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Michael Witt, FSA, MAAA, is a consultant with Milliman in Williamsburg, Va. and supports Milliman's São Paulo office. He can be reached at [Michael.witt@milliman.com](mailto:Michael.witt@milliman.com).

## A Beautiful Opportunity: A Brief Overview of the Brazilian Life and Annuity Market

By Michael Witt

**B**razilians often refer to their style of playing soccer as “the beautiful game.” They play with creativity and risk taking that is unmatched by other countries and the results are indisputable. Brazil has won five World Cups, more than any other country.

In recent years, Brazilians have developed another thing of beauty, although it is nearly devoid of creativity and risk-taking. Internal management, combined with external events, have turned Brazilian life and annuity insurers into strong companies providing consistent results.

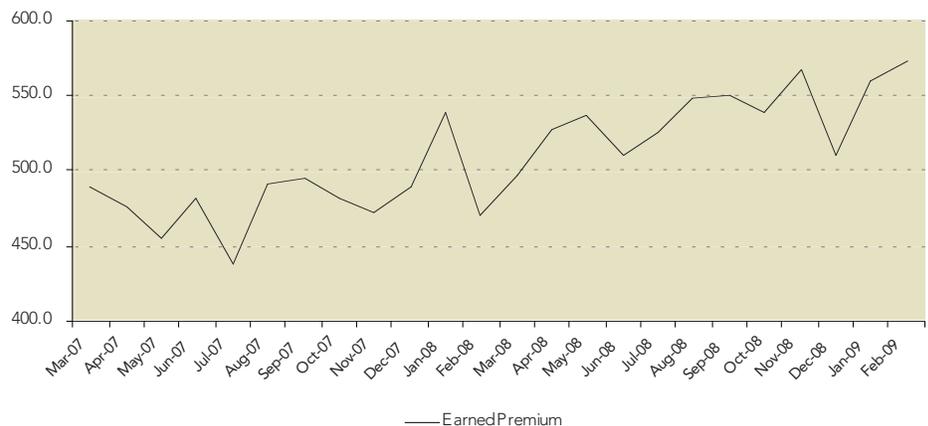
In light of the current turbulent economy, this certainly represents a beautiful opportunity for foreign companies desiring to enter and take advantage of Brazil’s growing, stable insurance market.

### LIFE INSURANCE

Life insurance products in Brazil are generally simple for the customer and carry very little mortality or investment risk for the insurer. The majority of policies sold are annually renewable term (ART) policies, so there are no long term reserves that would bring investment risk in the current economic environment. Because of strong distribution networks (generally through large banks), companies are also able to price their products conservatively. This allows insurers to withstand moderate increases in mortality.

The slowing economy seems to have had little effect on the sales of life insurance in Brazil. As can be seen in the following graph, the premium growth has trended upwards over the last two years, resulting in record profits for many companies.

**Earned Life Insurance Premium**  
(in R\$ millions)



Brazil did not always have a low-risk approach to their life insurance products. In the mid to late '90s, several companies began offering ART products where the premium was constant over time. While this product had large margins in the early years, providing large profits, the margins slowly deteriorated as policyholders aged and premiums remained level. Many of these products are already producing losses, and the products that are still profitable now are expected to produce losses in the next few years.

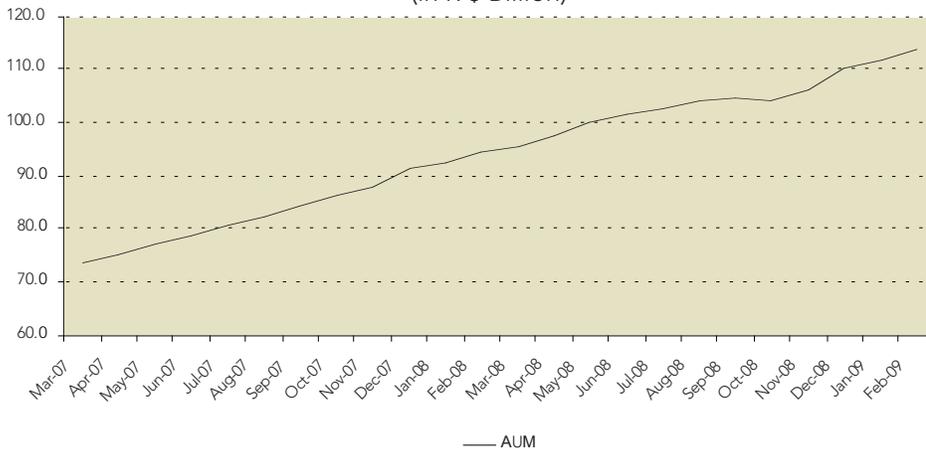
To manage these products, many companies have begun to establish reserves for the future losses and are consistently monitoring the performance of these blocks. Additionally, insurers have taken further steps to mitigate these risks. Some companies have developed new products

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and encouraged customers to replace their current policy with one of the new products. Others have changed their operational procedures, training call center representatives to not try to retain customers who want to cancel one of these policies. These management steps have generally served well to reduce the risk of the non-adjustable policies as they work themselves out of the companies' portfolios.

**Annuity Assets Under Management**  
(in R \$ Billion)



**ANNUITIES**

Annuity products in Brazil are also simple and represent little risk to the insurer. The policyholder is offered a number of funds and assumes all of the investment risk for their fund allocations. However, regulations require that the funds cannot invest more than 49 percent of their assets in equities, with the remainder of the assets invested in fixed income instruments (generally, federally issued inflation linked government bonds). In practice, the policyholders still overwhelmingly choose fixed income options, so companies have (on average) about 10 percent of their assets under management

(AUM) in equities. During the current economic crisis, insurers have benefited from the Brazilian annuity structure in two ways. First, the lack of guarantees has eliminated the market risk that is present in countries where variable annuities carry guarantees that have gone in the money under the current economic conditions. Second, the fact that the majority of funds are in fixed-income options has resulted in continued AUM growth even though the stock market has lost value. The average fund return during the last two years has stayed in the 10 to 12 percent range. This means that the fee income that is based on AUM has continued to grow throughout the economic downturn. The following graph shows the total AUM growth for the Brazilian market over the last two years.

As with the life insurance products, annuities in Brazil were not always low-risk. In the early years of the private annuity market, annuities carried rich interest guarantees, the most common of which was a guarantee of inflation plus six percent. When these products were developed in a high interest rate environment, it seemed unlikely that the guarantee would ever come into play. However, over the last five years, interest rates began to drop dramatically, and insurers were forced to make changes. First, most companies began to develop more robust asset/liability management (ALM) practices to immunize their portfolio and lock in high interest rate returns for as long as possible. Secondly, companies began aggressive campaigns to convince policyholders to replace their guaranteed annuity with a non-guaranteed annuity, usually offering some benefit if the policyholder converted. As a result of these management tactics, most of the guarantee annuities are “under control,” and are not expected to present large losses in the future.

## EXTERNAL EVENTS

In addition to the internal events that have strengthened and stabilized Brazilian insurers' profits, external events over the last two years have made it more attractive for foreign insurers to enter or expand their presence in the Brazilian market. The Brazilian real has weakened during the economic crisis, making it cheaper for foreign companies to invest in Brazil. The following graph shows the exchange rate for the U.S. dollar and the Brazilian real over the last two years.

Additionally, several foreign companies have ran into difficulties and decided to exit the Brazilian market. Last year, AIG and Tokyo Marine sold their portions of Brazilian joint ventures to their partners. It is possible that other foreign companies might look to sell their stakes in Brazilian insurers in order to raise capital, and it may be possible to acquire these stakes at below market prices.

Existing companies are generally solid, the market is stable, and currency rates are favorable, but entering the Brazilian market is not without its challenges. The market is currently dominated by insurance sold through large banks, and these banks seem to be shying away from joint ventures. So entering into this type of arrangement may be more difficult or costly than acquiring a stand-alone insurer. But the traditional distribution channels through smaller banks have eroded as these smaller banks have been acquired by the large banks. So a new entrant in the market will have to demonstrate some creativity in developing a distribution system that will allow it to penetrate the insurance market outside of bank channels.

US Dollar vs. Brazilian Real  
Exchange Rate



## CONCLUSION

The management and regulatory culture in Brazil has produced life and annuity companies that have remained extremely profitable during the current economic downturn. Current sales have continued to grow for products that represent little investment risk to the company, and risks on existing blocks of business have largely been mitigated. External events such as the weakened Brazilian real and troubled foreign owners have produced companies that can be acquired at relatively low values. It is clear that in this troubled economic environment, Brazilian life and annuity insurers represent a beautiful opportunity for foreign companies that want to enter the market. □