

**Address**

**To**

**The Barbados Association of Insurance and Financial Advisors**



**by**

**Dr. Marion Williams**

**Governor**

**Central Bank of Barbados**

**Sherbourne Conference Centre**

**February 20, 2004**

Thank you, Madam Chairman, Mr. President, Mr. Treasurer, Madam Secretary.

I wish to thank the President for inviting me once again to address the membership of the Association of Insurance Advisors. Your Association is an integral part of the financial system and I am pleased that you have provided me with the opportunity to update you on the performance of the economy, and to also share some of my views on emerging industry issues.

### **Economy on the Rebound**

The country's performance in 2003 provides reason for optimism. In 2003, Barbados emerged from a two-year recession, as real economic activity grew at an estimated 2.2%. The improved outturn is owed in large measure to a strong tourism performance, along with increased output in the non-traded sectors, primarily construction and the wholesale and retail sectors. Net international reserves – the NIR in its abbreviated form - rose by approximately \$126 million despite a significant increase in imports and a less-than-stellar performance of the domestic export sectors, excluding tourism. The combined effects of the rise in imports and the weak export performance, led to a further widening of the external current account deficit.

The good NIR outturn was largely as a result of an extraordinary inflow from Government's divestment proceeds. The divestment proceeds to which I make reference, relate to Government's receipt of \$189 million for the sale of its shares in the Barbados National

Bank to Republic Bank of Trinidad and Tobago. However, this inflow of divestment proceeds combined with continued sluggishness in the demand for bank loans by the private sector provided additional resources for an already highly liquid system and kept interest rates depressed.

With respect to the operations of Government, it was pleasing to see that the fiscal deficit of Central government as a percentage of gross domestic product or GDP, narrowed by 1.2 percentage points to 4.5%. Rising tax collections, typically consistent with an economy on the rebound, and a scaling back of on-budget capital expenditure were the main proponents of the improved Government position.

With such an encouraging performance in 2003 what can we expect in 2004? At the Central Bank, we are projecting that economic activity should continue to expand in 2004. We have based this positive outlook on the strength of expected good performances in the tourism, construction and wholesale and retail sectors. The rate at which the economy continues to rebound is expected to feed on strong recoveries globally, especially in the economies of our main trading partners, the US, Canada, the UK and – in the region - Trinidad and Tobago, in particular. Indeed, we have already observed very strong growth in tourism arrivals from the US during early 2004. Also, with the anticipated expansion in economic activity, more job opportunities should become available.

Notwithstanding the generally positive outlook, the Barbadian economy will need to confront a number of challenges during the coming year and beyond. Despite the anticipated strong performance, and a narrowing of the current account deficit, manufacturing and agriculture, beset by high operating costs, and low-priced competition, will almost certainly continue to struggle in the face of trade liberalisation. Though under less pressure, the financial services sector will also need to perform at the highest levels of efficiency in order to compete, in the face of the continued onslaught of liberalisation.

With respect to our reserves position, the expected surge in spending by tourists, particularly those coming for the Barbados leg of the English cricket tour, should help mitigate the effects of a projected rise in retained imports, and continued sluggishness in domestic exports. This should help to contain the growing current account deficit. Government's fiscal position which had weakened during the recent recessionary period should continue to improve during 2004, as the expansion in the economic activity leads to higher tax revenues, while expenditure should be further reduced, provided Government maintains tight control of capital spending. While we expect that Government will continue to rein in on-budget expenditure, in recent times Government has also been involved in a number of significant off-budget capital projects and these will need to be closely monitored.

While import growth is likely to slow from the pace of 2003, when Barbadian businesses were engaged in an extensive restocking exercise relating to intermediate and capital goods, the projected levels of imports for 2004 is expected to remain high. Lower capital account inflows are expected to lead to a slower accumulation of the NIR. Indeed, given the expected boost in domestic deposits as activity intensifies and consumer business and consumer expectations rise, the level of liquidity within the banking system should continue to be high. However, the consequential pickup in private credit should stunt any significant growth.

Meanwhile competitiveness remains our biggest challenge. It will be important that we focus our energies on making our goods and services more competitive. I do not think that there is enough appreciation of what is required to increase our competitiveness. We need to make every effort to lower our costs of production so that this can be reflected in our prices, particularly with respect to goods and services we export. However, as trade liberalisation is resumed that will apply more and more to goods produced on the domestic market, as goods imported both from within CARICOM and outside, can for the most part be produced more cheaply than in Barbados. Increasingly, many services will be accessed from outside Barbados, so that service quality and price will be increasingly important in increasing the competitiveness of our service sector. Utilities costs, labour costs, interest costs - all these are part of the costs which must be controlled. The rest of the world is bringing these costs down. It is important for our future that we do so as well.

In the financial sector we have to be vigilant that the mergers and acquisitions which have taken place bring the kind of economies of scale and therefore the lowering of costs which one should expect under these circumstances. What we have to guard against is that the system does not become more oligopolistic. It will therefore be important in fostering the competitive spirit that mergers and acquisitions bring the economies of scale that are expected and that this be reflected in lower prices.

### **A Stable Industry**

After that brief update on the economy, please allow me to now turn my attention to that pivotal component of the financial system, the insurance industry.

There is a thriving offshore and onshore insurance sector in Barbados, but most of my comments today, which can equally be applied to the offshore sector, will be made with reference to the onshore sector. Despite the slight downturn in the economy in recent years, insurance companies generally performed well and profits of the industry as a whole continue to grow. In the most recent Annual Statistical Digest published by the Central Bank, between 1997 and 2001, the local assets of the general insurance and life insurance companies, respectively, rose at average annual rates of 10.4% and 7.3%.

According to the 2000 report of Swiss Re Sigma - cited in the IMF's Financial Sector Assessment Programme (FSAP) Report - the market, with total premium of US\$184 million, is small in global and regional terms, with a global ranking of 79<sup>th</sup>. The regional leader is Trinidad and Tobago, with US\$424 million in premium, and ranked 57<sup>th</sup>, followed by the Bahamas, US\$321 million, ranked 65<sup>th</sup>, and Jamaica, US\$303 million, ranked 66<sup>th</sup>.

We all recognise that the insurance industry globally has been undergoing a turbulent phase in recent years. After substantial losses arising from the oft-mentioned events of September 11, 2001, insurers are still facing challenges. It is interesting that the US Government gave substantial assistance to two industries after September 11, one was the airline industry, in which demand fell and the other was the insurance industry, in which demand rose. It is interesting to note the different outcomes for these industries and it hinges on consumer demand. The non-life insurance industry is one industry which has gone against the trend of declining costs and again the answer lies partly in increased demand. Other developments highlighted are weaker investment returns while others point to hardening premium rates, as reinsurance capacity in international markets contracts even further. Still, fierce competition, the globalisation of business, convergence of financial organisations, persistent low interest rates and uncertainties about the risk from terrorism, form the major stumbling blocks to the insurance industry.

All of these factors have forced insurers to adopt a leaner and meaner approach to management, marketing and financial planning in order to simultaneously achieve the goals of maintaining market share, attaining business growth, and complying with regulatory requirements. In some jurisdictions they are further burdened with having to deal with emerging technical issues, such as the application of random modelling in certain types of insurance contracts.

Markets in the United States, for a while, reacted to levels of uncertainty about how to price coverage under the U.S. Terrorism Risk Insurance Act, which placed a greater focus on security. As a result, reinsurance coverage for U.S. terrorism exposures had to be improved considerably. According to the Reinsurance Market Review 2002-2003, "...the influx of new capital into the industry following the events of September 11, appears increasingly inadequate against the massive outflow caused by falling investment markets, reserve strengthening, and escalating catastrophe losses." This of course produces ripple effects for the pricing of the insurance product across the globe, including in Barbados. I am sure that as financial advisors you have kept abreast of these developments.

### **New Markets, New Products**

Despite the challenges ahead, there will be opportunities. With the enormous growth potential in the market for innovative insurance products – in which some activity has already started – there should be heightened activity in the development of more hybrid products. In

the life insurance area, the distinction between certain types of products is becoming less and less clear-cut. As a supervisor of the financial system, the Central Bank closely monitors these developments since the way the overall financial system is being reformulated is of great interest to us.

Local insurance companies are already gearing themselves to seek out other markets. There are a number of means by which this can be done and strategic mergers come to mind where local firms are able to meet the relevant market access conditions through such arrangements. The benefits of such partnerships are widely discussed and I will not highlight them here, but one such relationship might engender a cross-fertilisation in the product market.

Ten years and more of heightened merger and acquisition activity have significantly remodelled the global financial services sector, blurring the distinction between commercial banks, investment banks insurance companies and asset management firms. It is estimated that the value of global mergers and acquisitions peaked at about US\$2.4 trillion in 1998, compared to an estimated value of US\$500 billion in 1990. Barbados' financial sector has not been left out, as within the last five years, there has been a number of corporate amalgamations within the insurance and the banking sector, such as the acquisition of the Barbados National Bank and Life of Barbados Ltd. by the Republic Bank Ltd. and the Barbados Mutual Assurance Society, respectively.

Merging is seen as a response to strengthen companies' position in preparing for foreign competition. In addition, firms acquire other companies in overseas territories in search of new opportunities in response to technological change to improve market share, to eliminate competitors, or acquire a crucial supplier among other reasons.

Successful consolidations however, depend heavily on the ability to create added value after the deal. Linking distribution systems, meshing of information technology platforms, and dealing with distinct corporate cultures are therefore challenges.

Indeed, cross-border amalgamations sometimes call for the development of Memoranda of Understanding with the regulatory agencies in each jurisdiction and some coordinated policy may even be required among the competitors themselves. The Central Bank has been involved in this type of coordination and no doubt it needs to be replicated at the in-firm levels.

Calamities and uncertainties increase the demand for insurance so that unlike many other goods with which the consumer becomes satiated as his per capita income rises, it is often the reverse with insurance. Individuals tend to require more insurance as their per capita income rises. The greater the asset, whether it be life or non-life, the greater the need for protection. For this reason insurance has become one of those integral, and in some ways indispensable facets of our daily lives. Today there are an unimaginable few who

live without the protection against the numerous perils that we face: we need to insure our homes, cars, health and – to many the most important – life. In Barbados, there are over 80,000 life insurance policies in force, a high number compared to the size of the population. Annuity business is a growing market component, and this highlights the increased emphasis which people are placing on retirement planning. On the other hand, group life insurance is fairly mature. In all, total levels of life insurance measured by sums insured are in excess of BDS\$5 billion, suggesting that on a per capita basis, sums insured are high relative to average earnings.

What's clear, is that the demand for protection will continue to grow, the form which it takes may not be insurance as conventionally defined. What is important is that the industry must see itself as not only in the business of insurance but in the business of protection. This opens the door to innovative thought and the design of new instruments. If there are hurdles which you see to developing this perspective, it is important that the industry articulates them so that they can be ventilated and dealt with.

Indirectly, the same FSAP report to which I made reference earlier, noted that, despite our smallness with respect to absolute premium size, insurance personnel have done a sterling job in educating the population on the benefits of insurance. On a per capita basis, the numbers are quite impressive. Premiums per capita are high at US\$692, ranked 28<sup>th</sup> in the world, and second only in the region to the Bahamas. In addition, premiums as a percentage of GDP for

Barbados, commonly referred to as “insurance penetration”, stood at 7.4%, ranking Barbados 16<sup>th</sup> by this measure.

The relatively small population combined with the levels of insurance and numbers of distributors suggest that companies must grow themselves by concentrating on the external market, and as a result, should focus on increasing product lines to the customer base along with achieving economic alliances with other countries – not necessarily through acquisitions or mergers but through alliances and partnership arrangements. It might be useful for the industry to develop greater synergies between the local market and the exempt insurance market as is for example the case in Bermuda.

### **Integrated Products and Holistic Financial Risk Management**

Aside from the traditional products being offered, such as retirement income, savings instruments, security instruments or supplements to other contracts, such as a basic pension plan, where the consumer insures himself against all risks, new products are being offered where the policyholder bears some of the risks.

This type of product could be particularly successful in the current low interest rate environment where there is a demand for higher-yielding investments. I would caution, however, that it is important, that consumers who show an interest in such instruments are adequately informed of the risks to which they are exposed in such an arrangement.

Integrated risk products provide coverage for multiple sources of risk, including traditional insurance and other non-insurance risks faced by the insured party. This requires holistic financial risk management, with consideration paid to equipping personnel with the tools available to evaluate and manage a variety of risks.

### **New Delivery**

As we further liberalise our exchange controls, some of the protection which might have been perceived to exist will be eliminated, particularly with respect to CARICOM because we have a commitment under the CSME to free up all cross-border flows within CARICOM. This could occur as early as December 31, 2004. These moves require careful planning, and I am sure that some of you have already been reflecting on your responses – you may even see yourself using air travel to market your products within the region.

In the 1990s, many industries found they had to become more flexible, more nimble and faster and many have sought additional operating avenues. The insurance industry too can respond in this way.

Modification and customisation are assets since if all insurance products were identical and sold and processed in the same way, profit margins would all but disappear. Systems should be viewed as tools that nurture and exploit differences for competitive advantage.

## **Globalisation and Regional Development**

The insurance industry also has an important role to play in the creation of an integrated financial market within the context of an expanded regional bloc. A vibrant insurance sector is critical to the development of a single, deep and liquid capital market, where the pool of the region's savings – private savings invested in pension funds, life insurance and other financial vehicles work to the full advantage of the regional savers and corporate borrowers, which help to finance the development of Barbados. In this regard, decisions relating to the deployment of investment funds will be influenced by competitiveness and by returns. We may find ourselves having to compete for the use of the investible funds of our locally based insurance companies.

Regulatory compliance may also be increased. The recommendations that came out of the FSAP report on the regulatory system highlighted a range of issues to be addressed, so it is quite likely therefore that there will be new regulatory compliance guidelines to be met in this regard.

The International Insurance Regulatory Agency (IAIS) is still relatively young compared to other agencies, such as the Basle Committee for banking supervision, but that agency too is developing quickly and their guidelines too may have a future impact on compliance in the industry.

We cannot resist the effects of globalisation and deregulation by opting out. We need to influence it where we can, judiciously accommodate it, and find competitive solutions. The region's financial sector will continue to undergo significant change as we move toward a single market and economy and towards FTAA. We need to use this period to position the financial sector and ourselves.

Potential new risks are emerging for the insurance industry associated with the rapid pace of globalisation, the aging population, the development of e-commerce and the convergence of financial activities. As insurance companies become affected by these global shifts, I am positive that industry officials will monitor these changes with a view to continuously assessing their impact on the risk profile of the local industry. As key players in the system, I am sure that you will rise to the challenge.

Thank you, ladies and gentlemen.

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