S&P Dow Jones Indices

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Research

A Survey of Mexican Insurance Investment Officers

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OVERVIEW

In February 2020, S&P Dow Jones Indices and the Association of Mexican Insurance Companies (AMIS) conducted our second annual survey of insurance investment officers in Mexico about the state of the local insurance industry.

The objective of the annual survey is to better understand how Mexican insurers invest and allocate their excess capital and how they view issues such as regulation, passive strategies, and the implementation of environmental, social, and governance (ESG) investment criteria. With each annual survey, it is our aim to reflect the current state of the insurance investment landscape from the perspective of the investment decision-makers.[1]

We administered the survey between Feb. 4 and Feb. 28, 2020, prior to the aggressive spread of COVID-19 in North America and the declaration of the virus as a global pandemic by the World Health Organization. As such, the coronavirus and its potential implications for the financial markets may not have been as top of mind for respondents as they likely would be today. Answers to questions regarding expected returns, adjustments in allocations, concerns, and economic projections represent the respondents' perspectives pre-crisis, under comparatively "normal" market conditions.

This report summarizes respondents' perspectives on the following themes:

- Investments and asset allocation, with a focus on excess capital;
- Sensitivity to and potential impacts of regulation;
- The implementation of ESG criteria within the investment process;
- Indexing and the use of passive strategies and instruments; and
- 2020 economic indicators.

[1] Please see Appendix A for a description of the survey methodology.

INVESTMENTS AND ASSET ALLOCATION

As of year-end 2018, the size of the Mexican insurance market was MXN 1.5 trillion in terms of total assets.

As of year-end 2018, the size of the Mexican insurance market was MXN 1.5 trillion[2] in terms of total assets, while the overall insurance penetration rate—the ratio of premium underwritten in a particular year to the GDP—was 2.3%.[3] While the assets represent a sizable market, the penetration rate indicates that Mexico is a market that is still maturing—by way of comparison, the insurance penetration rate in the U.S. was 11.3%.

For the purpose of this survey, we asked respondents to focus on the asset allocation of their excess capital, where they have a bit more latitude in what they can invest. Between the 2019 and 2020 surveys, companies decreased their allocation to sovereign bonds while they increased their allocation to corporate, private, and foreign debt. Companies also showed a decline in the use of mutual funds. Exhibit 1 shows the average percentage of the portfolio allocated to each asset class.

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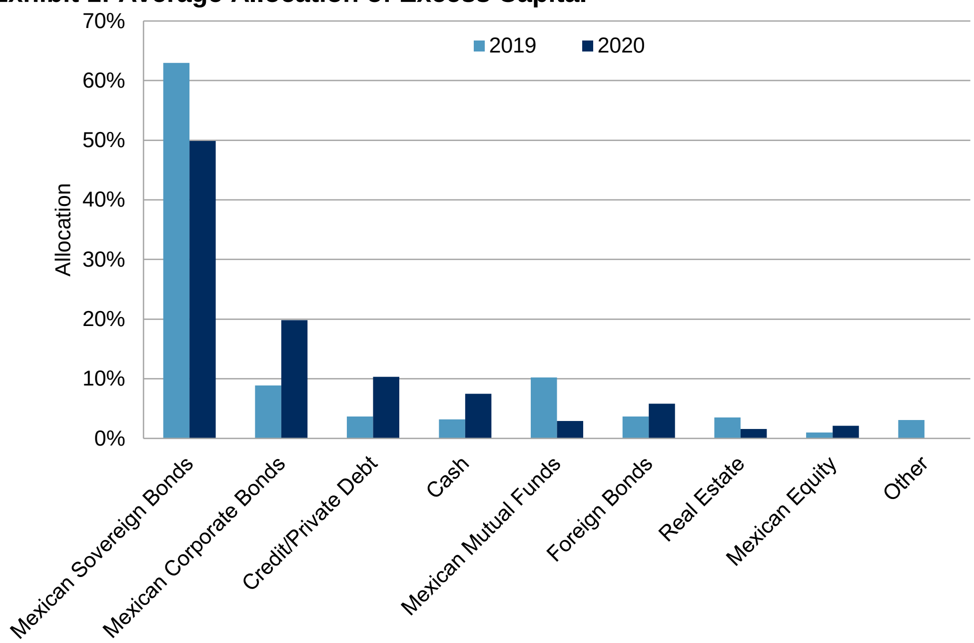
Exhibit 1: Average Allocation of Excess Capital



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

We also asked whether or not companies used derivatives and if so, what type. Only 16% of respondents—all representing Mega insurers—said that they used derivatives (see Exhibit 2).[4]

[2] Total gross premiums converted from USD to MXN using a factor of 1:19.635, the exchange rate as of Dec. 31, 2018, per the Federal Reserve.

[3] "Insurance Statistics," OECD.Stat, 2020.

[4] Please see Appendix B for definitions of Small, Medium, Large, and Mega insurers in terms of assets.

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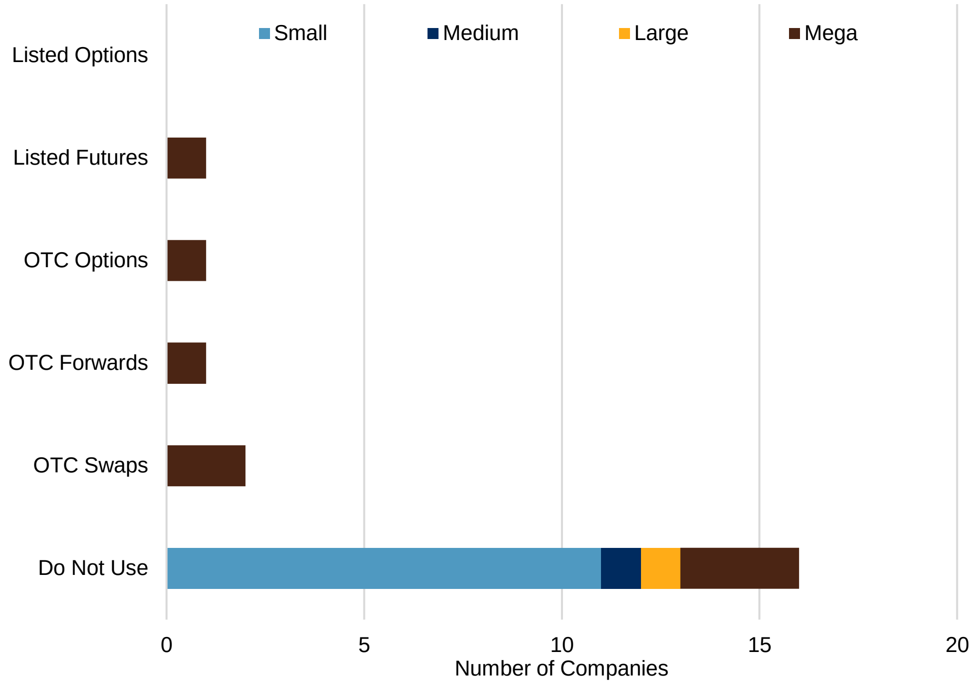
Exhibit 2: Derivatives Usage, by Company Size



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

Respondents described their risk appetite on a spectrum from risk averse to risk seeking. About one-quarter of the companies were risk neutral, with the remainder split between those who described themselves as risk averse and moderately risk seeking (see Exhibit 3).

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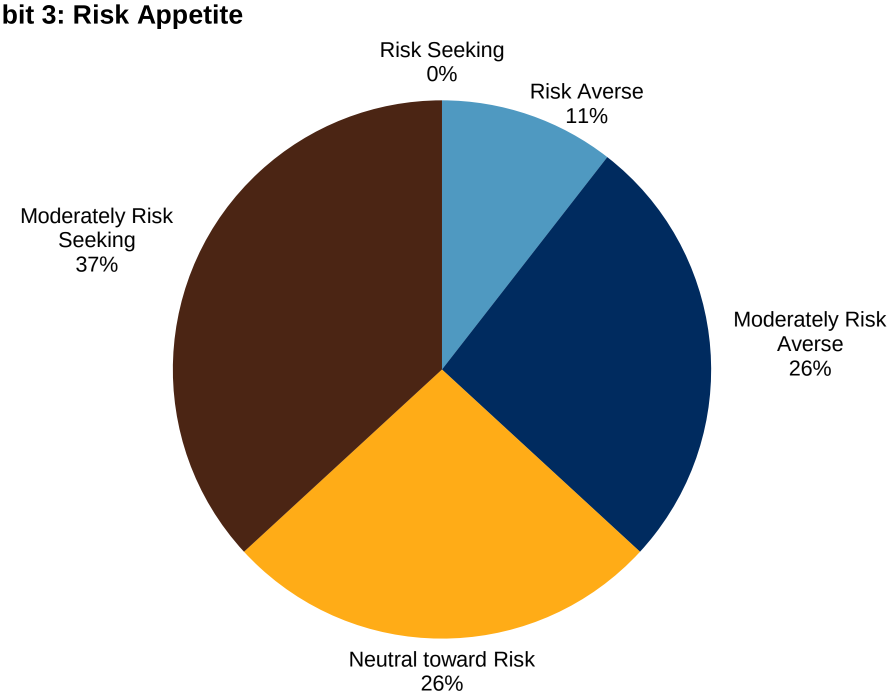
Exhibit 3: Risk Appetite



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

What is most interesting, perhaps, is that when comparing risk appetite with other characteristics, such as company size or regulatory ratio, there are no clear trends to indicate what might make one insurer more likely than the next to be risk seeking or risk averse (see Exhibit 4). However, the only respondents that described themselves as risk averse were small insurance companies.

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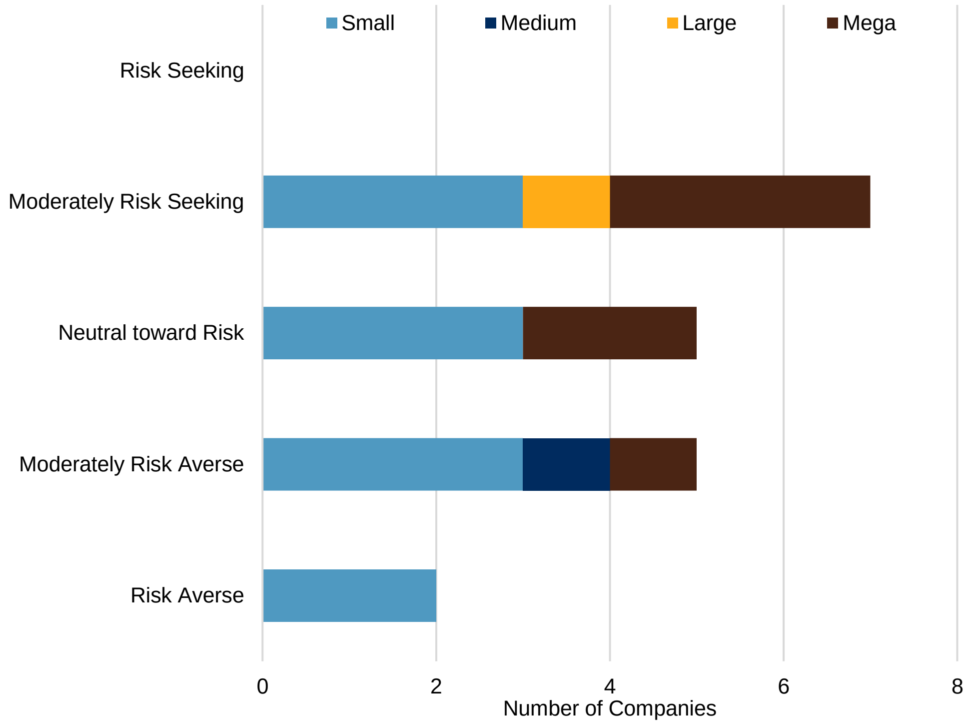
Exhibit 4: Risk Appetite by Company Size



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

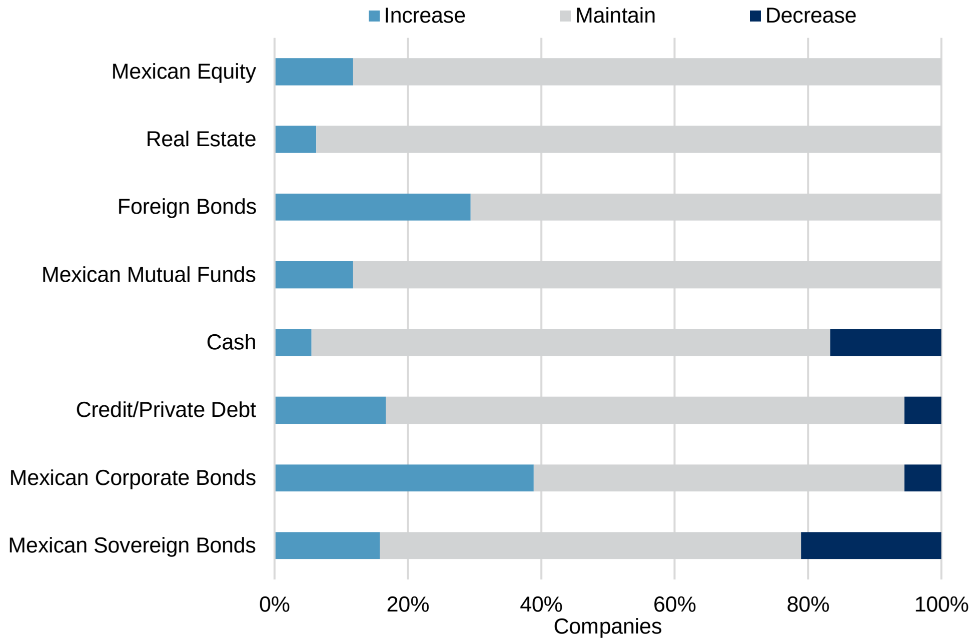
We asked companies about their expectations for the return of various assets classes and their plans to change their risk profile. Again, we collected these responses prior to the global spread of COVID-19, and perspectives and expectations today might be quite different.

Several respondents said they expected to decrease allocations to Mexican sovereign bonds and cash.

At the time of the survey, respondents planned to increase allocations to Mexican corporate bonds and foreign bonds more than any other asset class. Several respondents said they expected to decrease allocations to Mexican sovereign bonds and cash. Across all asset classes, however, the majority of respondents said they planned to maintain their current allocations, which could include not investing in a given asset class at all (see Exhibit 5).

The majority of respondents said they planned to maintain their current allocations.

Exhibit 5: Expected Changes to Asset Allocation in 2020



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

Similarly, the majority of respondents said that they would maintain their current risk tolerance for each asset class. However, in instances where they said they would make changes, they were more likely to decrease their risk tolerance than increase it (see Exhibit 6).

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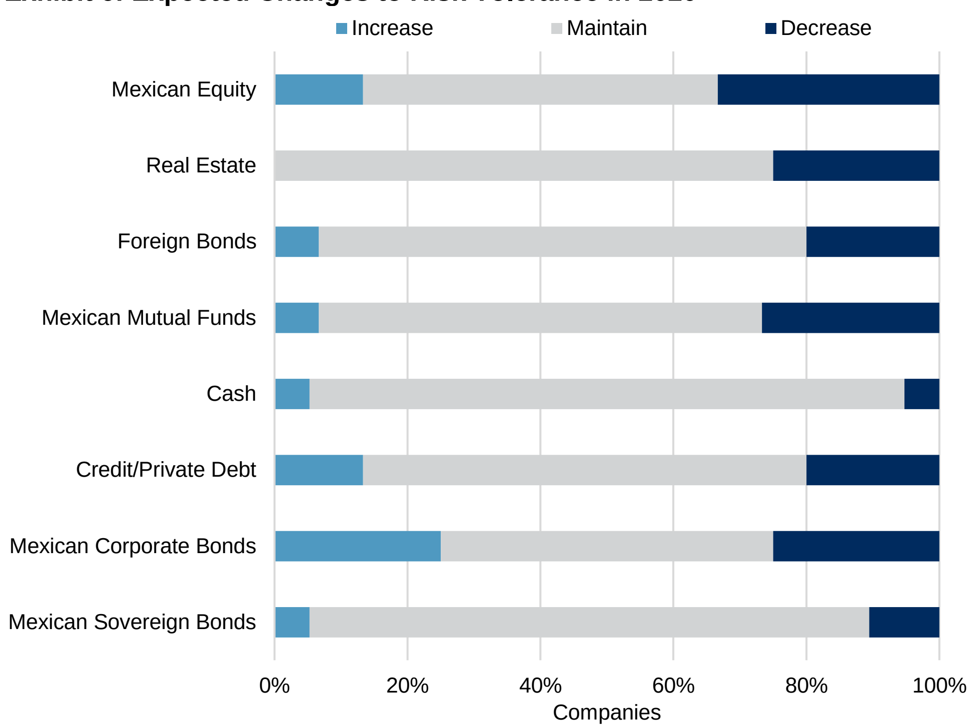
Exhibit 6: Expected Changes to Risk Tolerance in 2020



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes

We asked respondents to order the asset classes in terms of expected return.

We asked respondents to order the asset classes in terms of expected return—irrespective of their allocations or risk tolerances—where "1" corresponded to the highest expected return. Exhibit 7 shows that the three asset classes with the highest expected returns were the same in 2019 and 2020: credit/private debt, Mexican sovereign bonds, and Mexican corporate bonds. It also shows the most significant decrease was in respondents' expectations for cash. The "Change" column shows the direction of change—up or down—in the ranking from 2019 to 2020.

Exhibit 7: Average Asset Class Ranking, Based on Highest Expected Return at Year-End 2020

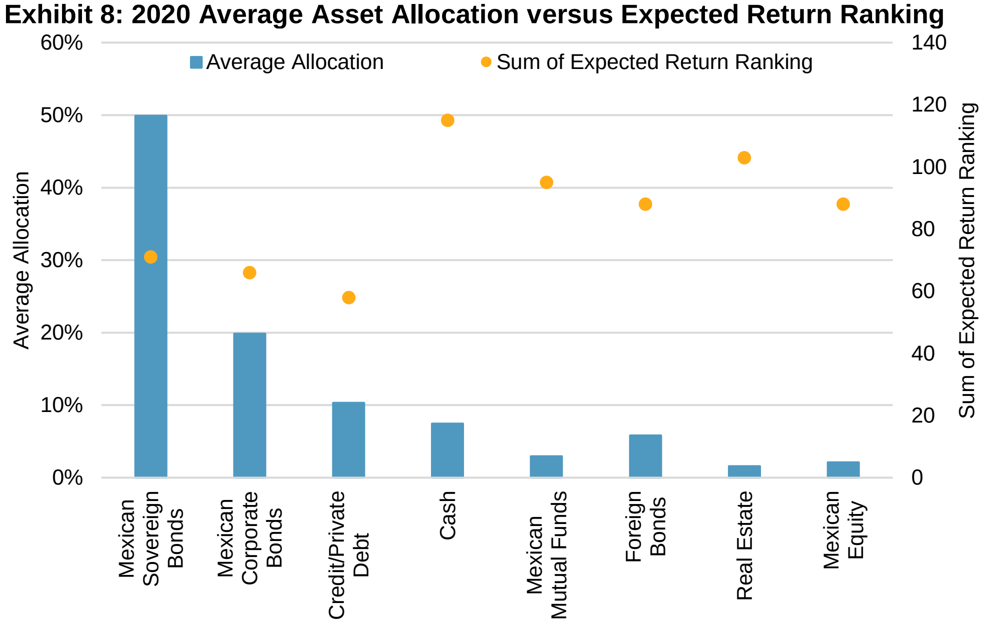
ASSET CLASS	2019 RANKING	2020 RANKING	CHANGE
Credit/Private Debt	1	1	-
Mexican Corporate Bonds	2	2	-
Mexican Sovereign Bonds	3	3	-
Foreign Bonds	4	4	-
Mexican Equity	5	4	▲
Mexican Mutual Funds	7	6	▲
Real Estate	8	7	▲
Cash	6	8	▼

Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Table is provided for illustrative purposes.

The asset classes they expected to perform best generally happened to be those in which they were most heavily invested.

In comparing the average asset allocation in 2020 versus this ranking of expected returns, the asset classes they expected to perform best generally happened to be those in which they were most heavily invested (see Exhibit 8).

Exhibit 8: 2020 Average Asset Allocation versus Expected Return Ranking

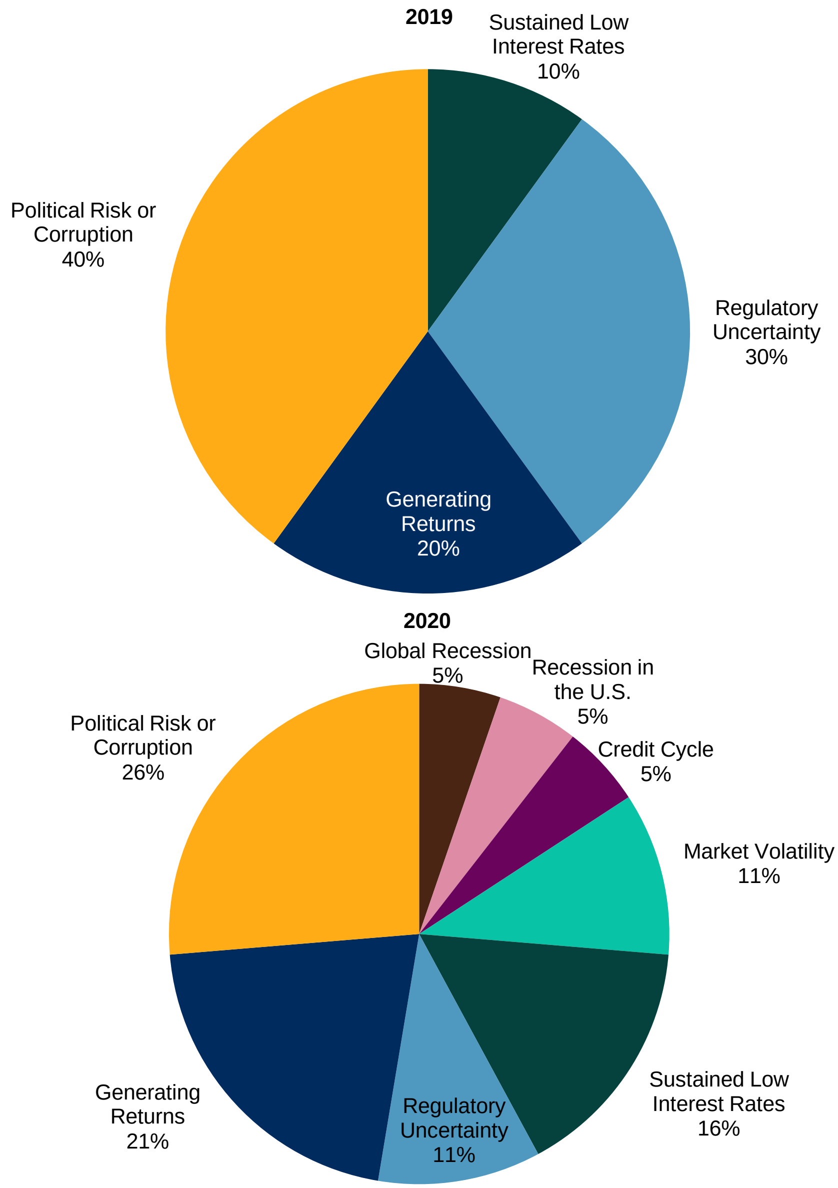


Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

In thinking about their portfolios and all of the potential factors that could introduce risk, at the time of the survey, respondents were most concerned about political risk or corruption, generating returns, and sustained low interest rates (see Exhibit 9).

In 2020, respondents were most concerned about political risk or corruption, generating returns, and sustained low interest rates.

Exhibit 9: Primary Concern



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Charts are provided for illustrative purposes.

REGULATION

Perhaps unsurprisingly, respondents reported that their asset allocation decisions were highly dependent upon regulation—this was true in 2019 and even more so in 2020. Respondents' regulatory ratios also suggest that they were moderately conservative with respect to regulatory requirements, with 83% of respondents indicating that their regulatory ratio was greater than or equal to 1.25 (see Exhibit 10).

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Exhibit 10: Regulatory Ratio

REGULATORY RATIO	RESPONDENTS (%)
1.00 ≤ regulatory ratio < 1.25	1
1.25 ≤ regulatory ratio < 2.00	33
regulatory ratio ≥ 2.00	50

Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Table is provided for illustrative purposes.

However, as Mexico is now more than four years into its Solvency II-based regulatory framework—the European Commission granted Mexico equivalence in 2016[5]—more than one-half of respondents reported in 2020 that the way they invest had changed very little or not at all since the implementation of Solvency II (see Exhibit 11).

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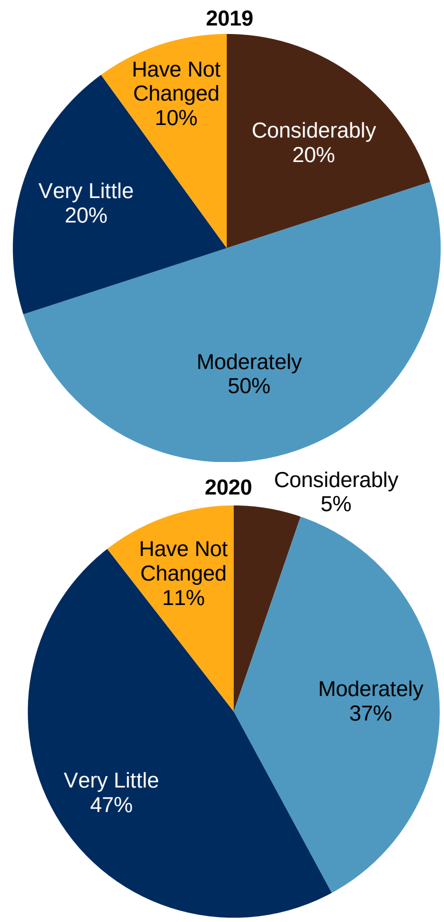
Exhibit 11: Degree to Which Respondents' Investments Have Changed Due to Solvency II



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Charts are provided for illustrative purposes.

5 "Insurance: European Commission adopts a first package of third country equivalence decisions under Solvency II," European Commission, June 2015.

It seems that while regulation plays a significant role in insurers' asset allocation decisions, it plays less of a role in determining who manages the assets. Of the total respondents, 89% indicated that they either managed assets internally or used a combination of internal and external managers, while the remaining 11% used an external manager. None of the respondents said that regulatory change would make them more likely to use an external manager.

ESG INVESTING

As ESG investing continues to move from the margins to the mainstream within the global investment community, many of the insurers in Mexico have not yet integrated ESG criteria into their investment processes (see Exhibit 12).

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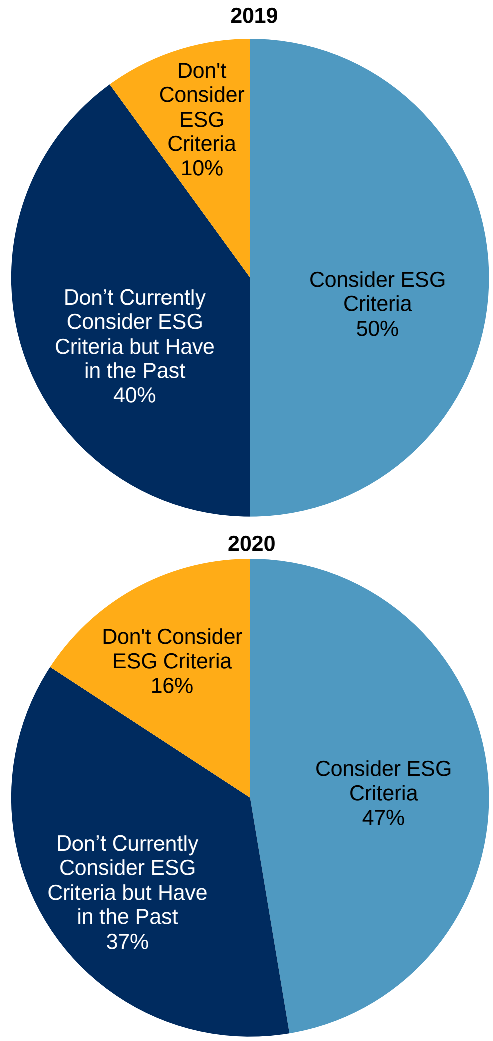
Exhibit 12: Adoption of ESG Criteria in Investments

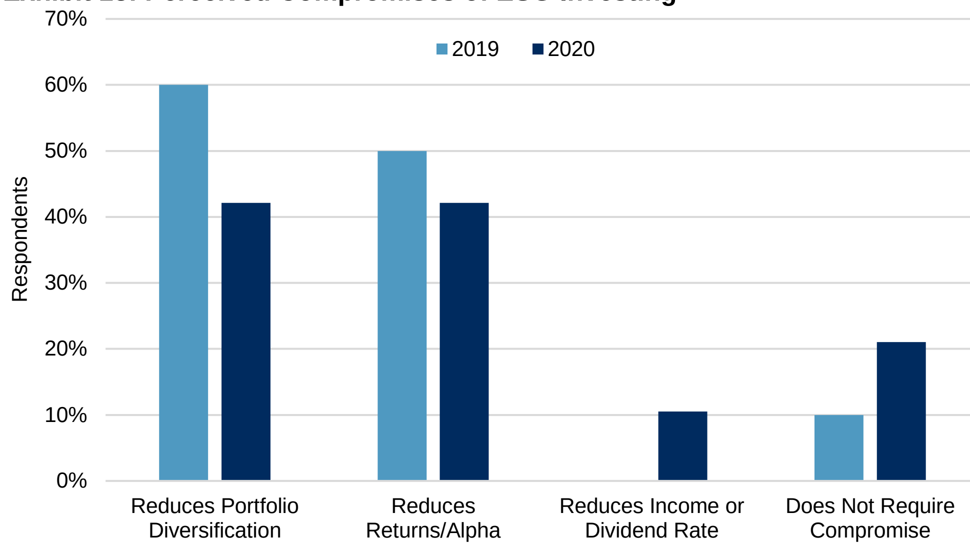


Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Charts are provided for illustrative purposes.

A higher percentage of respondents in 2020 versus 2019 indicated that they did not consider ESG criteria when investing.

The percentage of respondents who said they consider ESG criteria as part of their investment process remained roughly the same in 2020, at 47%, compared to 50% in 2019. A higher percentage of respondents in 2020 indicated that they did not consider ESG criteria when investing. While many respondents said that ESG investing reduces portfolio diversification, alpha, and/or income, 21% of respondents said that ESG investing does not require compromises, which is more than twice the percentage of respondents who replied with the same answer in 2019 (see Exhibit 13).

Exhibit 13: Perceived Compromises of ESG Investing

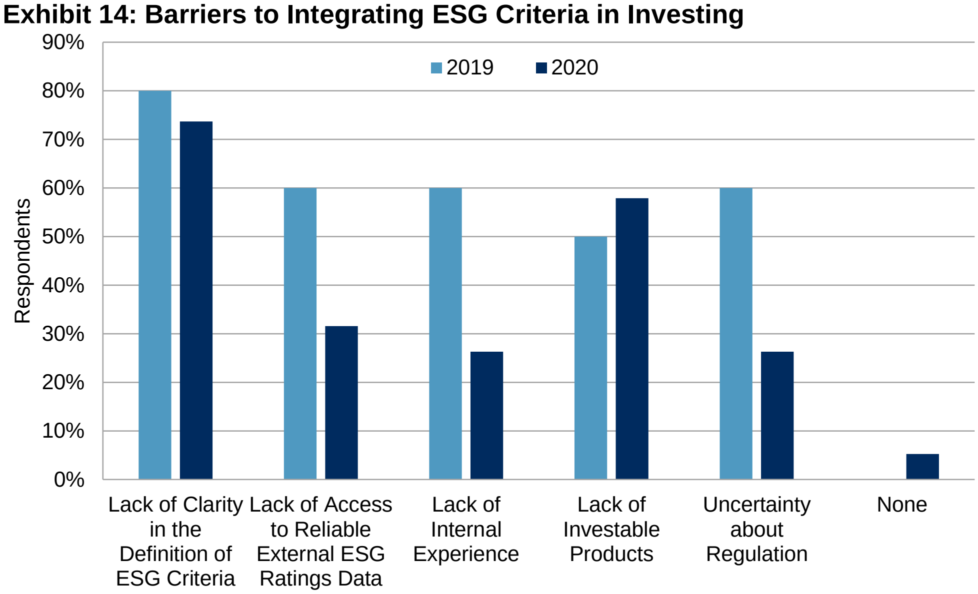


Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

According to respondents, there were a number of barriers to the adoption of ESG criteria.

Still, according to respondents, there were a number of barriers to the adoption of ESG criteria within the investment process (see Exhibit 14).

Exhibit 14: Barriers to Integrating ESG Criteria in Investing



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

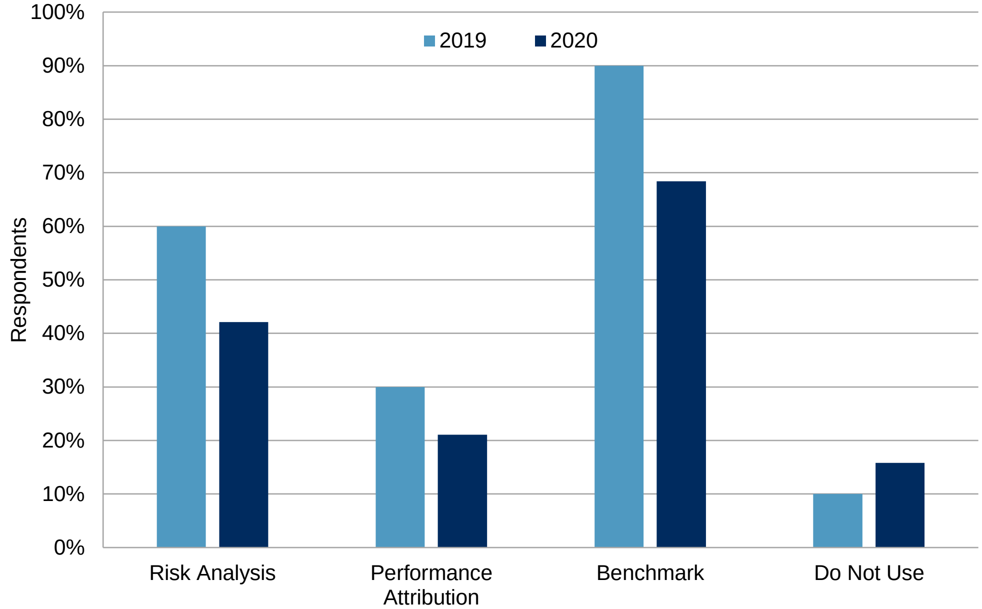
The two most significant barriers that respondents indicated in 2020 were the lack of clarity in the definition of ESG criteria and the lack of investable products. These responses suggest that there is still an opportunity for service providers to improve the quality of ESG data available to investors and how that data is used in the creation of new ESG investment products.

INDEXING AND PASSIVE STRATEGIES

While the vast majority—more than 84%—of respondents indicated that they used indices, only half that amount indicated that they invested in ETFs or other passive strategies based on indices, citing regulation as the most significant barrier to adoption (see Exhibit 15).

More than 84% of respondents indicated that they used indices.

Exhibit 15: Index Use



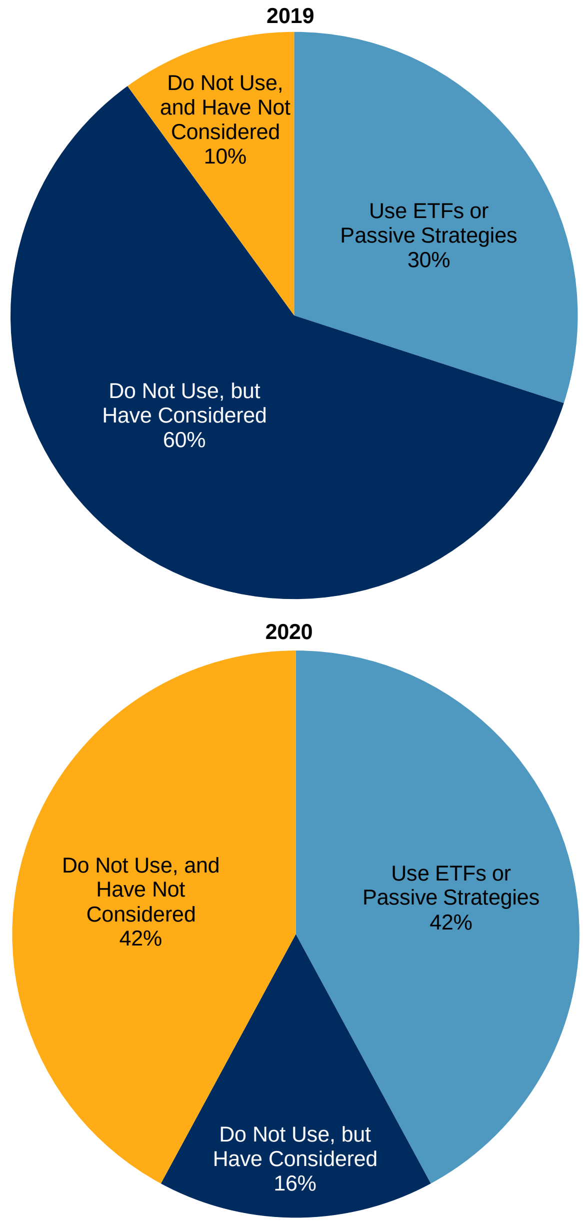
Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

In 2019, 90% of respondents indicated that they used indices for benchmarking, compared with 68% in 2020. Moreover, in 2019, respondents were more likely to indicate that they used indices for multiple purposes than they did in 2020. A slightly higher percentage of respondents said that they did not use indices in 2020.

However, only one-half that amount indicated that they invested in ETFs or other passive strategies based on indices.

As a percentage of the total, far more respondents in 2020 had not considered investing in ETFs or other passive strategies compared with 2019.

Exhibit 16: ETF or Passive Strategy Usage



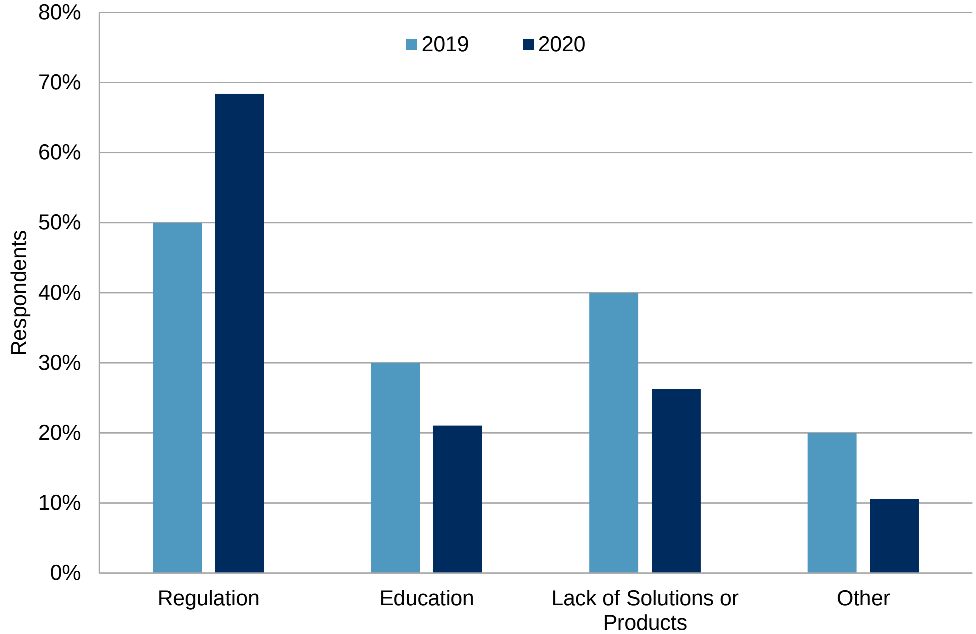
Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Charts are provided for illustrative purposes.

As a percentage of the total, far more respondents in 2020 had not considered investing in ETFs or other passive strategies compared with 2019. However, the same holds true for those who indicated that they did use passive strategies. It is perhaps unsurprising that of those who said they had not considered using passive strategies in 2020, 75% were small insurance companies, with invested assets of less than MXN 20 billion. While company size can often help explain investment tendencies—the larger the company, the more potential latitude they have to assess and invest in various asset classes and instruments—it is not a sole determinant of behavior. For example, some mega insurers (those with invested assets in excess of MXN 100 billion) also said that they did not use passive strategies.

While 42% of respondents indicated that they used passive strategies, all respondents indicated at least one, and in some cases more than one, barrier to the adoption of passive strategies. Exhibit 17 shows the potential barriers to the adoption of passive strategies and the percentage of respondents who selected each barrier. As was true in 2019, respondents in 2020 said that regulation was the largest hurdle to the adoption of passive strategies by insurance companies in Mexico.

All respondents indicated at least one, and in some cases more than one, barrier to the adoption of passive strategies.

Exhibit 17: Barrier to Passive Strategy Adoption



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2020. Chart is provided for illustrative purposes.

ECONOMIC PROJECTIONS

As part of the survey, we asked participants to forecast the following measures of the Mexican economy as of year-end 2020: unemployment rate, inflation rate, interest rate, GDP growth rate, and the USD-MXN exchange rate.

Exhibit 18: Economic Projections

MEASURE	2019 SURVEY AVERAGE	YEAR-END 2019 ACTUAL	2020 SURVEY AVERAGE
Unemployment Rate(%)	6.45	3.51	3.82
Inflation Rate (%)	4.04	2.83	3.23
Interest Rate(%)	7.68	7.56	6.44
GDP Growth Rate (%)	1.72	0.17	0.79
USD-MXN Exchange Rate	19.72	18.86	19.48

Source: S&P Dow Jones Indices LLC, OECD, and the U.S. Federal Reserve. Data as of Dec. 31, 2019. Table is provided for illustrative purposes.

Again, participants in this survey provided their projections amid relatively normal economic conditions, prior to the rampant spread of COVID-19 in North America.

Mexico's central bank enacted a series of rate cuts in the second half of 2019.

At the end of 2019, the unemployment rate was 3.51%, slightly higher than the 3.30% at the end of 2018. It was also the first time since 2013 that the unemployment rate increased—even if just slightly—instead of decreased year over year.

After spiking in 2017 at 6.77%, the inflation rate eased in 2018 and 2019 but showed signs of an uptick at the start of 2020.

While interest rates held steady during the first half of 2019, Mexico's central bank enacted a series of rate cuts throughout the second half of 2019, which have continued into 2020. Respondents expected these cuts to continue.

The rate cuts have continued into 2020, with respondents expecting these cuts to persist.

Between 2013 and 2018, the GDP growth rate remained between 1.4% and 3.3%, but in 2019, the GDP experienced a meager 0.17% growth rate—a significant decrease and departure from the expectations of both economists and our survey participants. Participants' projections for 2020 suggested a slightly larger growth rate than that of 2019, but one that is still below 1%.

It is unclear if or how the global pandemic will affect projections; however, at the time of writing, the USD-MXN exchange rate reached an all-time high of MXN 24.03—a value significantly higher than respondents' expectations for year-end 2020.[6]

[6] "Foreign Exchange Rates – H.10 Weekly," Board of Governors of the Federal Reserve System, March 2020.

APPENDIX A: METHODOLOGY

S&P DJI and the AMIS developed and administered the survey of insurance investment officers in Mexico collaboratively. S&P DJI managed data collection via an online survey tool. While we collected firmographic information—such as type and size of insurance company—we did not collect any information that could identify a specific firm or an individual at that firm; all responses remained anonymous. The 2020 data included in this analysis was collected between Feb. 5, 2020, and Feb. 28, 2020; the 2019 data used in calculating year-over-year comparisons was collected between March 1, 2019, and March 20, 2019. There were 19 insurers that participated in the 2020 survey, while 10 insurers participated in 2019.

APPENDIX B: FIRMOGRAPHIC DATA

Exhibits B1-B6 break down survey participants based on various company characteristics. Please note that due to rounding, values may not sum to 100%.

Exhibit B1: Type of Company

TYPE OF INSURANCE	RESPONDENTS 2019 (%)	RESPONDENTS 2020 (%)
Traditional Insurance	100	95
Reinsurance	-	5

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Table is provided for illustrative purposes.

Exhibit B2: Type of Insurance Company

TYPE OF INSURANCE COMPANY	RESPONDENTS 2019 (%)	RESPONDENTS 2020 (%)
General Insurance	50	37
Life Insurance	20	26
Surety	-	11
Combination	30	26

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Table is provided for illustrative purposes.

Exhibit B3: Type of Ownership

TYPE OF OWNERSHIP	RESPONDENTS 2019 (%)	RESPONDENTS 2020 (%)
Private	70	58
Public	10	16
Bank-Owned	-	16
Mutual	10	11
Other	10	-

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Table is provided for illustrative purposes.

Exhibit B4: Size of Company

SIZE OF COMPANY	INVESTED ASSETS (MXN MILLIONS)	RESPONDENTS 2019 (%)	RESPONDENTS 2020 (%)
Small	Invested Assets < 20,000	-	58
Medium	20,000 ≤ Invested Assets < 50,000	60	5
Large	50,000 ≤ Invested Assets < 100,000	30	5
Mega	100,000 ≤ Invested Assets	10	32

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Table is provided for illustrative purposes.

Exhibit B5: Type of Insurance

TYPE OF INSURANCE	RESPONDENTS 2019 (%)	RESPONDENTS 2020 (%)
Primary Insurance	80	74
Reinsurance	-	5
Both Primary Insurance and Reinsurance	20	21

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Table is provided for illustrative purposes.

Exhibit B6: Local Company or Foreign Subsidiary

LOCAL COMPANY OR FOREIGN SUBSIDIARY	RESPONDENTS 2019 (%)	RESPONDENTS 2020 (%)
Foreign Subsidiary	60	63
Local Company	40	37

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Table is provided for illustrative purposes.

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