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Reinsurance in Brazil

by Ronald L. Poon-Affat

A common question that I am asked is why does the General and Cologne Re have an office in a country that has a closed reinsurance market? The answer is that we are anticipating the opening of what could be one of the last great opportunities in the highly competitive world of reinsurance. In addition to which, we have always liked Brazil and have maintained close contact with this market over the years.

Cologne Re signed its first Brazilian contract in 1880 and in the 1950s General Re, Citibank and Chubb got together and bought Argos Seguradora, one of the oldest companies in Brazil. General Re invested in Argos in anticipation of the opening of the reinsurance market. However, it subsequently sold its shares to its partners after accepting the fact that this opening was not about to happen. Therefore 1997 for us was our return to Brazil.

In the 1880s we were probably one of the very few to have Brazilian reinsurance treaties, but now there is lots of competition. Other reinsurers that have offices here include Gerling Re, Hannover Re, Mafre Re, Munich Re, Scor Re, Swiss Re, and Trans-atlantic Re.

The Brazilian insurance market stands at around \$US 17 billion, which is just about the size of the rest of Latin American put together. This is in spite of being a monopolistic state reinsurance company (IRB Brazil Re) being in existence for 59 years and legislation which explicitly prohibits the transaction of reinsurance with any other reinsurance company. Just for the record, only a handful of countries still have such tight controls on reinsurance—India, North Korea, Cuba and Costa Rica.

The present reinsurance premium being transacted by the state reinsurance company (IRB Brazil Ltd) is just over US\$ 1 billion but there is an active co-insurance market that accounts for an additional US\$ 1.5 billion. The fact that there was little alternative other

than the state reinsurer gave rise to a spirit of cooperation between direct writers, the likes of which I have never seen. Brazilian companies made the pragmatic decision to share both market information and premium with their competitors to limit their exposure to large individual risks.

So the present market is US\$ 2.5 billion. Is this market big enough to satisfy the appetites of all of these reinsurers who have had the foresight to establish their offices in Brazil before the opening of the market? The answer is "No." But according to a 1997 Sigma report, the insurance density (annual premium per capita) of Brazil, the 10th largest economy in the world, is US\$ 90; whereas the insurance density of Italy, the seventh largest economy in the world is US\$ 674. This simple statistic suggests that the potential is tremendous. Simply put, anyone who is serious about being a player in international reinsurance must have a presence in Brazil.

So when is the market going to open? The latest word is that it will be in June 1999. Only a few months ago, it was supposed to be March 1999. There was a bit of a scare when the second leading presidential candidate included a promise within his manifesto to desist with the privatization of the IRB Brazil Ltd. However, he was unsuccessful and President Fernando Henrique Cardoso easily won a second term during the October 1998 elections. Cardoso is committed to continue his drive to privatize the IRB Brazil Re and open the reinsurance market.

The actual date that the market will open is a moving target, but things are happening. An October 1998 IMF report regarding Brazil explicitly mentioned the forthcoming privatization of the IRB Brazil Re (always a very good sign). Earlier this year, the government formally appointed a team of local consultants to undertake a study of the privatization process (the local offices of Ernst & Yong & N.M. Rothschilds)

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6. The Education and Examination restructuring will present a number of special issues to actuarial students outside North America. We are working with the Continuing Education Coordinating Committee to assure that adequate opportunities exist for foreign students to meet these new requirements.
7. In October 1999, the 50th Anniversary meeting of the Society of Actuaries will take place. The International Section will join with all the other Sections to make this event really special.
8. We worked with the Education and Research Section to establish a teacher bank of teaching resources for actuarial programs in other countries.
9. In 2002, the next International Actuarial Association meeting will take place in Cancun. The Mexican actuarial body (CONAC) is managing that, but other North American organizations will help promote that meeting and make sure it is a success. The International Section will be involved in that activity, which has already begun.

These activities are all intended to better serve our members, both by serving their current needs, and also by helping promote the recognition of the profession and of the Society, worldwide. We will appreciate any feedback you wish to offer. Where are we succeeding? Where should we do more? And where would you like to help out? Please feel free to contact me or any of the other Section Council members with your thoughts.

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and they are already at work. The body which represents the insurance industry, Fenaseg (Federação Nacional das Empresas de Seguros Privados e de Capitalização) has already published its study on the issue, which has been very well received by the industry.

The form in which the market will be opened will be via the privatization of the IRB Brazil Re. This is presently owned 50% by the government and 50% by the insurance companies established in Brazil. But 100% of the all important voting shares are owned by the government. The reason that the local insurance companies own 50% is due to the fact that it is a mandatory requirement that all licensed insurers must be shareholders.

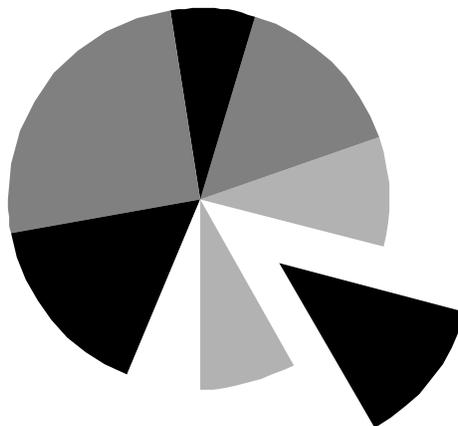
The questions which any interested buyer of the IRB Brazil Re should be concerned with are (1) what is the price, (2) the extent to which due diligence has been performed, paying particular attention to the adequacy of reserves and (3) the business environment of the market post-monopoly.

Regarding the third point, the concerns of the industry include the following:

- Will the privatized IRB Brazil Re still retain some form of compulsory cessions for a period of time?
- Will there be easy access to all foreign reinsurers and brokers? Fenaseg has suggested that there could be three categories of reinsurers: local, admitted and non-admitted. Depending on your classification there will be different tax, capital and reserving requirements,
- What will be the minimum AM Best rating in order to do business in Brazil? It has been suggested that

the minimum rating should be B+ . Interesting enough, the IRB Brazil Re presently has a rating of BB.

- What will be the financial impact of reinsurance on ceding companies' mathematical reserves and solvency margins? What allowances will be offered? It is possible that this could depend on your "classification"



Conclusion

We are quite optimistic that we will be up and running sometime next year. We are making use of this pre-privatization time to deepen our knowledge of the market, establish client relationships and build statistical databases of Brazilian experience. In addition, we are operating in a limited capacity as retrocessionaires to the IRB Brazil Re.

Finally, here are the three other questions that are often posed:

- 1) Is General & Cologne Re in association with Berkshire Hathaway going to buy the IRB Brazil Re? Admittedly there are other more interested parties, but we definitely have a keen on-going interest in the negotiations,

- 2) Has the current financial crisis affected our expectations regarding Brazil? Yes, but we feel that the overall potential of the reinsurance market has suffered only a relatively small dent.
- 3) Are the reinsurance rates going to fall when the market is open? The market has been led to believe that rates will fall; this speculation has even been quantified to be within the range of 15-20%. In all honesty, no one knows. No body of industry data exists to properly project such figures. If one compares international reinsurance rates with what the IRB Brazil charges, one will see that the Brazilian insurance market has both been over-and under-charged. As a result, rates will both rise and fall depending on the line of business.

All in all, 1999 is going to be a very interesting year.

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