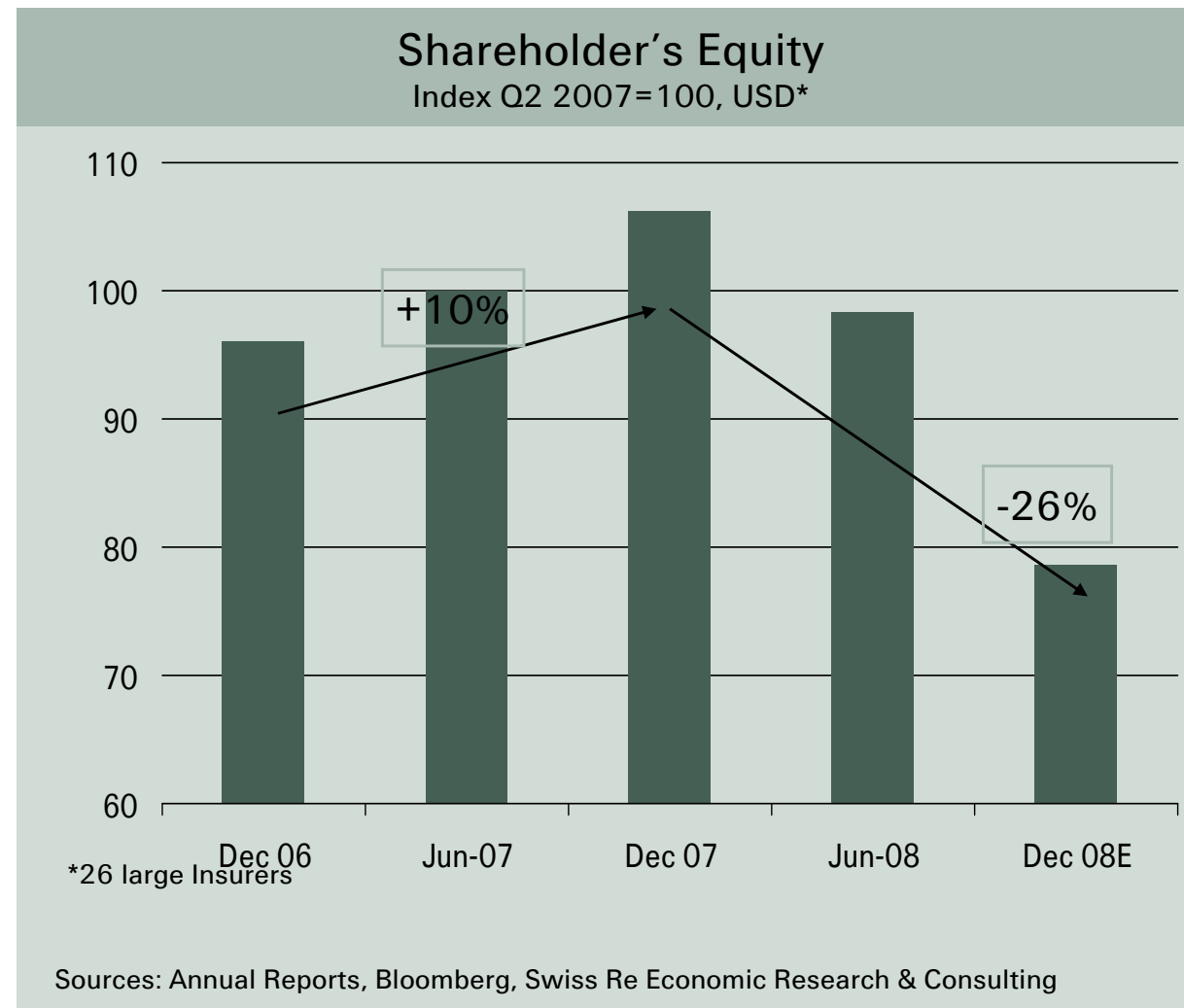
Insurers respond by

- Reducing investment risks
- Focusing on core business
- Promoting underwriting discipline
- Higher demand for reinsurance
- Redesigning life products
- Consolidation



In 2009-2010, a key global issue will be recapitalisation ...

In 2008, the non-life insurance industry lost about 20% and the life insurance industry between 30-40% of the capital base



RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES



Global P&C market overview – closely watching for signs of price firming

- Global surplus declined about 20% in GAAP terms.
- Rates will begin to harden in 2009 in most G3 markets. Property prices are firming first; casualty is still soft. There will be a moderately hard market through 2011.
- High volatility and low returns are expected in all asset classes in the medium-term. This will be a drag on profitability through 2009. Stabilizing returns thereafter will support earnings.
- The cost of capital has risen: equity markets are depressed and hybrid capital is expensive. Reinsurance is currently the most efficient source of capital.
- Capital management has shifted from returning capital to preserving / raising capital. Primary and reinsurers are de-risking their balance sheets.



The global L&H industry faces a very challenging outlook

- L&H insurers have lost 30 - 40% of shareholder capital due to heavy losses on investments and costly product guarantees
- Profitability will deteriorate in 2009 due to low new business, low to negative investment income, higher lapses, and lower asset management fees
- Limited access to credit markets, high cost of capital, and constrained liquidity will be a challenge for many companies
- In 2009-2010, L&H premium growth will be below the long-term trend due to weak new business and worsening persistency
- Life companies will have to recapitalize and restore their balance sheets in 2009 and 2010
- The industry will be back on track in 2011

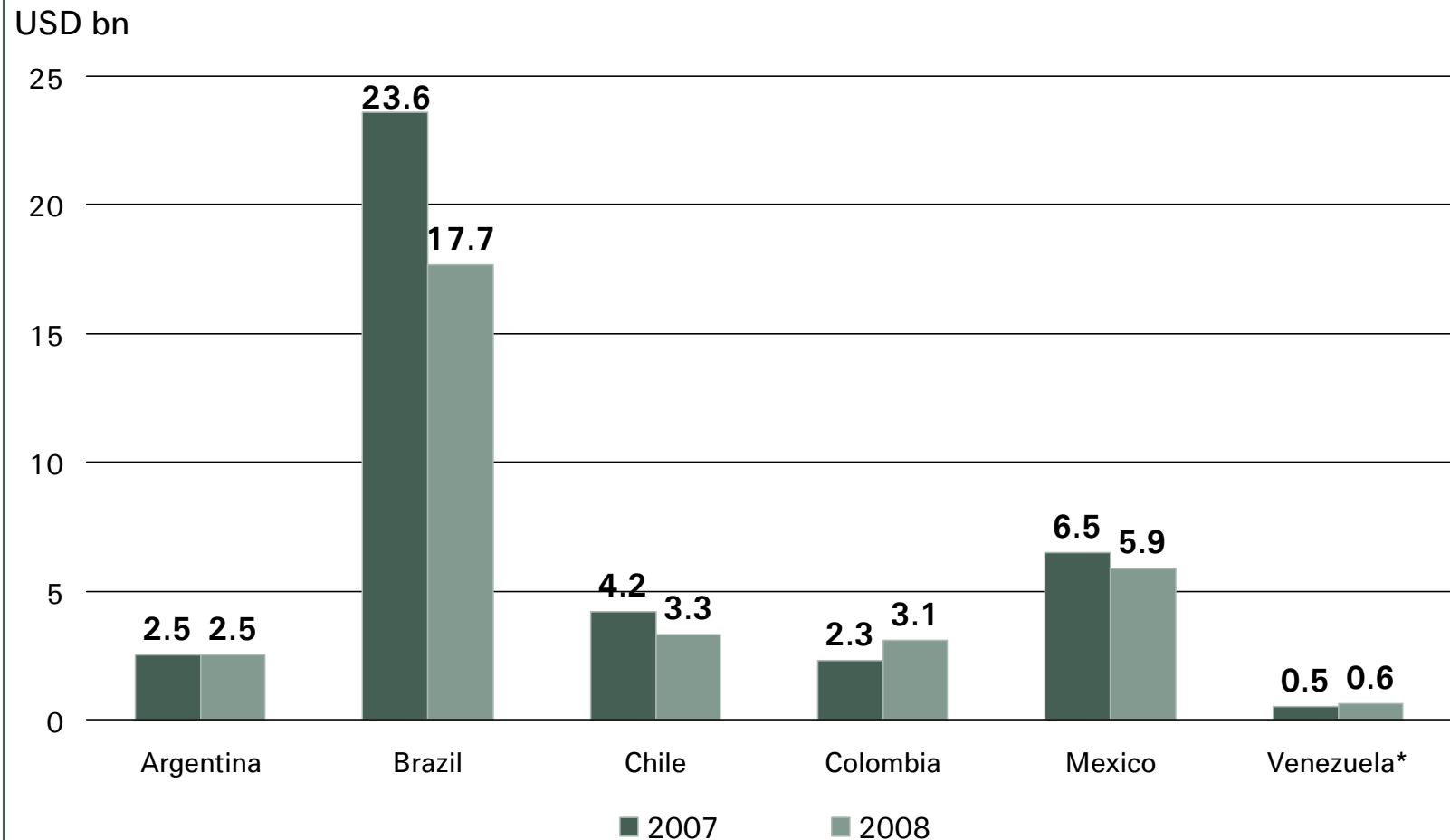
RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES



Shareholders' equity in Latin America has been holding up well in local currencies

In Brazil, more than 50 insurance companies increased their capital by some USD 1.6bn in 2008 to comply with new capital rules.

In Mexico, insurers exposed to hydro-meteorological risks, have been required to increase capital.



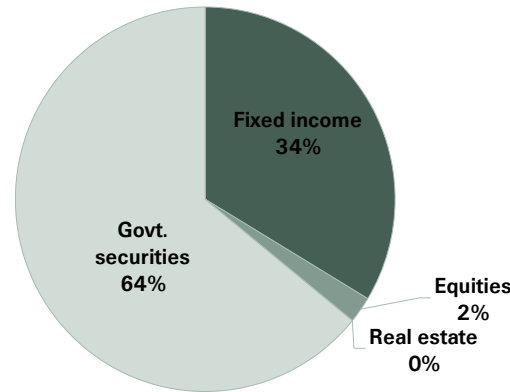
* 10 large insurers

Source: Supervisory authorities, insurance associations, Swiss Re Economic Research & Consulting

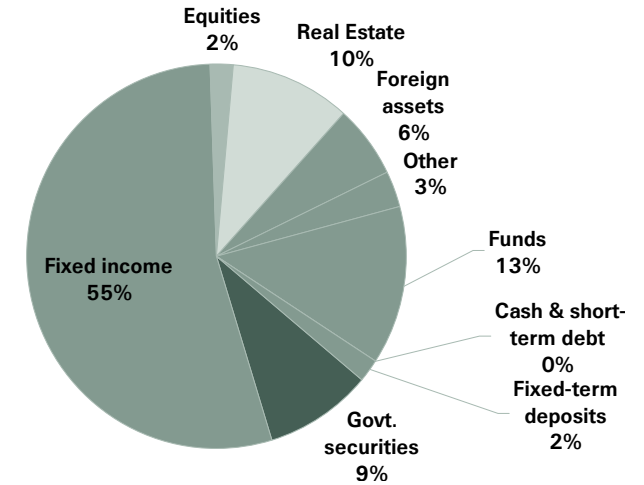


The average investment mix was less exposed to risky assets, preventing assets losses

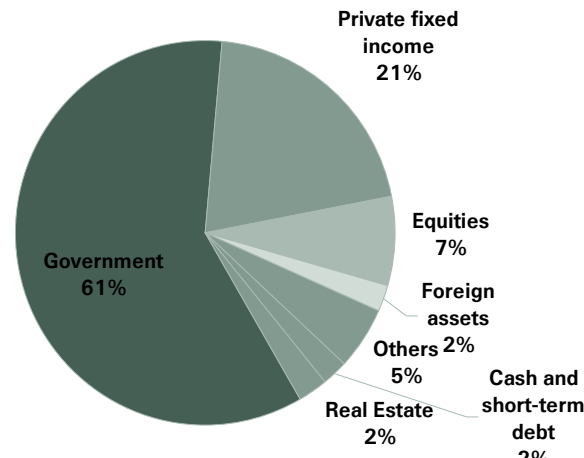
Brazil*



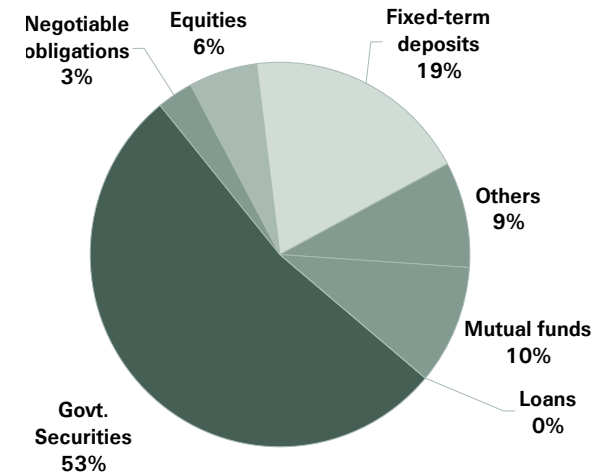
Chile



Mexico

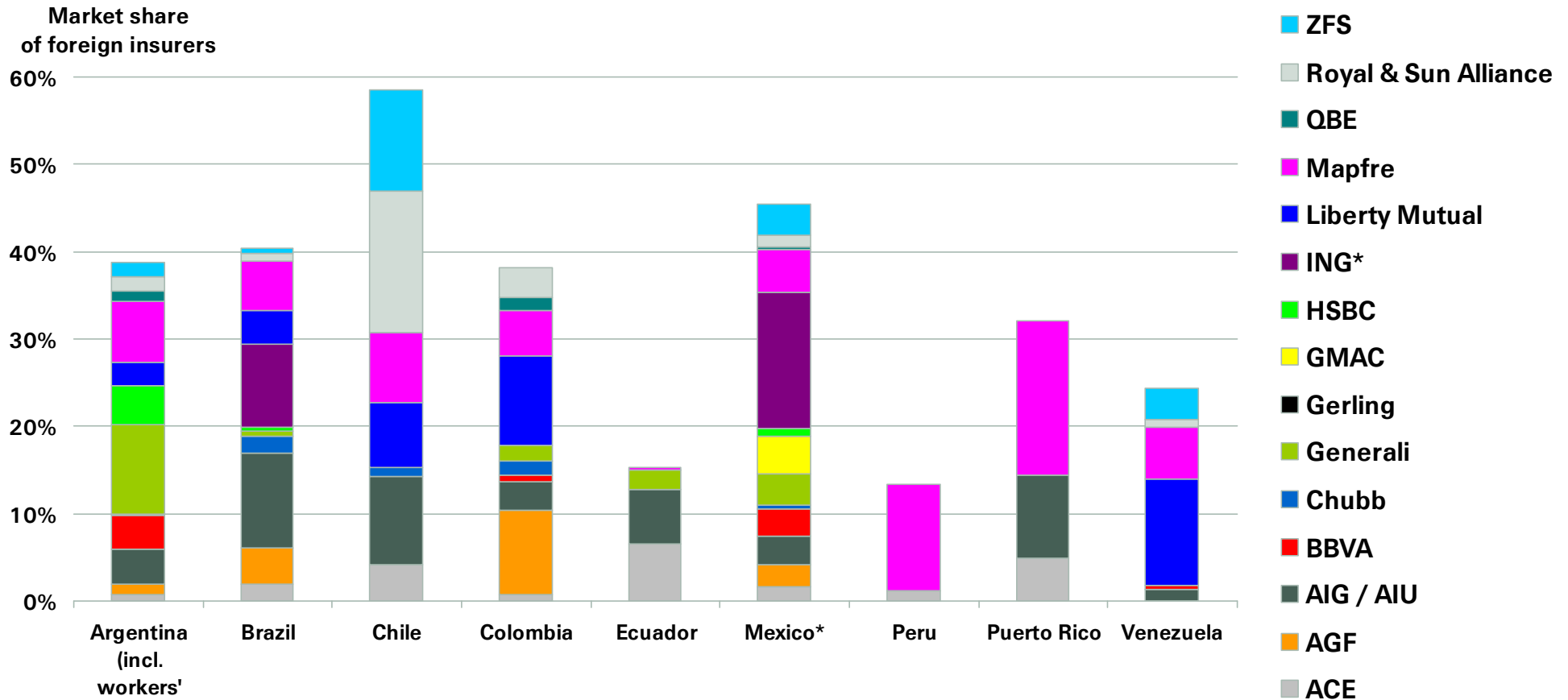


Argentina



RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES
*(assets backing
technical reserves)

There is a link to European and US balance sheets via global insurers' significant market presence



Global companies wrote 39% of regional p&c premiums and 30% of life premiums in 2007

* ING sold its Mexican book to AXA in early 2008

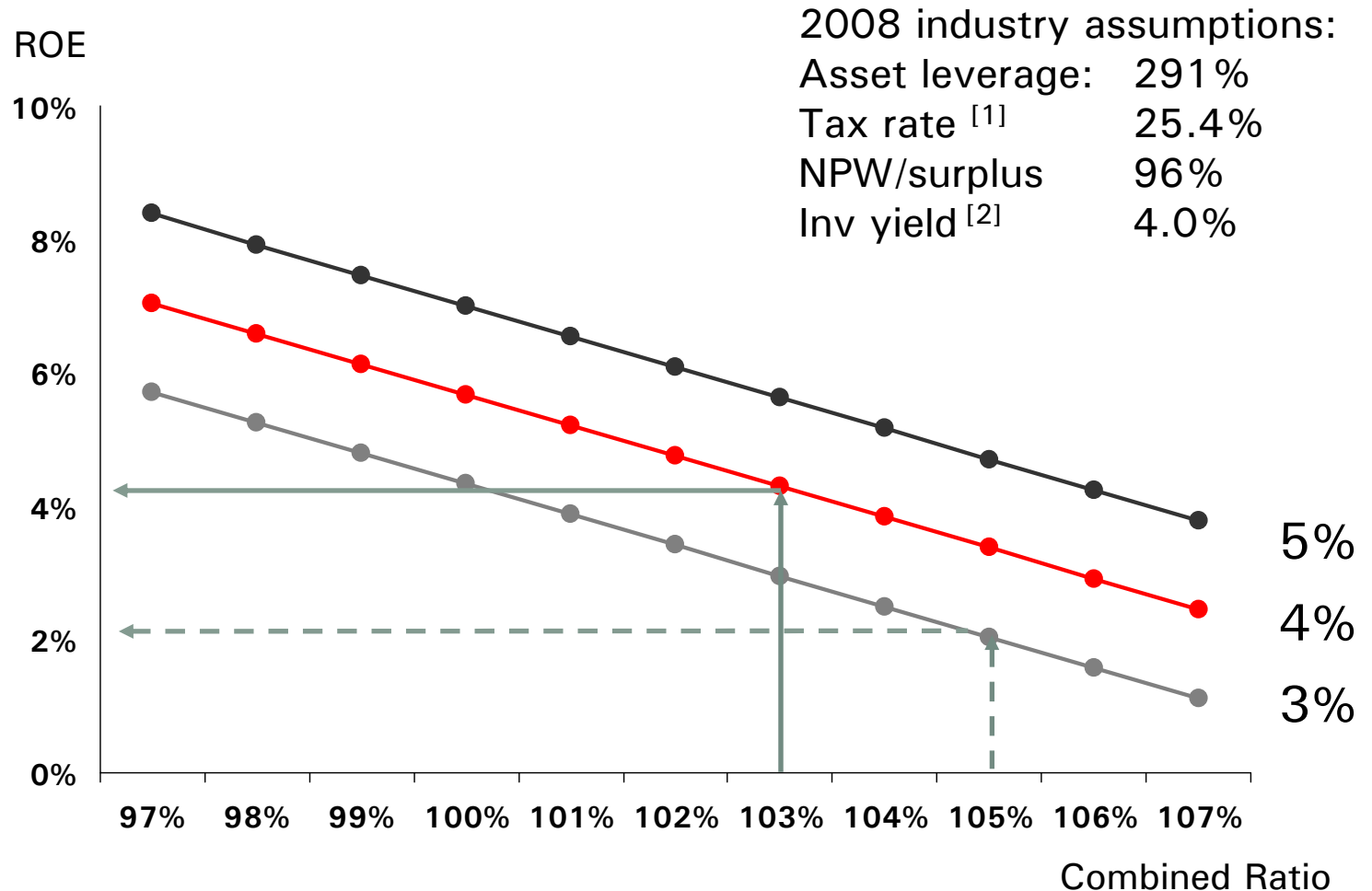
Source: Swiss Re Economic Research & Consulting



Low yield environment reduces the profit potential – example US p&c

High volatility, low expected investment returns in all asset classes in the medium-term

RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES

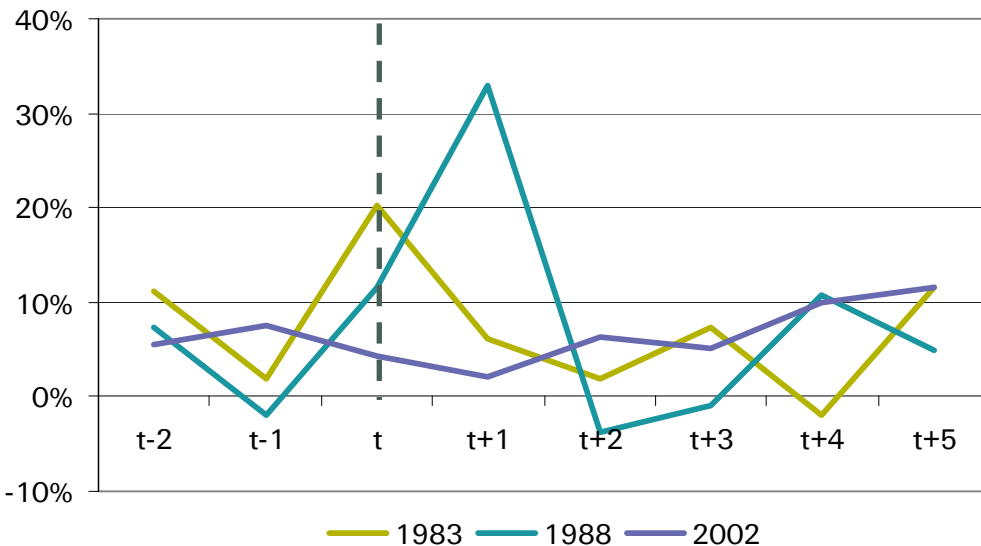


Sources: A.M. Best, estimates by Economic Research & Consulting.
 [1] based on 1H08 effective statutory tax rates.
 [2] 9M08 total investment yield was 3.0% and CR was 105

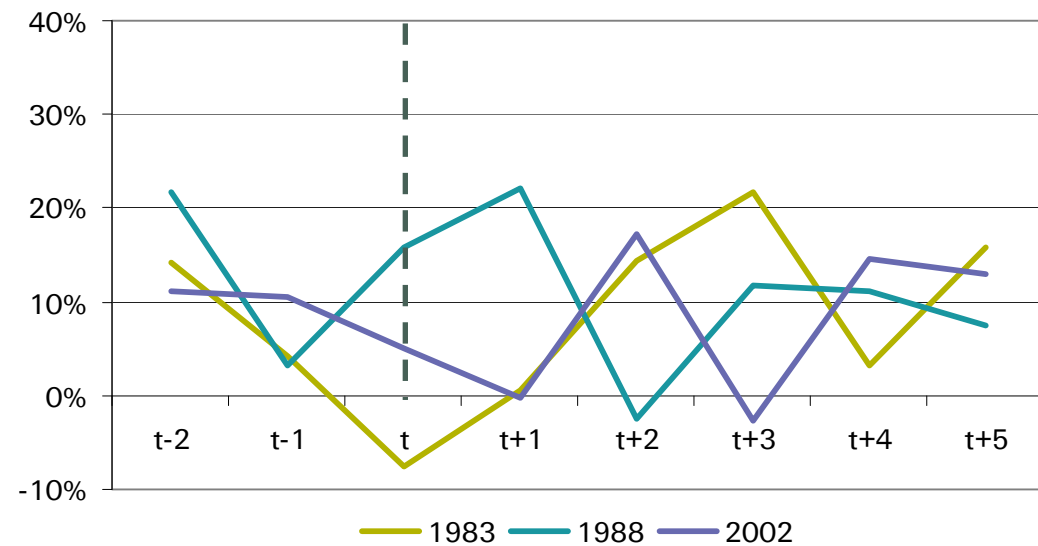


What does a recession mean for the Latin American insurance industry?

Non-life premiums, real growth



Life premiums, real growth



Source: Swiss Re Economic Research & Consulting, sigma
 DO NOT DISTRIBUTE
 OR MAKE COPIES

Source: Swiss Re Economic Research & Consulting, sigma

There were significant dips in premium growth in previous recessions in Latin America



Short term outlook outlook – Non-life

Real premiums growth, Latin America



Source: *sigma*, Swiss Re Economic Research & Consulting

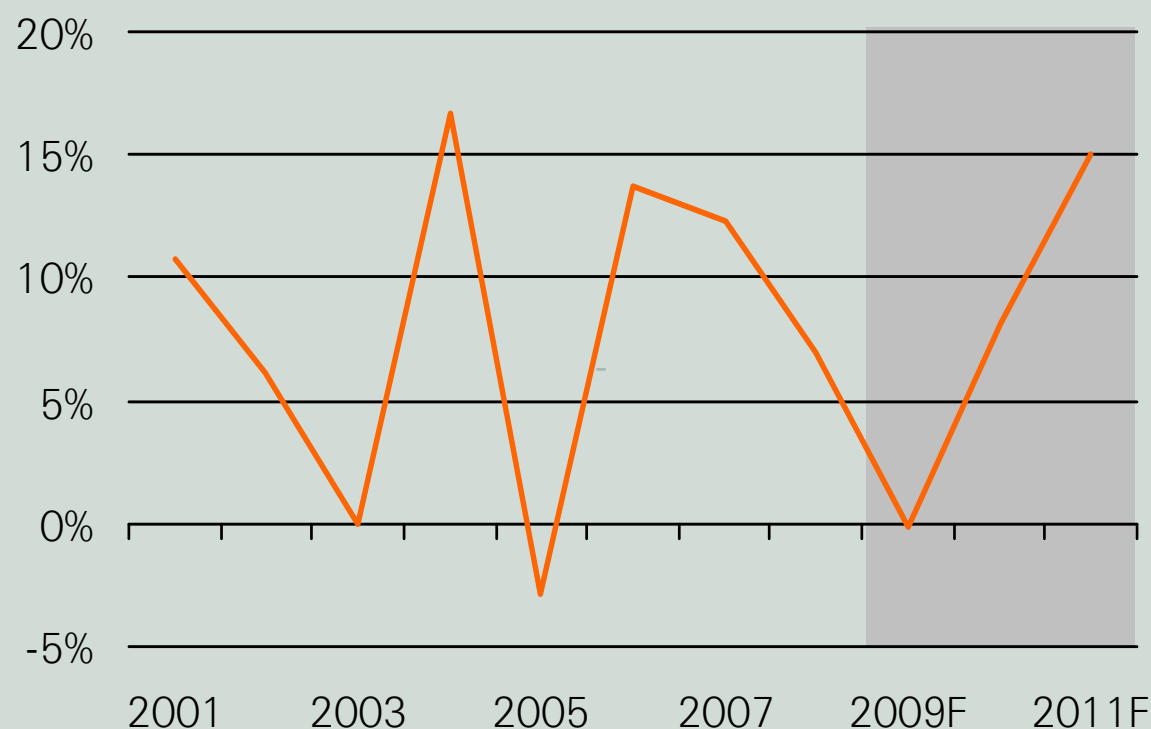
Non-life:

- real growth in 2009 is expected to stagnate on the back of a cooling economy
- mostly affected will be personal lines due to reduced household income and higher unemployment, and international trade-related lines
- in the mid-term, growth is expected to accelerate reflecting both the recovery of the economy, and higher direct prices as a result of lower investment yields and stricter solvency requirements.



Short term outlook outlook - Life

Real premiums growth, Latin America



Source: *sigma*, Swiss Re Economic Research & Consulting

Life:

- real growth in 2009 is expected to contract as new business will suffer from a drop in unit-linked, single premium products.
- new mortgage- and credit-related protection products may also slow down
- surrenders and lapses may increase
- the negative impact will be temporary in nature



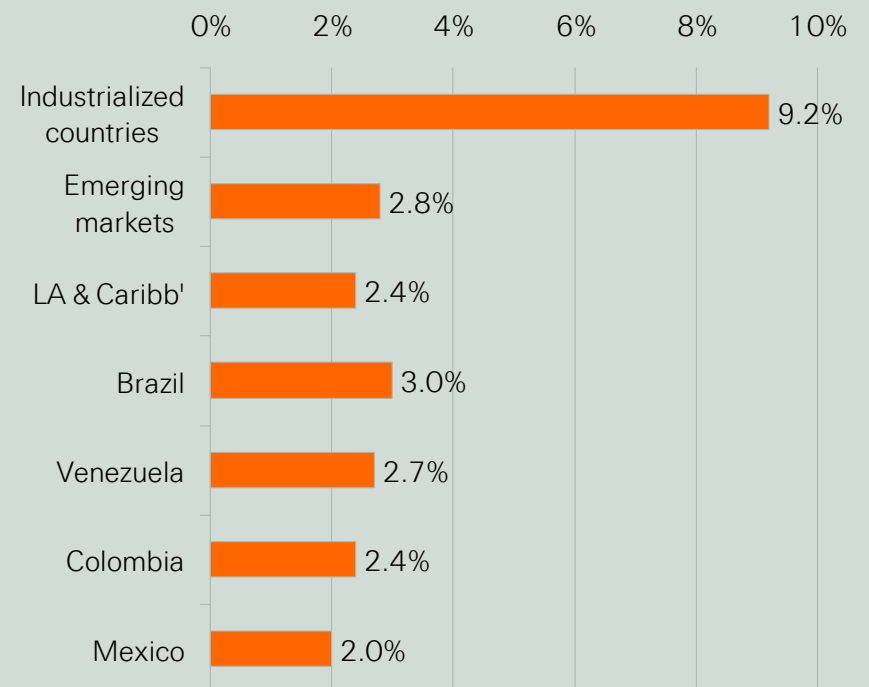
Long-term outlook – strong growth potential

Latin American countries show solid growth rates in direct premiums ... Real CAGR (02-08) in GWP



Sources: Swiss Re ER&C

... while insurance as an industry is significantly under-penetrated Penetration GWP/ GDP



Source: Swiss Re ER&C

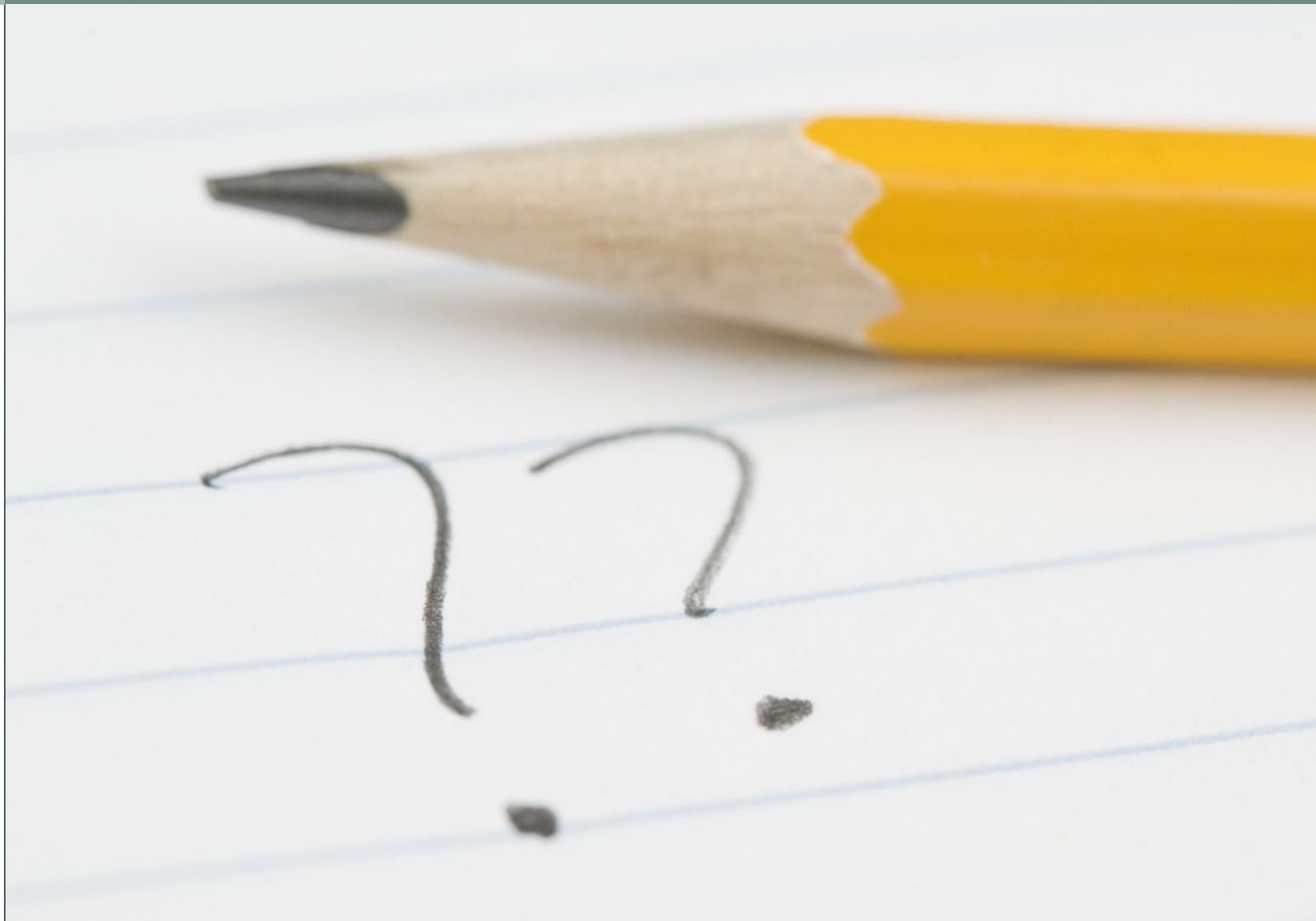


Conclusions

- The economy and the capital market environment will remain difficult for another year
- Global capital destruction will continue in 2009, particularly in life insurance. Impact on LA via global insurers
- Demand for reinsurance is up to manage capital shortages
- Slow premium growth due to economic headwinds. This will be a major impact in LA markets
- Low yield and high volatility investment environment puts pressure on rates to restore profitability
- Long-term growth prospects look bright



Questions?



RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES



Disclaimer

©2008 Swiss Re. All rights reserved. All rights, including copyright, in this presentation are owned or controlled by Swiss Re. You may download or print out a hard copy for your private or internal use. You are not permitted to reproduce, create modifications or derivatives, transmit, publish, distribute, disclose, convey or make accessible this work or parts of it to any other party, or use it for any other than the by Swiss Re designated purpose, without the prior written permission of Swiss Re.

This presentation is for information purposes only and contains non-binding indications as well as personal judgment. It does not contain any recommendation, advice, solicitation, offer or commitment to effect any transaction or to conclude any legal act. Any opinions or views expressed are of the author and do not necessarily represent those of Swiss Re. Swiss Re makes no warranties or representations as to this presentation's accuracy, completeness, comprehensiveness, timeliness or suitability for a particular purpose. In no event shall Swiss Re be liable for any loss or damages of any kind, including any direct, indirect or consequential damages, arising out of or in connection with the use of this presentation.

RESTRICTED
DO NOT DISTRIBUTE
OR MAKE COPIES