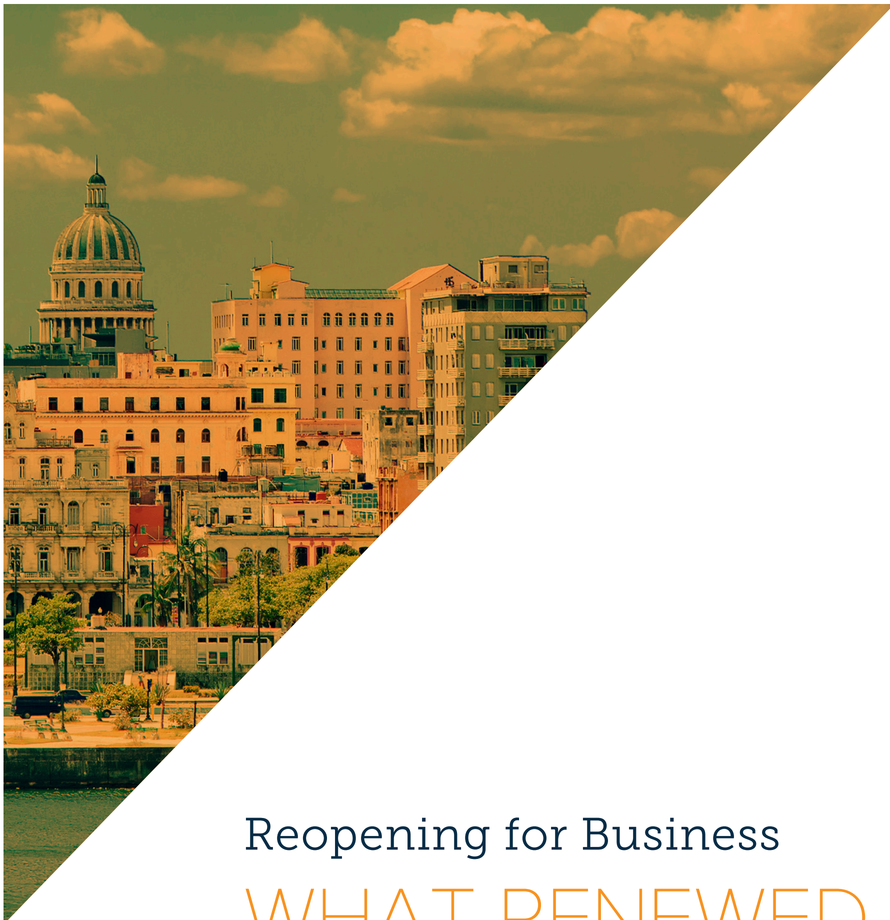

Reopening for Business

WHAT RENEWED TIES BETWEEN THE U.S. AND CUBA MEAN FOR PROPERTY/CASUALTY INSURERS

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As Cuba and the U.S. renew ties, risk management and underwriting are poised to play a key role in revitalizing the island nation's economy—but how ready (and willing) are Cuba's government, citizens and outside investors to embrace insurance businesses?

INTRODUCTION

President Barack Obama will make history this month when he becomes the first U.S. president to visit Cuba since Calvin Coolidge in 1928, the latest action toward ending the five-decade divide between the two countries. The possibility of developing trade ties with a nation in such close proximity to the United States—a mere 90 miles from Key West, Florida—has captured the attention and imagination of U.S. businesses. And, as they begin to explore the prospect of a future that allows foreign capital to flow into the country, the Caribbean's largest island, insurers will be among them.

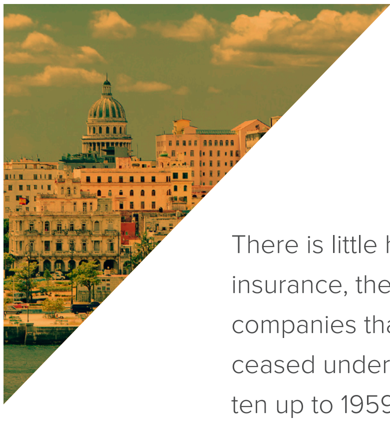
Is there a future for property/casualty insurers interested in the Cuba market?

Although initial steps have been taken to ease trade and travel restrictions with Cuba **(see Appendix 1)**, only the U.S. Congress can ease restrictions on trade between the two countries. The Republican majority leadership and some in the Democratic Party believe the embargo should remain in place as long as the Cuban government continues to repress its political opponents and maintain its monopoly over much of the country's infrastructure and operations.

Meanwhile Cuba is positioning itself for progress. The country remains on the verge of change; it is not yet in the midst of it.

Roadblocks are to be expected. Cuba has a history of abruptly launching economic experiments, and just as abruptly calling them off—and that will make it a challenge to do business there. Equally challenging will be selling insurance to a socialist population accustomed to relying on the state to provide for basic needs while absorbing many of the greatest risks. Developing a basic understanding of the Cuban people, and their culture and history, is an essential first step to gaining a foothold in this emerging market.

The biggest obstacle to doing business in Cuba may be Havana itself; so far, the Cuban government has failed to make the regulatory and policy changes that U.S. businesses would need to set up shop.



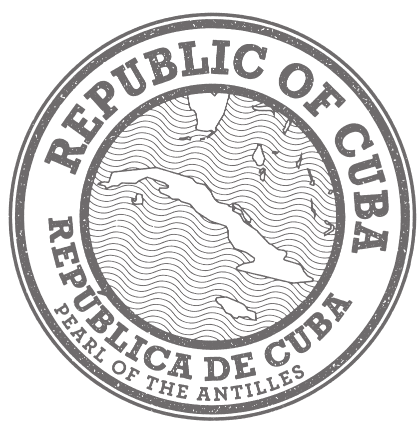
There is little history of an insurance market in Cuba outside of travel insurance and life insurance, the latter issued primarily through Canadian corporations. Canadian life insurance companies that had been branches of foreign insurers were nationalized in the 1950s and ceased underwriting new policies. Today, they exist only to pay claims from policies underwritten up to 1959.

Indeed, there is little incentive to purchase non-life insurance products. While the country is at considerable risk of multiple types of natural disasters—earthquakes, hurricanes, floods and drought—the socialist government owns the majority of property and provides subsidies for those who suffer property damage. Furthermore, entrepreneurship on the island is in its infancy, with very limited private ownership of equipment and inventory.

Additionally, rules for travel to Cuba by U.S. citizens have not changed. The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) will continue to administer regulations that provide general licenses for the 12 categories of authorized travel to Cuba; they do not include tourist travel. And, before any foreign investment is allowed, the Cuban government must authorize it.

Like most hard freezes, the thaw has been slow. In February, the Obama administration approved the first significant U.S. investment in the country in more than 50 years, a tractor manufacturer expected to launch in the first quarter of 2017.[1]

There are a variety of factors to consider for U.S. insurers contemplating a move into Cuba. This report assesses the nation's risk profile and the current state of its insurance market, and provides an overview of the country's economic history and current political situation.

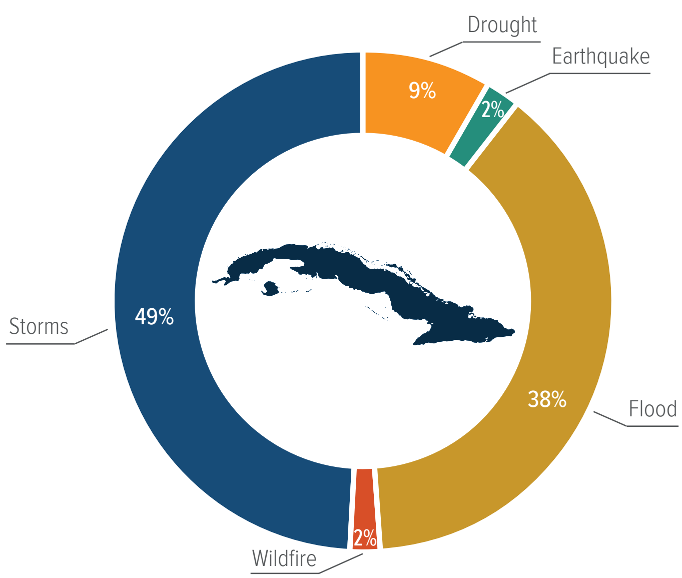


CUBA'S RISK PROFILE

While Cuba's current economic and political situation may not create an ideal business environment for insurers, it is clear that the country is in need of at least some level of protection against risk. Cuba's supply chain is highly susceptible to climatic conditions, and its antiquated infrastructure exacerbates the problem. The United Nations Environment Program (UNEP) categorizes Cuba at high risk for many types of natural disasters—hurricanes, tropical storms, non-tropical depressions with intense rainfall and high winds, earthquakes and droughts. **(Fig. 1)** Last year Cuba experienced its worst drought in 115 years and, as a result, was spending around $2 billion annually to import food.[2] Unusual winter rains imperiled this year's tobacco crops.[3]

Fig. 1

Frequency of Natural Disasters in Cuba



Source: UNISDR Global Risk Assessment 2015.

The island's Caribbean location makes it prone to occasional cold fronts, which can bring frequent coastal flooding. Landslides are also a threat in some areas following heavy rains. Physical factors, such as areas with dense population and industries concentrated in vulnerable locations, make certain municipalities even more susceptible to damage.

Despite the climate threats, Cuba has been lauded as a model for consistently weathering Category 4 and 5 hurricanes with few casualties. In fact, the Center for International Policy, a Washington, D.C.-based research and advocacy group, said a person is 15 times more likely to be killed by a hurricane in the United States than in Cuba.[4] The island has a well-orchestrated

storm preparedness protocol that involves practicing evacuations and proactively identifying hazards. While even the United Nations has recognized Cuba's disaster preparedness protocols as a model for lower-income countries to follow, the country may face even greater threats as the climate changes.

Since 2001, Cuba has been struck by 16 hurricanes and tropical storms, giving it considerable opportunity to demonstrate its ability to execute mandatory evacuations. However, major weaknesses exist due to a limited ability to invest in mitigation for the country's many antiquated buildings, which deteriorate even further with repeated weather events. Reconstruction and recovery are severely limited post event, resulting in a housing deficit currently estimated at between 600,000 and 1 million units.[5]

Assessing Natural Catastrophe Risk in Cuba

Cuba is exposed to a variety of natural catastrophes. Insurers measure the exposure through a risk metric called Probable Maximum Loss (PML). PML represents maximum losses expected from certain perils, within a given number of years. For example, the table in **Fig. 2** shows the 20-year PML for wind is $997 million. That means over a 20-year period Cuba on average will have one wind event (a hurricane) with losses above $997 million. It is used to establish the magnitude of resources that insurance companies or a government should have available to buffer losses. Cuba's greatest natural threats are wind (generally hurricanes) and storm surge.

Fig. 2

Probable Maximum Loss (PML) for Cuba

Mean Return Period in Years (Values in US$, Millions)

Years	Wind	Storm Surge	Earthquake
20	$ 997	$ 977	$ 6
50	1,886	1,602	21
100	2,334	1,955	50
250	2,885	2,348	137
500	3,445	2,776	264
1,000	3,659	2,972	475

Source: UNISDR Global Risk Assessment 2015.

The Average Annual Loss (AAL) is the expected loss associated with the occurrence of future perils, over a very long timeframe. It considers the damage caused by different sizes of events (from small to extreme) and is used to rank and compare various risks. **(Fig. 3)**

Fig. 3

Annual Average Loss by Hazard for Cuba (Absolute in US$ Millions)

Source: UNISDR Global Risk Assessment 2015.

There will be little historical information related to catastrophe risk coming directly from Cuban officials upon which to base future insurance pricing. Fiscal details coming out of Cuba, for any purpose, are something of a mystery—incomplete, inaccurate and questionable. However, the international insurance market has proven to be adept at appropriately pricing risk in new and uncertain locations around the globe, a skill that will come into play when evaluating risk in Cuba.

CHALLENGES: POLITICAL, LEGAL AND MONETARY

Cuba is not yet open for business. Despite recent rule changes, the U.S. government has asserted that just about any business with Cuba must continue to be licensed by the Office of Foreign Assets Control (OFAC). U.S. companies, U.S. citizens and foreign subsidiaries of U.S. companies are not yet allowed to transact business that either helps the Cuban government or undermines U.S. policy. And enforcement of these mandates by OFAC continues.

The Cuban government's control of business and the weak regulatory environment make the nation one of the world's most difficult places in which to do business.

AON Crisis Risk Rating puts Cuba at high risk for political interference.[6] Even with Cuba's recent reform agenda, which is positively reflected in the modest improvement in some of the country's risk factors, political violence risk is expected to increase. The Cuban Commission of Human Rights and National Reconciliation reported that arrests of political dissidents were increasing, with May 2014 arrests reaching the largest numbers in the past decade.[7] The report suggests that actual arrests are likely higher, noting that the regime makes it impossible to know the exact numbers.

The Cuban government's control of business and the weak regulatory environment make the nation one of the world's most difficult places in which to do business. The primary approved business structure is limited to joint ventures with the Cuban government. Although new types of business models were approved in 2014 to incentivize foreign companies to invest in Cuba, all remain under government control. Structures for doing business in Cuba include:

- A totally foreign capital company,
- Joint venture,
- International economic association contract,
- Contract for the joint production of goods and services, and
- Contract for product or services management and hotel management contracts.

Fig. 4

Number and Type of Foreign Companies in Cuba

Foreign Investment Regulation	Form of Business	Number of Businesses
Foreign Investment Law No. 77 (1995)	International Economic Associations Joint Venture International Economic Association Contract	218
	Totally Foreign Capital Company	6
Agreement 5290 (2004)	Contract for the Joint Production of Goods or the Provision of Services	14
	Contract of Product or Services Management	6
	Hotel Management Contract	60
Total		**313**

Source: University of Havana Center for the Study of the Cuban Economy.[8]

As of December 2015 there were only six totally foreign capital companies in Cuba: three in oil and energy, two in maritime transport and one in financial activities. **(Fig. 4)** International economic association entities, by contrast, comprise 70 percent of the foreign businesses. About 16 percent of those entities are in the tourism industry.

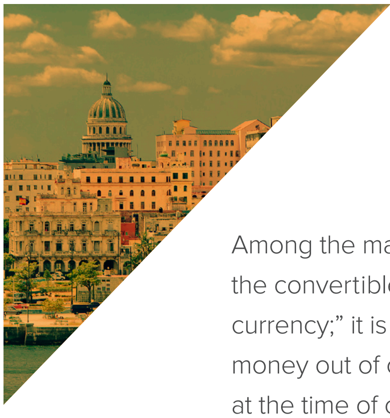
Cuba's gross domestic product (GDP) per capita has not changed much in 30 years. The nation is ranked 76th in the world, behind Kenya. Its percentage GDP growth rate places it 177th in the world. Cuba's economy peaked in 1984, and it experienced another spike through the deeply discounted oil prices Venezuela offered. However, it has not recovered from the effects of the 2008–2009 financial crisis. **(Fig. 5)**

Fig. 5

Cuba's Purchasing Power

Year	Gross Domestic Product (Billions, US$)	GDP Growth Rate (%)	GDP Per Capita (in 2010 US$)
2014	$128.5	1.3	$10,200
2013	$126.9	2.7	$10,000
2012	$123.5	3.0	$10,000

Source: CIA World Fact Book.[9]



Among the many obstacles to doing business in Cuba is the existence of two official currencies, the convertible peso and the Cuban peso (CUP). The convertible peso (CUC) is known as "tourist currency;" it is only exchangeable within the country. It was introduced to take all non-Cuban money out of circulation. A CUC is equal to one U.S. dollar, and it is subject to a 10 percent tax at the time of conversion. The latest exchange rate for the CUP is approximately 26.5 Cuban pesos per one U.S. dollar.

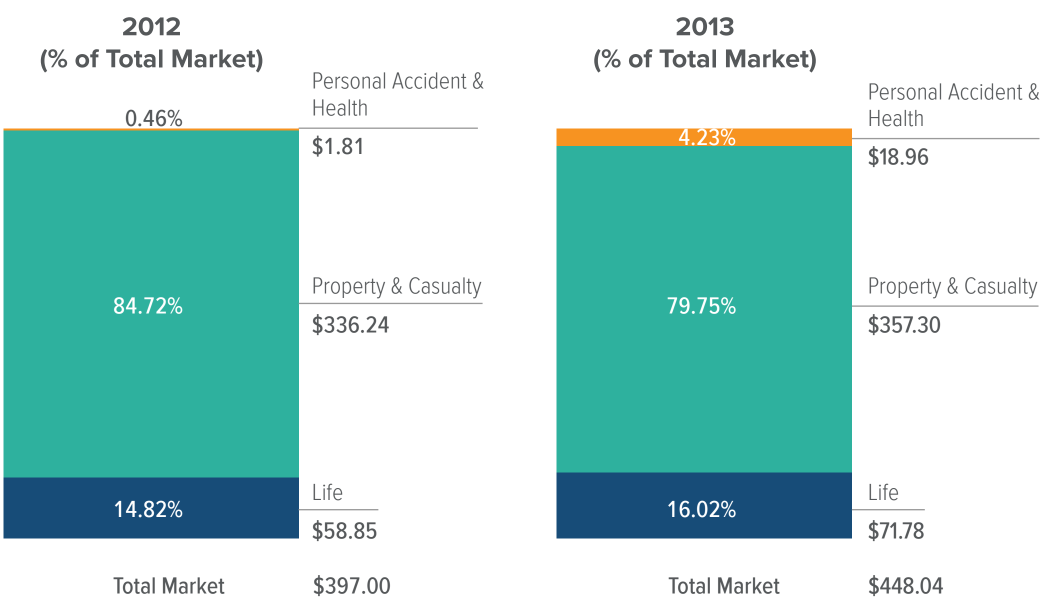
Until Cuba fully adopts a single currency strategy, it will be very difficult for foreign investments of any type to flow in. That process is, in fact, starting in anticipation of opening up to the global markets. In late 2013, the Cuban government announced a plan for a single currency system, and its central bank began circulating higher denomination Cuban pesos in February 2015.

INSURANCE MARKET OVERVIEW

It is an understatement to call Cuba's current insurance marketplace underdeveloped. Particularly for property/casualty insurers, the market is in its infancy, perhaps even in an embryonic stage. With about $450 million in writings, Cuba's entire insurance market is about as big as Alaska's personal auto market. It will take time to develop, and the transition is likely to be awkward **(Fig. 6)**.

Fig. 6

Cuba's Insurance Market (Premiums in US$, Millions)



Source: Axco Global Statistics/ Industry Associations and Regulatory Bodies.
*Note: The 2013 exchange rate of U.S. dollars to Cuban pesos was 1:1.

Businesses authorized to establish or maintain a physical presence in Cuba are limited, although providers of carrier services and certain travel services are among the few that are authorized. The U.S. Treasury recently compiled a list of frequently asked questions related to Cuba, reiterating that U.S. insurers and their subsidiaries are not permitted to issue policies, provide reinsurance coverage or pay insurance or reinsurance claims "related to non-U.S. persons, including entities such as foreign airlines, providing goods or services that facilitate travel by third-country nationals from a third country to Cuba." However, U.S. insurers can issue policies and pay claims for group health, life and travel insurance for third-country nationals traveling to or within Cuba—providing it is a "global policy," meaning a policy that was not issued specifically for travel to Cuba.[10]

Insurers that paid claims through subsidiaries have been fined by OFAC for doing so. That reinforces the fact that the insurance industry's approach to writing Cuban risk has not yet changed.

Development of the Cuban Insurance Sector

Canada and Mexico are the only two countries in the Americas that did not sever ties with Cuba during the 1960s revolution. Canadian companies already have strong relationships from doing business in Cuba, having built trust over the years. Spain also has a large percentage of foreign investors in Cuba, primarily in tourism and in several other sectors. It is expected that established connections such as these will be called upon to pave the way for further developing the financial services sector.

First-to-launch new foreign business ventures in Cuba are expected to be those linked to the tourist trade. There are no 100 percent foreign-owned hotels; all are owned and run by the state or are joint ventures with foreign companies.

In January 2015, non-tourism categories of travel to Cuba were expanded; a specific travel license is no longer required. Easing these restrictions increased the need for travel insurance, as all travelers are required to have insurance to cover medical expenses. U.S. insurers cannot guarantee medical coverage in Cuba, and coverage can be provided only through an insurance company "recognized" there. So, U.S. insurers offering travel insurance have an association with Cuba's Havanatur-Celimar Company.

A government memorandum from June 1957 noted the "preponderant" role of Canadian life insurance companies, stating that between 75 and 80 percent of life insurance policies in force were underwritten by Canadian companies.[11] The consistent growth of both Canadian insurance and banking in Cuba was due to a lack of U.S. competition and also to the strong alliance Cuba developed with Canada-based enterprises. In 2013, Axco Global Statistics ranked the Cuban life insurance market as the 101st largest in the world, yet mentioned that the ranking may be overstated because the official exchange rate of local pesos to the U.S. dollar was at par.

Cuba's Ministry of Finance governs all insurance activity. It is responsible for the activities of insurers and reinsurers, brokers, agents and other insurance intermediaries. A division of the Ministry of Finance, the Superintendent of Insurance, implements its directives. Given the provisions introduced to invite trade into Cuba, it is expected that rules will eventually be adopted to allow foreign insurers to enter.

Insurance activity can be conducted by private companies, a mutual company or estate companies. Generally, companies can be organized under any of the following structures:

1. With 100 percent foreign capital paid by a foreign investor without the participation of a local investor.
2. With mixed capital, comprised of nominative shares owned by one or more local investors and one or more foreign investors.
3. With 100 percent local capital or as a Cuban-state company.

All Cuban insurance enterprises were nationalized by January 1964. Although insurance never accounted for more than 1 percent of national income, new opportunities gradually emerged throughout the insurance sector as a result of the changes in economic structure. Seven insurance companies and two reinsurers had offices in Cuba in 1997.[12] They concentrated on freight insurance, but there was interest in development and diversification.

In 1997, a new insurance law was passed to permit the establishment of private insurers to compete with the state-owned companies. Private insurance will not replace state social security provisions, and the infrastructure will continue to favor businesses with Cuban participation or ownership. Although limited foreign penetration into the Cuban market is expected to help develop the sector, authorities will continue to encourage the development of Cuban insurers before the sector is fully opened.

Given the provisions introduced to invite trade into Cuba, it is expected that rules will eventually be adopted to allow foreign insurers to enter.

Foreign Investment Law No. 118, passed in March 2014, was intended to stimulate direct investment, but has had no impact yet. The law stated that joint ventures and totally foreign-owned companies must insure all their property and casualty risks, with the first option for coverage going to Cuban insurers. If Cuban insurers do not offer terms and conditions that align with international markets, then a window of opportunity opens for foreign insurers—subject to Ministry of Finance rules.

Two insurance companies are currently operating in Cuba, organized under the banner of the Caudal Group, which is owned and operated by the state. Caudal was created as a holding company; it is somewhat independent from the state in the sense that the company and its subsidiaries have a capital share, their own boards of directors and are responsible for their own budgets and paying taxes.

The companies are:

- ESEN (Empresa de Seguros Nacionales) – Handles life, auto, agriculture, third party liability and travel insurance, the latter of which is required of visitors to cover medical expenses. Agriculture comprises the bulk of the ESEN portfolio, about 70 percent.13

  ESEN appeared to be preparing to compete with foreign companies in the domestic market in 1997. It launched a major marketing drive with an expanded sales force of 3,500 to persuade Cubans to take out new personal insurance policies. They had some success, despite the lack of a private insurance tradition. The volume of premiums was 30 percent higher in 1995 than in 1990. New products included not only travel and medical insurance, but also pensions and life insurance policies.

- ESICUBA (Seguros Internacionales de Cuba, S.A.) – Concentrates on aeronautical and maritime insurance, transportation and construction, and medical insurance for tourists. It provides coverage to foreign-owned interests, including hotels and resorts. ESICUBA also acts as a local reinsurance company with business ceded to international markets, principally Lloyd's. Some third party liability risks, primarily related to the tourism sector, are reinsured in the Canadian market.

In addition to ESEN and ESICUBA, Caudal operates INTERMAR, a loss adjustment entity, and Asistencia al Turista (ASISTUR), an insurance brokerage and consultancy for travel and auto insurance policies. ASISTUR has agreements with international insurers to provide coverage.

An indication of the expected pace of progress can be seen in the case of Brazilian insurer Capemisa. The company, which offers primarily microinsurance, announced in July 2013 that it hoped to be operating in Cuba that very year. It also planned to offer other coverages, including life, travel and property insurance. Capemisa reportedly received authorization to sell travel insurance in 2015[14], but as of January 2016 the company's website said it had temporarily suspended offering an insurance product in Cuba and expected to re-launch soon.[15]

A (Slowly) Growing Need for Insurance

Compared to other Caribbean countries, Cuba lags far behind in what is spent on a per capita basis on non-life insurance products. In non-life insurance markets, Cuba was ranked No. 85 in 2013 (the latest data available) **(Fig. 7)**.

Given Cuba's past record for seizing personal and corporate assets, business seeking to invest there may have concerns. Cuba has investment treaties[16] with 60 nations, although 19 of them are signed but not in force. Its Foreign Investment Act 118 states that foreign investments "could not be expropriated, unless such action is executed for reasons of public or social interest [with] appropriate compensation for their commercial value established by mutual agreement."[17]

Fig. 7

Market Penetration Comparison Among Caribbean Countries (2012/2013)

	Life, Including Riders		Property & Casualty		Personal Accident & Healthcare*		Total	
Year	Premium as % of GDP	Per capita (US$)	Premium as % of GDP	Per capita (US$)	Premium as % of GDP	Per capita (US$)	Premium as % of GDP	Per capita (US$)
Cuba								
2012	0.08	5.25	0.45	30.03	0.00	0.16	0.53	35.45
2013	0.09	6.41	0.46	31.92	0.02	1.69	0.58	40.03
Puerto Rico								
2012	1.45	251.75	2.80	485.06	12.87	2,230.06	17.12	2,966.86
2013	1.53	289.04	2.62	496.77	10.87	2,060.22	15.02	2,846.04
Jamaica								
2012	1.73	91.60	2.23	117.90	0.74	38.89	4.70	248.39
2013	2.17	111.77	2.08	107.10	0.79	40.55	5.03	259.42
Trinidad & Tobago								
2012	1.48	260.23	0.77	135.85	0.35	61.51	2.60	457.58
2013	1.69	308.03	1.66	302.68	0.44	79.65	3.79	690.37

*Personal Accident & Healthcare reflects other than life riders, whether written by life, non-life or specialist healthcare insurers.
Source: Axco Global Statistics/ Industry Associations and Regulatory Bodies.

The Cuban government controls vehicle ownership, and a foreign individual or corporation must get approval to own one. Only two vehicles can be purchased for each foreign worker living on the island. Cuban workers are restricted to one vehicle. These restrictions apply to all vehicles, including imported cars, which are rare due to the embargo, and a 100 percent import tariff.

Third-party automobile liability is compulsory for foreign residents (including diplomats) and for vehicles carrying either freight or people. There are several rental car agencies in Cuba, and Cubans may drive rental cars, with coverage extended on their own insurance for an additional cost. Such coverage may also extend to a second foreign driver. Insurance for rental cars must be paid in cash and generally does not cover liability. Some rental car insurance does not cover theft, but travel sites note theft is a minor problem.

In a country so poor that monthly salaries average $20, there is a scarcity of personal real estate or property to insure. Rent is free, and should a national disaster strike, the government provides subsidies to replace personal property. Therefore, there is currently little incentive to buy property insurance. Furthermore, in an environment where the state controls so much, educating the population about the value of protecting ones' assets with insurance will require an ongoing, long-term commitment.

Cuba began allowing permanent residents to buy and sell real estate freely in late 2011. (U.S. citizens are prohibited from buying property until the embargo is lifted.) It has also added real estate agents to its list of approved self-employment jobs. Websites such as cubisima.com have sprung up offering property for sale.

The step has been a small one. Home ownership is restricted to one primary residence and one vacation home. Buyers and sellers generally agree on a property's price, or they simply swap residences—and that means there are no home mortgages. Because little or no capital is accumulated by this sales process, there remains little to protect with insurance.

Still, Cubans are starting to see the value in the real estate they own. There is a new interest in proactively maintaining it. This will allow Cubans to build net worth, creating a reason to buy insurance—eventually. Cuba's economy will not become dislodged from the past easily.

A PROFILE OF CUBA'S ECONOMIC HISTORY

Familiar scenes of classic 1950s-era automobiles on postcard-quaint Cuban streets are a metaphor for the economy itself: It is stuck in a time warp. Yet, change may be on the horizon. Cuba is poised at the very beginning of a long, perhaps unprecedented, balancing act. It is making adjustments to relieve some of the constraints of a socialist economy, while striving to retain socialist political control. Reforms have come and gone over the decades since the U.S. embargo. With history as a guide, it is reasonable to expect a series of small steps forward, followed by occasional reversals. Yet, Cuban President Raúl Castro appears to be committed to making the latest reforms stick.

In 2007, Castro made a public announcement about the necessity of making "structural and conceptual reforms," and he has publicly criticized past mistakes. In April 2011, Castro made a pronouncement that seemed to emphasize reform was the best way forward. He said, "The only thing that could result in the failure of the Revolution and of socialism in Cuba…is our inability to overcome the errors that we have made over more than 50 years, and the new ones that we might incur in the future."[18]

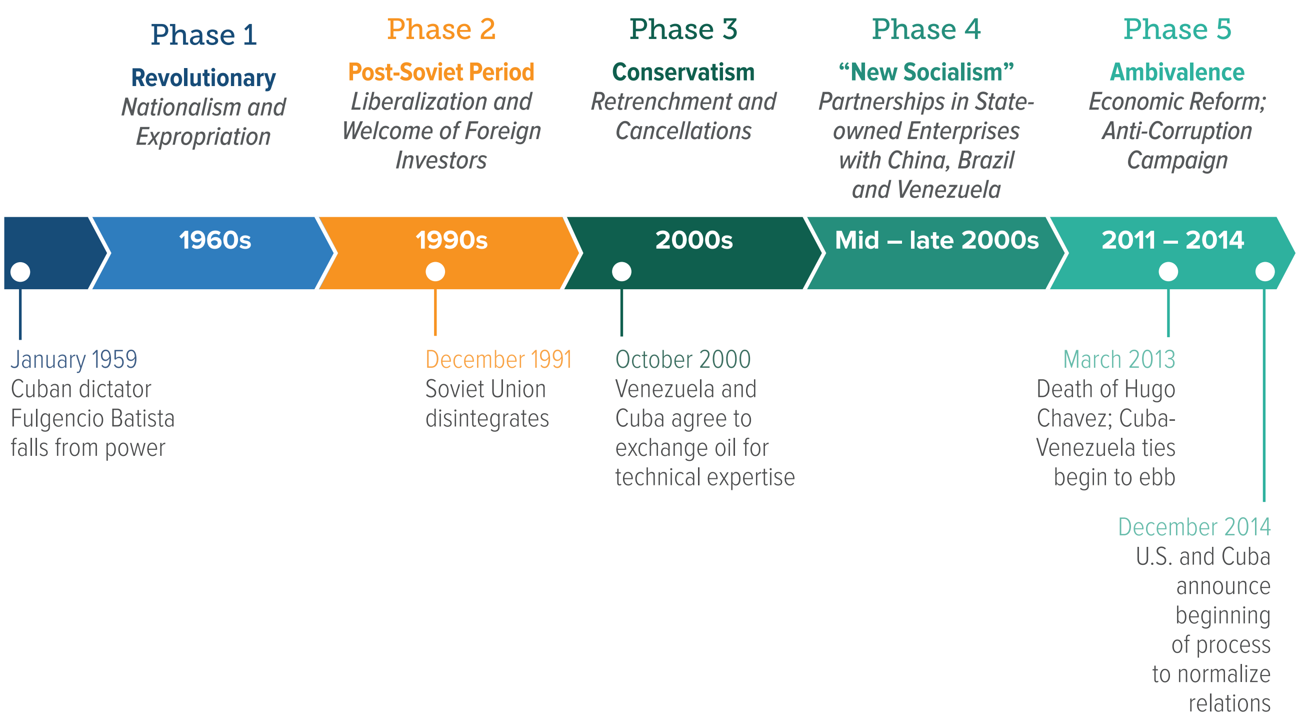
The Five Phases of the Cuban Economy

How did the country reach its current state of incipient reform ("Phase 5" below)? With a cycle of fits and starts for economic revival, Cuba's volatility has long been problematic. Opening up to outside influences in past decades brought some limited results, yet advances were always short lived and progress met too soon with skepticism. Often, deeply ingrained suspicion of capitalism triggered retrenchment. Advancement would come, followed by a purposeful retreat, as evidenced by five major shifts in Cuban economic policy **(Fig. 8)**.

First came the nationalization of foreign and Cuban-owned assets in the 1960s, which lasted as long as Soviet subsidies remained in place. When Soviet subsidies ended in the 1990s, Cuba was forced to set out a welcome mat to survive. That brought an influx of investors from Europe,

Fig. 8

Five Phases of Cuban Policies Toward Foreign Direct Investment



Source: "The New Cuban Economy," Latin America Initiative at Brookings.

Canada and Latin America. The incoming capital propelled the economy, but it did not dissipate a lingering distrust of outsiders harbored by the Cuban government, nor concerns that foreigners might compromise national security. This caused Fidel Castro, who led Cuba's revolution in 1959 and served as president until 2008, to reevaluate foreign investments and, subsequently, rein them in by centralizing the economy once again.

The fourth phase in the mid-2000s saw a reacceptance of foreign partnerships, with China, Brazil and Venezuela, with the latter as the largest trading partner. In late 2000, Venezuela began providing oil to Cuba on extremely favorable terms. Cuba paid for the oil, in part, by providing the services of an estimated 40,000 Cuban professionals, 75 percent of whom were healthcare workers. Venezuela paid the Cuban government billions annually through joint ventures, concessional oil financing and overpayment for these professional services. Payments were estimated at between 11 and 16 percent of Cuba's gross domestic product between 2008 and 2010.[19]

As a result of the political and economic crisis in Venezuela, that country's investment in Cuba has declined. Some call that a positive outcome that could help spur the growth of the middle class.[20] However, because oil prices are dropping, Cuba currently finds itself in a cash crunch that may impact its ability to take advantage of the relaxation of U.S. sanctions.[21]

> The dichotomy that is Cuba can be summed up in a 2014 report that called it one of the 20 "Markets of the Future" for consumer goods, while at the same time describing it as "one of the least attractive places to do business worldwide."

Doing Business in Cuba

Cuba is among the world's worst business environments, with only Iran, Libya, Angola and Venezuela rated lower in a 2014 ranking by the London-based Economist Intelligence Unit.[22] It is ranked No. 78 out of 82 nations. Foreign executives have lamented the difficulty of getting permission for a commercial representative to seek business opportunities. Although Cuban law permits foreign ownership of businesses, the reality is that almost all enterprises operated through government partnerships give foreigners only minority control.

The dichotomy that is Cuba can be summed up in a 2014 report that called it one of the 20 “Markets of the Future” for consumer goods, while at the same time describing it as “one of the least attractive places to do business worldwide.”[23] A recent article in *Time* magazine said “the country has always been an economic basket case.”[24]

Cuba’s uneven economy has caused more capital to flow out to foreign investors, with a relatively small amount flowing back in. According to a 2012 report by the Latin American Initiative at Brookings, the Cuban economy has become an increasingly low-productivity service economy. Industrial production is at less than 50 percent of pre-1989 levels. Agriculture has improved but it is still insufficient to feed the population, so imports of food take a large share of foreign exchange earnings. Cuba typically imports more than 60 percent of its food.[25] This approached 80 percent last year as the island experienced an historic drought.

> There are an estimated 500,000 microbusinesses now licensed in Cuba, and an estimated two million people are working in businesses operating under those licenses.

The same Brookings report notes merchandise exports, reported at $4.6 billion in 2010, were less than 10 percent of national output, reflecting the low international competitiveness of much of Cuba’s industry and agriculture. To put it in perspective, if Cuba were a U.S. state, its gross domestic product of about $70 billion would rank it at 41st—about even with New Hampshire.

It is worth noting that Cuba’s official blueprint for reform does more than propose progress. It also sets out guidelines for accelerated exports, ways to improve island agriculture to reduce the need for food imports and for launching a national savings program. Cuba is also warming to an emerging small business sector to transition formerly state-run enterprises over to entrepreneurs. This is a small step, one that newly minted workers are navigating as they learn about the risks and rewards of business operations.

Among the formidable obstacles to normalizing relations between the two countries is the issue of property claims over economic damages. U.S. companies and private U.S. citizens say Cuba owes them a combined total of nearly $2 billion, excluding 50 years of interest payments at 6 percent annually, for property seized by the socialist state during the Cuban revolution. For its part, Cuba claims it has suffered about $121 billion in damages due to U.S. economic sanctions (not including interest). Negotiations over this long-standing barrier to diplomatic relations began at the end of 2015. A recent paper by the Brookings Institution[26] suggests this decidedly contentious situation can be presented as opportunity if it is structured as "the centerpiece of a grand bargain that would resolve some of the other remaining points of tension between the two nations." Brookings suggests this is not new territory; precedents for similar agreements were struck with the Soviet Union, China and Vietnam.

Reforms and compromise in dealings with Cuba cannot be expected to mirror every ambitious-sounding proposal; change is expected to be very slow within a decidedly chilly business climate. Given its history of anti-capitalism, patience will be a necessary attribute for those entering into the Cuban frontier.

ENTREPRENEURIAL MARKETS EMERGE

Cuba's private sector is called the "non-state sector." It comprises both the self-employed and enterprises that are a combination of foreign- and state-owned businesses. In 2010, regulations were eased to allow self-employment to expand and by 2012, the government listed 181 job categories that were no longer under its control, such as shop owner, taxi driver and construction worker. Although the Cuban government is gradually shifting jobs and business ownership into private hands, the land those businesses occupy remains state owned.

There are an estimated 500,000 microbusinesses now licensed in Cuba, and an estimated 2 million people are working in businesses operating under those licenses.[27] But non-state jobs are typically low wage, and these small, private businesses compete with government-owned establishments. Many of the Cubans working independently are part of worker-managed cooperatives.

Cubans may open private restaurants in their homes, with government approval, and new ones open every day. They also close every day. Such enterprises have a steep learning curve and few entrepreneurial role models. This, in combination with a weak foundation for financial literacy typical of a socialist country, will be an ongoing challenge to building the economy and providing opportunity for insurers.

Individual enterprises are mostly of the mom-and-pop variety, and they have practical reasons to stay small. The number of employees typically stalls at four or fewer. That is because a business with five or more employees experiences a significant tax rate increase. The obvious objective of Cuba's tax structure is to prevent private accumulation of property; however, the effects of the tax structure discourage job growth in a private sector that has the potential to revive the economy and provide for its population of approximately 11.2 million people.

Fig. 9

Comparison of the Tax Regimes for Cuban Small Enterprise and Foreign Investors Operating in Mixed Enterprises After the 2014 Foreign Investment Law

	Small Enterprise Sector	Foreign Investors in Mixed Enterprises or "Economic Associations"
Nominal Tax Rates	**Personal Income Tax Rate:** 15% rising to 50% of income above CUP 50,000 or $2,000 per year	Profits Tax: 15% of **Net Corporate Income** [perhaps 50% for resources]; Personal Taxes Exempt for those earning profits.
Effective Tax Base	**60% to 90% of Gross Revenues**; [Maximum of 10% to 40% allowable d for input costs, depending on activity]	**Net Income after deduction of all production and investment costs from Gross Revenues**
Effective Tax Rates	**May approach or even exceed 100% of Net Income**	15% of Net Income; [perhaps 50% for mining and petroleum]
Tax Holiday	**None**	Eight Years Profit Tax Exemption
Deductibility of Investment Costs from Gross Revenues	Deductible only within the 10% to 40% allowable deduction limits	Fully deductible from Gross Revenues in determining Taxable Income
Deductibility of Input Costs from Gross Revenues	Deductible only within the 10% to 40% allowable deduction limits	Fully deductible from Gross Revenues in determining Taxable Income
Employee Hiring Tax	Tax exemption for first five employees; Tax required on six or more	Complete Tax Exemption
Social Security Payments	Yes	Yes
Lump-Sum Taxation	Up-front Fixed Fee Tax Payments Necessary	None
Input Importation Rights	Direct Import Purchases Prohibited	Freedom to Import Directly
Profit Expatriation	No	Yes

Source: "Cuba's New Foreign Investment Law: Amplified Discrimination against Cuban Small Enterprise Operators and in Favor of Foreign Enterprises," The Cuban Economy, April 17, 2014.

For example, 10 percent of the money cooperatives take in, such as the horse-drawn carriage businesses catering to tourists, go to taxes.[28] Additionally, drivers are expected to pay taxes to the government, a minimum of 3.5 Cuban convertible pesos (CUCs) every day, except Sundays. And, 5 percent of the money they earn goes to preserve the Old Havana historic district, which is listed as a UNESCO World Heritage Site. The tax system itself incentivizes tax evasion, which creates a problematic situation for the Cuban economy as a whole. **(Fig. 9, previous page)**[29]

Foreign Investment in Cuba

In 2014, the Cuban government produced a comprehensive document called the "Portfolio of Opportunities for Foreign Investment,"[31] making an appeal to international companies to invest in over 246 specific development projects estimated at more than $8 billion. The move signaled that the government was interested in opening up the economy. The law cut the profits tax in half, from 30 to 15 percent, and it exempted investors from paying the tax for eight years—although many of the tax benefits were available only to joint ventures between the Cuban state and foreign companies, not to 100 percent foreign-owned businesses.

Foreign ownership had previously been legal, although it was never allowed in practice. And, thus far, there are no wholly owned foreign enterprises. In November 2015, at the 33rd Havana International Fair, Cuba enlarged the "portfolio of opportunity" to include 80 additional development projects, bringing the total to 326, with some of the most attractive projects in the Mariel Special Development Zone, west of Havana. The focus remains on tourism, energy and oil exploration, and agriculture.

Many early entrants to the Cuban business sector have noted the challenges of navigating through the fledgling economic improvements, particularly the necessity of not only collaborating with the Cuban government, but also remaining compliant with U.S. law.

CONCLUSION

Cuban laws are expected to evolve, and so they must if they are to bring economic prosperity to the island. Cuba's relationship with the United States will be framed around mutual economic benefits. Opportunity may well exist for property/casualty insurers in Cuba but, in the near term, are likely to be limited to travel-related products, agriculture and the hotel industry. Easing of travel restrictions will, of course, encourage more people to visit Cuba, and the accompanying growth in sales of travel insurance will likely usher in the first wave of new business. Furthermore, all travelers are required to have medical insurance, and coverage must be provided by a company already recognized and approved by the Cuban government.

The biggest challenge facing insurers is that insurance is simply not yet a valued commodity for Cubans. The Cuban economy and infrastructure has a long way to go before the need for more sophisticated, complex insurance products will be recognized, let alone developed and sold.

Appendix 1

Timeline of U.S.-Cuba Relations Reestablishment

Dec 17, 2014
President Obama announced the reestablishment of bilateral relations with Cuba.

May 29, 2015
U.S. State Department removes Cuba from its list of state sponsors of terrorism.

Jul 20, 2015
Embassies reopened.

Sep 17, 2015
José Ramón Cabañas named Cuba's ambassador in the U.S.

Oct 27, 2015
Cuban President Raul Castro makes his 24th appeal to the United Nations to marshal international support to end the embargo.

Dec 8, 2015
Discussions begin over each country's property claims. U.S. companies and citizens say they are owed about $7 billion; Cuba says it is owed $181 billion in damages caused by the decades-long embargo.

Dec 17, 2015
U.S. and Cuba agree to restore commercial flights between nations in 2016. A pilot program to re-establish direct postal services is also announced.

Feb 18, 2016
U.S. President Barack Obama announces he will visit Cuba.

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