NEWSSTAND

Costa Rica: Opportunity and Risk in a "New" Market

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While relatively small in comparison to the major Latin American insurance markets, Costa Rica is the largest insurance market in Central America (excluding Panama). The country also has a uniquely diversified economy for the region, has experienced rapid annual growth in the insurance market (between 15% and 46% annual growth in recent years) and still has a relatively low insurance penetration rate (2.6%). Prior to 2008, however, the country had maintained a government monopoly over the insurance and reinsurance market through the Instituto Nacional de Seguros (INS).

In August 2008, new legislation was passed in Costa Rica and signed into law by president Dr. Oscar Arias Sanchez that ended the more than eighty-year-old state-sponsored monopoly over the Costa Rican (re)insurance business. While the new Ley Reguladora del Mercado de Seguros opens the insurance market to private competition from domestic companies and foreign companies with local branches, it also contains prohibitions and increased penalties that may come as a surprise to any foreign (re)insurers that do not carefully review their activities in connection with any Costa Rican risks.

Market Trends and Characteristics
Due to dependence upon the United States and European economies, Costa Rica's insurance market growth is expected to remain flat for 2009. This plateau is expected to be only temporary, however, and comes on the heels of 28% growth in 2007 and double digit growth in the prior years. Furthermore, Fitch predicts continued growth in both the general economy and in the insurance market specifically well in to the future. Fitch based its recent opinion of the Costa Rican economy on the nation's high per capita income, strong governance indicators, net external creditor position, improved public finances and relatively diverse economy and the full implementation of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) and its accompanying legislation, which should help sustain these trends over the medium to long-term. As to Costa Rica's insurance market, Fitch expects continued premium growth and increased market penetration as private companies enter the market and increase price competition.

Not surprisingly, these economic indicators and the opening of the (re)insurance market to private and foreign competition has led to significant, if cautious, interest in the past year. Seguros del Magisterio, a Costa Rican company that formerly provided services exclusively to the nation's teachers under an exemption to the government monopoly, became the first private competitor in February 2009. Aseguradora Mundial, a Panamanian company, received initial authorization in July 2009. A number of other companies, including Qualitas of Mexico and ALICO of Panama, are also in the process of obtaining authorization.

Recent Regulatory Developments

Under the new law enacted in August 2008, the interim (re)insurance regulator was charged with establishing an insurance regulatory authority and implementing the other mandates of the new law. While certain regulations governing the market have still not been finalized as of the time of this writing, the basic tenets of the regulatory structure, such as authorization and solvency requirements, are already in place in the form of the statute itself and several sets of regulations issued since the opening. Companies seeking to sell personal lines or general insurance will be required to have minimum operating capital of $3 million, companies wishing to sell both will be required to have minimum capital of $7 million and companies wishing to operate as reinsurers will be required to have minimum capital of $10 million. While the minimum capital requirements contained in the new law are far lower than those contemplated in earlier drafts, which ranged from $10 million to $40 million, they remain fairly high in comparison to many other developing and established insurance markets.

In addition to opening the Costa Rican insurance market to private competition, however, the new statute and regulations also established new prohibitions against "insurance activities" in the jurisdiction by non-registered foreign insurers and reinsurers and created a new framework of far more serious penalties for violations of these prohibitions. Given these new provisions, and the newly created incentives for the INS to report and the regulators to investigate any violations, the risk of adverse enforcement actions has risen significantly with the new legislation. Potential fines for illegal sales of foreign insurance (the definition of which includes marketing of foreign policies by phone, email or facsimile) appear to range as high as $360,000 per violation under the new insurance laws.

In this regard, it should be noted that, while the old law was essentially a non-solicitation statute, the new law's definition of "insurance activities" that non-registered insurers and reinsurers are prohibited from undertaking in the jurisdiction is not limited to sales solicitation. To the contrary, the definition appears broad enough to implicate any sort of claim investigation or adjusting activities, whether conducted directly or through a local agent. Therefore, while the statute does not prohibit Costa Rican person and entities from seeking insurance outside of the jurisdiction, an insurer holding such a policy would be left with little ability to investigate or adjust any potential loss.

Indeed, the interim regulator recently issued a technical note providing further guidance as to several regulatory issues of significant importance to foreign (re)insurance companies.

- The Costa Rican law applies to any person involved in the development or realization of any insurance activities, whether in the nature of insurance, reinsurance, intermediary or auxiliary services. The law applies to such activity whether it occurs within the Costa Rican territory or from abroad directed toward Costa Rica and whether such activities are conducted directly or through intermediaries.
- The public offering of insurance services, which is prohibited in the absence of proper authorization or an applicable exemption, includes any activity that procures the sale of an

insurance policy or provides specific or concrete information concerning a particular insurance policy.

- Any provider of cross-border insurance services that includes a risk within Costa Rica must register with the Superintendency. This requirement does not apply to providers of cross-border reinsurance or retrocession, reinsurance intermediary services or auxiliary reinsurance service -- such entities may contract with authorized Costa Rican insurers when contacted directly by such authorized companies.
- No company may commercialize or otherwise market cross-border insurance services in Costa Rica unless the policies in question have been registered with the Superintendency, which is only permitted if such policies have been registered in the company's home jurisdiction.
- The only cross-border direct insurance services currently permitted by law in Costa Rica are those established by the CAFTA-DR treaty. As concerns direct insurance, said treaty applies only to space, maritime transport and commercial aviation insurance and only to member countries.
- Surplus lines insurance may only be purchased after local vetting and may not be publicized in Costa Rica and may only be offered through brokers.

Therefore, even for companies that opt to wait and see as to the development of the Costa Rican insurance market, it is imperative to reevaluate underwriting activities regarding risks related to Costa Rica.