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## Brazil: Reinsurance In A Closed Market

by Ronald Poon Affat

**B**razil is home to approximately 15 representative offices of international reinsurers. This article summarizes the manner in which it is possible to conduct reinsurance in a market which is effectively closed. This is a follow up article to that which was originally published in the International Section newsletter dated February 1999.



### Who are they?

The reinsurers in question are: 1) GeneralCologne Re, 2) Munich Re, 3) Swiss Re, 4) Zurich Re, 5) Mafre Re, 6) American Re, 7) ERC, 8) Transatlantic Re, 9) Scor Re, 10) Copenhagen Re, 11) Catalyst Re, 12) Sorema Re, 13) Secura Re, 14) Toa Re, 15) Gerling Re. In addition to these, there are many representatives of Reinsurance brokers such as Aon, GuyCarpenter, Jardines and Health.

### Where are they?

The vast majority are in Sao Paulo; however there are four who are based in Rio de Janeiro, and a couple have offices in both cities.

### The IRB

The Instituto de Resseguros do Brasil SA, founded in 1939, is owned 50% by the insurance companies that are licensed to do business in Brazil (non-voting shares) and the Government of Brazil (voting shares). All reinsurance business must be transacted with and via the IRB.

### What are the business opportunities?

The main business opportunity lies in the retrocession of the IRB portfolio. The

present portfolio is approximately R\$1.2 billion (US\$0.6 billion); this includes both Life & P&C business split approximately 2%/98% respectively. Thirty

percent of the IRB's total premium is retroceded to the international Reinsurance market. The IRB retroceeds whenever their own internal capacity is exceeded or when they do not have sufficient experience in the line of business.

In general, life business is reinsured by the IRB on a proportional surplus basis, and health business is reinsured on an excess loss basis.

Any premium that is retroceded to the exterior bears a 2% retrocession tax and an additional commission, which is paid to the IRB (approx. 5%). If the IRB decides to take a proportional percentage of the risk in a particular contract, then the taxes and commission are only applicable to the amount which is not retained by the IRB.

For example, if the reinsurance net risk premium (excluding the IRB commission & retrocession taxes) is R\$10 million, and the IRB's retention is 25%, the final gross reinsurance premium, which includes the IRB commission (5% say) and retrocession tax (2%), will be  $R\$7.5 * (1.07) + R\$2.5 = R\$10.525$  million.

### Currency of transaction: Brazilian Real R\$2 = U.S.\$1

Depending on the risk, the original risk may be denominated in R\$ (e.g., life and

health) or U.S.\$ (e.g. aviation). Let's consider the case of life & health. The original risks are in R\$, the client pays R\$ to the IRB, the IRB may decide to accept a percentage of the risk, that part which is retroceded to the exterior is converted to U.S.\$ (using a floating rate of exchange). Any future claims that arise (in this case it will be in R\$) are converted to U.S.\$. This amount is paid to the IRB who then converts it to R\$. Therefore, if the R\$ devalues against the U.S.\$ during the term of the contract, then the external reinsurer receives an additional margin. If the R\$ strengthens against the U.S.\$, the external reinsurer receives a financial loss.

### Opening an account with the IRB

In order to work with the IRB, a reinsurer must visit the IRB, present its financials, and enter a formal request of its intention to work in the Brazilian market. If the reinsurer's petition is successful, the IRB will formally advise the Reinsurer that its request has been successful and will then ask it to indicate an "assigned foreign account" via which all future transactions will be made. There is no need to establish minimum deposit within this assigned foreign account.

Let's consider the scenario where the IRB has a small percentage of a particular risk. In the event of a claim, the IRB will include a clause in the slip/treaty advising that claims will only be paid (to the local Brazilian insurance company) when the foreign reinsurer has transferred the necessary funds into the assigned foreign account.

If the IRB has a majority stake in a particular risk, then in the event of a claim, the IRB may pay the entire claim and then will ask the foreign reinsurer to then transfer the necessary funds into the assigned foreign account. This process really depends on the relationship that the

IRB has with its Brazilian client and the foreign reinsurer.

### ***How does one do business on a direct basis?***

Reinsurers are very busy visiting potential clients. If a Brazilian client decides that it would like to place a health risk (say) with a foreign reinsurer, the procedure is as follows. The foreign reinsurer and the local Brazilian insurance company exchange data, terms, and conditions and arrive at a price. The local Brazilian insurance company must then advise the IRB of the details of the risk and its desire to place the risk with the foreign reinsurance partner. The IRB may decide to:

- 1) Accept the entire risk itself
- 2) Place the risk 100% with the foreign reinsurer
- 3) Ask various reinsurers to quote on the risk and then divide the risk between several reinsurers, which may or may not include the indicated foreign reinsurer
- 4) Share the risk between itself and the indicated reinsurer, or
- 5) Any permutation or combination of these options

The final arrangement between the IRB and the foreign reinsurer

will be based on the IRB's relationship with the foreign reinsurer, the perceived quality of the underwriting, the suggested price and the perceived relationship between the local Brazilian insurance company and the foreign reinsurer.

In the case of the recent Petrobras disaster involving the P-36 offshore

platform, the IRB placed 100% of the risk with foreign reinsurers.

At the same time, the external reinsurer should visit the IRB's retrocession department and advise of its desire to accept the risk. If the reinsurance is transacted on a direct basis, the risk transfer is as follows: 1) The direct writer that assumes the original risk passes it on to 2) the Brazilian insurance company, who then passes it on to the 3) IRB, who finally passes it on to the 4) foreign reinsurer.

If a reinsurance broker is involved, the risk transfer is as follows: 1) the direct writer assumes the original risk, the risk is then passed on to 2) the Brazilian insurance company, who then passes it on to 3) the IRB, who passes the risk on to 4) the reinsurance broker, who finally passes it onto 5) the foreign reinsurer. The reinsurer will bear the credit risk in the event that the reinsurer broker defaults in paying the reinsurer.

### ***Health Reinsurance***

The IRB is authorized to accept reinsurance only from registered insurance companies. Therefore, if a health risk is originating from a non-Insurance company (e.g., self-administered plan (autogestão), HMO (Medicina de Grupo),

the Association of Insurance Companies involved in the risk, a fronting insurance company may carry no risk whatsoever, but this may soon change.

There were two previous articles published by the *International Section News* newsletter dated June and September 1998 which discussed the Brazilian health market.

### ***When will the IRB be privatized?***

We really cannot say. The general consensus is that it will be later this year. In

as few words as possible, the situation is as follows: The sale of the IRB was approved by means of a Presidential Decree (Medida Provisória), however at the 11<sup>th</sup> hour, the Opposition Party (PT, Partido dos Trabalhadores) filed an injunction saying that the sale procedure of the IRB was set out in the Constitution of Brazil and required a Congressional Act (Lei Complementar) to approve the sale. Such a Congressional Act would need to be presented to the Senate and receive a two-thirds majority. The Supreme Court has gotten involved, and they must decide whether the Presidential Decree can indeed be applied to determine the sale procedure of the IRB. The Supreme Court was supposed to meet during the first three months of 2001 to make its decision. We understand that the IRB decision is still very high on the Supreme Court's agenda, but a hearing date has not been announced as yet.

### ***Web sites***

IRB's Web site:

<http://www.irb-brasilre.com.br>

Society of Actuaries Brazilian Web site:

<http://www.soa.org/links/brazil.html>

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