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Brazilian Reinsurance Regulation Changes Again

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In November 2011, a number of associations, including the American Council of Life Insurers (ACLI), filed comments with the Brazilian regulatory authority urging Brazil to stop restricting reinsurance access to only domestic reinsurers in one of the world's leading emerging markets for insurance. This article examines the background and legitimacy of this complaint.

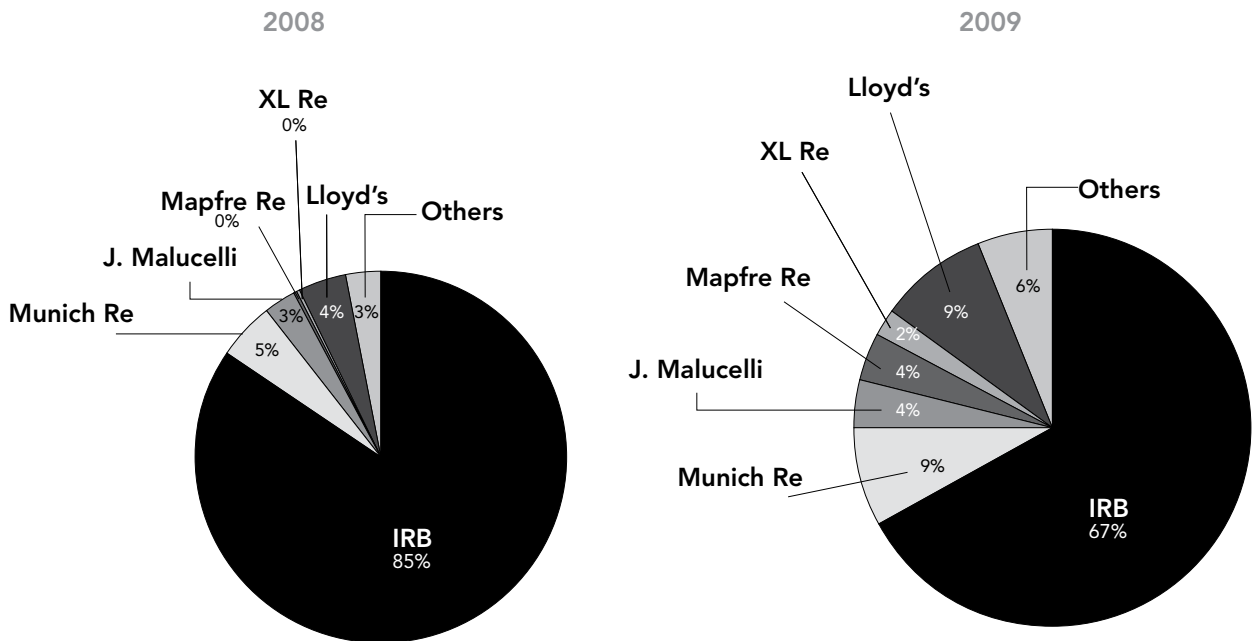
In 1939, the Brazilian Reinsurance market was closed to direct access by international reinsurers. It was officially reopened in April 2008 and is now home to 75 multinational reinsurance groups including the State Reinsurer, Instituto de Resseguros do Brasil (IRB-Brasil Re). Please note that several reinsurers (e.g., ACE) have multiple registrations, so records will show that there are 92 approved companies in total.

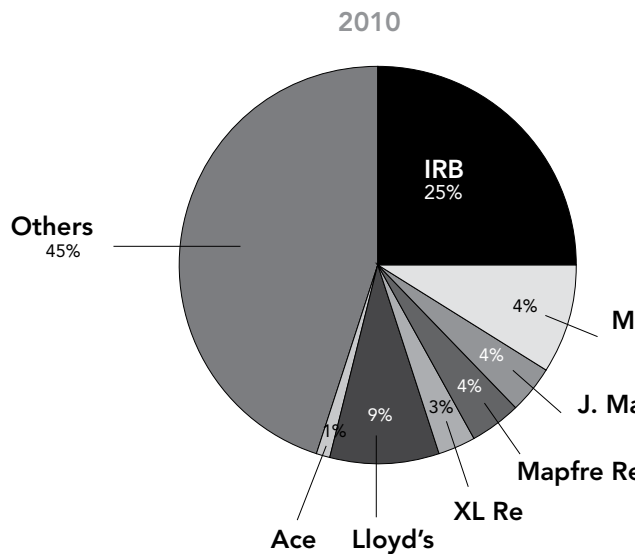
However, Brazil is still not an open reinsurance market; rather it's in the process of opening. At the moment, it's like a three-ring circus. Reinsurers may apply for classification as local, admitted or occasional reinsurers. Each classification requires different levels of capital and provides access to varying percentages of ceded risks.

The graphs below and on pg. 25 set out Gross Premium Market Share percentages of the local reinsurers over the period 2008 to 2010.

We can clearly see that the IRB-Brasil Re's share has declined from 85 percent to 25 percent over a three-year period. So let's summarize what it means to be a local or non-local reinsurer Brazil, and what were the alterations since the opening of the market that led to the ACLI's complaint.

The charts below show the variation in market share percentages, measured by Gross Premium 2008 - 2010."





1939 TO 2008

IRB-Brasil Re was the only show in town. For a multinational reinsurer to obtain any risk they either had to be a registered retrocessionaire of IRB-Brasil Re or IRB-Brasil Re needed to give their explicit written permission that such a risk/treaty could be executed between the said client/ceding company and reinsurer. There was also no official law that regulated Reinsurance. The IRB-Brasil Re's decision was the law. IRB-Brasil Re could decide to assume a share of the risk that ranged from 0 to 100 percent, e.g., for life business, the IRB-Brasil Re maintained a majority percentage of the cession, health business was retroceded 100 percent and certain special risks, e.g., petroleum companies, were given special dispensation and were allowed to work directly with foreign reinsurers.

2008 – 2010

In January, 2007 the monopolist regime was abolished with the establishment of new legislation (Law 126/07). This legislation defined the regulation of the reinsurance, retrocession and coinsurance markets and also transferred to SUSEP (Brazilian Insurance Regulator) all regulatory responsibilities formerly held by IRB-Brasil Re. According to the new legislation, reinsurers would be classified as "local," "admitted," or "occasional." Each classification requires different

levels of capital and provides access to varying percentages of ceded risks.

Specifically, the definitions of these three tiers were the following:

1. Local—have the right of refusal for at least a minimum percentage of all reinsurance cessions. During the first three years, insurance companies would have to offer local reinsurers 60 percent of their reinsurance cessions, with this requirement reducing to 40 percent after this period. These companies have to be locally established as a joint stock company with a minimum mandatory capital of BRL60 million (about USD34 million). Company is regulated by SUSEP.

Local reinsurance companies could retrocede up to 50 percent of their portfolio's premium. There was no law regarding inter-company transfers.

2. Admitted—needs to have a representative office in the country and set up an escrow account with USD5 million for all lines or USD1 million for life reinsurance only. Minimum rating of Baa3/BBB-.
3. Occasional reinsurers—do not need to set up a local office, but there is a limitation for insurance

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companies to cede only up to 10 percent of premium to them; they must have a minimum rating of Baa2/BBB.

Both the Admitted and Occasional effectively maintained 100 percent of the risk offshore with no reserves held in Brazil.

RESOLUTIONS 225 AND 232

When the market eventually opened in 2008, the reinsurance regulator (SUSEP) advised of this tiered structure, so all players choosing to enter the market would have been aware of the restrictions. However, the main reason behind the recent complaint is the fact that the Government keeps changing the rules and it always appears that the revised rules are aimed at frustrating the multinationals with the main benefactor being the state reinsurer (IRB-Brasil Re) companies made their capital allocation decisions based on the initial rules. However, the way in which regulation has been conducted just creates uncertainty. The ACLI complaints were triggered by two new rules that came into effect during 2011, namely:

225—Cession of 40 percent to Local (licensed to operate reinsurance in Brazil) reinsurers is now mandatory for all facultative and treaty business. Prior to the new resolution, any type of business had only to be “offered” to Local reinsurers but not necessarily placed with them (Formerly the local reinsurers had a right of first refusal, which if they did not exercise it, the ceding company could cede 100 percent abroad).

232—No reinsurance cessions or retrocessions will be allowed to cede more than 20 percent to any company from the same economic group, if the receiving company is located abroad. This limits cessions from any multinational insurance companies directly to their home office. (The original resolution was numbered 224 and initially forbid any inter-group cession). What is further complicating the market with this rule is “20 percent” is not clearly defined. No one knows if it is on a portfolio, line of business, or risk basis or if it is measured by premium, limits, or some other value.

SO WHY ARE ALL OF THESE CHANGES HAPPENING?

There is no doubt that the rapid decline of fortunes of IRB-Brasil Re is the main reason for the changing regulatory landscape.

The pie-charts on pgs. 24 and 25 confirm that the main share of the reinsurance market has gone to the multinational reinsurance companies who are registered as admitted or occasional. These companies are transferring risk between their locally based direct writing companies and their overseas reinsurance arms. No local company is even in the double digits regarding market share. It would appear that the objective of the regulation is to discourage the retroceding to the admitted and occasional and to insist on the formation of more local reinsurers and hence ensure that the majority of the risk is kept in Brazil. This of course defeats one of the primary functions of reinsurance which is to pool risks from many countries in one centralized location rather than maintaining reserves in every single country where it has risk exposure.

The local reinsurers include IRB Re, Munich Re, XL Re, ACE Re, Mapfre Re, Chartis Re, Austral Re and JMaluchelli. Since these controversial resolutions (224 and 232) were effected, Swiss Re, Terra Brasis and Argo Re have formally announced that they will be forming local reinsurers ... and several others are in the pipeline.

I would like to suggest that there may be four main reasons why the rules keep changing in Brazil:

1) Share ownership

Lets not forget who owns the IRB-Brasil Re. Fifty percent is owned by the Banco do Brasil, 21 percent by Bradesco, 15 percent by Itau Unibanco and the remainder by a variety others.

As of August 2011, <http://www.relbanks.com/worlds-top-banks/market-capitalization-2011> ranked the three major shareholders of the IRB-Brasil Re within the top 25 of the world’s banks by market capitalization. The

// ... THE WORLD'S EYES ARE ON BRAZIL AND FRANKLY ... THE WORLD EXPECTS MORE. //

sudden decline of premium/profits and ultimately value of their joint venture would no doubt have concerned these three financial powerhouses.

2) INdeR—Argentina

The Argentinian reinsurance market opened in the late 1980s and their state reinsurer, Argentina's Instituto Nacional de Reaseguros (IndeR), saw its final demise in 1992. The cumbersome tiered structures in Brazil seem to have had the objective of maintaining the IRB-Brasil Re as a going business concern in the face of stiff competition from the world's professional reinsurers. Recently new regulations have been passed in Argentina that copies parts of the Brazilian Reinsurance model thus making it very difficult to do business there; but this is a topic for another article.

3) Paternalistic ideology

Politically, Brazil still has very strong roots in socialist ideology and there is the belief that the primary responsibility of government is to protect the population and its resources. The political rhetoric is certainly slanted to the left and the government will always try to ensure the success of a state entity within this political environment.

4) Lack of Lobbying

As soon as the Reinsurance law was passed, the multinationals should have taken an active role in lobbying the government for a truly free and open reinsurance market. This did not happen. Instead the multinationals adopted a rather passive approach to work within the rules.

CONCLUSION

With the emergence of Brazil as the world's 6th largest economy (dethroning the UK), frenetic preparations are on the way for the 2014 World Cup and 2016 Olympics and of course the steady and sustainable projected growth of the economy; the insurance industry will undoubtedly be a direct benefactor.

The recent changes have clearly shown that the regulators/politicians have not kept up with the fact that Brazil is now considered to be an international economic powerhouse. There needs to be a paradigm shift in transitioning anachronistic state-dominated thinking to the modern reality.

The ACLI's complaint is a useful reminder that the world's eyes are on Brazil and frankly that the world expects more.

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