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The Opening Up of the Brazilian Reinsurance Market

by **Eliana Maria Filippozzi**,

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This year is a very important time for the insurance and reinsurance market in Brazil. After sixty eight years of reinsurance monopoly of the Brazilian Reinsurance Institute (“IRB”), and more than ten years from the initial steps being taken to open up the market, 2008 finally brings in the new rules that enable the effective opening up of the reinsurance market. As initially triggered by Complementary Law n. 126, published in the Official Gazette on 16 January 2007 and after submitting the draft regulation for the new Brazilian reinsurance market to public consultation,¹ the National Council of Private Insurance (“CNSP”), enacted the Resolution n. 168 on 17 December 2007. Resolution CNSP n. 168/07 will be in force as of 17 April 2008 (120 days after its publication, which took place on 19 December 2007). However, reinsurers interested in applying for authorisations to operate in Brazil can do so at any time after the publication of Resolution 168/07 on 19 December 2007.

The new legal framework is of a paramount importance in view of the fact that the Brazilian domestic capacity is far inferior to the huge domestic insurance demands. This is even aggravated by the fact that surety bonds, and other products which are

¹ The players of the insurance and reinsurance Brazilian market were able to provide their comments and suggestions in order to bring technicality and reality closer.

A complete list of partners is available upon request from any of the offices above.

indispensable for project financings, are classified as insurance in Brazil and thus so far subject to the limitations caused by the reinsurance monopoly.

Therefore, foreign reinsurance is vital for the Brazilian sustainable growth, but it is also necessary to ensure that foreign reinsurers, who are not subject to Brazilian legislation, comply with their obligations to Brazilian insurance companies. It is now possible to address all these matters in an efficient manner and some market players estimate that the Brazilian reinsurance market will increase to US\$ 5 billion per year, whereas the present turnover of IRB is approximately US\$ 1, 6 Billion.

Before the effective opening up of the reinsurance market, the Superintendence of Private Insurance (“SUSEP”) needed to adapt itself to the changed environment by making several new regulations in the insurance market in order to prevent the insolvency of insurance companies, as was the case in Argentina, for example. The most important change was the method used to calculate the solvency. This is the insurance company’s capacity to meet their future commitments. From now on this will be stipulated on the basis of the risk taken by the company, whereas before it was based on the total volume of its sales. Therefore, for each type of risk one part of the company’s assets will be earmarked.

These new steps will help Brazil’s insurance and reinsurance market to have a more effective and integral involvement in the Gross National Product (“PIB”).

General Provisions of Complementary Law 126/07 and Resolution CNSP n. 168/07

All of the original regulatory and monitoring responsibilities initially vested in the IRB are now being transferred to the CNSP and SUSEP. IRB therefore will, from now on, not dictate the reinsurance market; instead it will be a player in this market.

Reinsurance (defined as the assignment of risks from one assignor to a reinsurer) and retrocession (defined as the assignment of reinsurance risks from reinsurers to other reinsurers or insurance companies established in Brazil) can be carried out by the following types of reinsurers:

(i) a “local reinsurer”, defined as being a reinsurance company constituted and organised in Brazil as a company by shares, with the sole purpose of operating with

reinsurance and retrocession and duly authorised by SUSEP. Accordingly, IRB is now defined as a local reinsurer;²

(ii) an “admitted reinsurer”, defined as being a company with headquarters overseas; with a representative office in Brazil; complying with the applicable rules and registered with SUSEP for operating with reinsurance and retrocession as an “admitted reinsurer”; or

(iii) an “occasional reinsurer”, defined as being a company with headquarters overseas (provided that they are not located in jurisdictions with income tax at a rate lower than 20% or in jurisdictions imposing secrecy as to the identity of their shareholders); without a representative office in Brazil; complying with the applicable rules and registered with SUSEP for operating with reinsurance and retrocession as an “occasional reinsurer”.

Reinsurance contracts shall comply with the provisions contained in the Resolution CNSP 168/07. Reinsurance relating to risks in Brazil is subject to Brazilian law as well as to the jurisdiction of Brazilian courts or arbitration in accordance with the prevailing Brazilian law on arbitration.

Local insurance companies and local reinsurers shall not assign, respectively in reinsurance and retrocession, more than fifty per cent of the *premia* of all their underwritten risks in each calendar year. However, this restriction does not apply to performance bonds; or insurance of export financing; or rural insurance; or insurance of domestic financing.

Reinsurance relating to life and private pension shall be exclusively carried out by local reinsurers. This restriction does not apply, however, to insurance of risks of individuals, existing or commercialised together with plans of life insurance for survival or pension plans.

² Local reinsurers are subject, “*mutatis mutandi*”, to the rules applicable to local insurance companies. Local reinsurers must comply with all CNSP rules relating to establishment requirements and procedures, operating authorisation, transfer of controlling shares, relocating of shares, operating authorization annulment, and nomination and election of members of statutory bodies of corporations supervised by SUSEP. Local reinsurers are also subject to the following CNSP Resolutions, all issued on 17 December 2007 and published in the official gazette on 19 December 2007: 169 and 170 (minimum capital requirement); 171 (technical reserves); and 172 (limits of retention).

For a transitional period, which expires on 16 January 2010, “local (authorised) reinsurers” will have preference over foreign reinsurers offering the same conditions in relation to sixty percent of the total reinsurance being offered by an insurance company in relation to risks in Brazil. After the initial period of three years, the preferential treatment will be lowered to forty percent of reinsurance amounts transacted in Brazil.

IRB has 180 (One hundred and eighty) days from 17 April 2008 to adjust to the new regulations.

Lloyd’s is entitled to apply to become an “admitted reinsurer”, provided that it meets all the applicable requirements and presents a list of syndicates and members authorised to operate in Brazil, updating such a list annually. All members of Lloyd’s authorised to operate in Brazil will be considered as just one entity and Lloyd’s will be responsible for keeping and allocating funds of its members on a fiduciary basis, ensuring the solvency of the members.

Insurance, reinsurance and/ or retrocession may be contracted in foreign currency in Brazil, subject to the rules to be enacted by the National Monetary Council (“NMC”), in the following situations: (a) if the insurance has been contracted in foreign currency in Brazil³; (b) if the reinsurance or retrocession of risks is accepted abroad; or (c) when the majority of the reinsurers participating are foreign reinsurers, in this case, exclusively for non proportional reinsurance.

The NMC shall regulate bank accounts maintained in foreign currency to be kept by local insurance and reinsurance companies, by foreign reinsurers registered with SUSEP and by insurance brokers.

Mandatory insurance, as well as non-mandatory insurance contracted by individuals resident in Brazil, or by legal entities located in Brazil, insuring risks located in Brazil, must be contracted in Brazil.

Contracting insurance abroad by Brazilian residents or legal entities with headquarters in Brazil are only authorised in the following situations:

³ Placement of insurance in foreign currency in Brazil and placement of insurance of Brazilian risk abroad must comply strictly with the terms of the Resolution CNSP 165 of 17 July 2007.

- (i) when the insurance in question is not available in Brazil and not contrary to the Brazilian legislation;
- (ii) when the insurance in question covers risks located abroad for individuals, provided that the insurance is valid only during the period of their stay abroad;
- (iii) when the insurance in question is the object of an international agreement ratified by the Brazilian Congress;
- (iv) when the was legally contracted prior to 16 January 2007; and
- (v) when the insurance covers the risk located overseas of legal entities located in Brazil.

Main Requirements Applicable to “Admitted Reinsurers” or “Occasional Reinsurers”

For reinsurers to be authorized as “admitted reinsurers” or “occasional reinsurer”, requirements to be met include:

- (i) they must be duly authorised, in accordance with the rules applicable within their home jurisdiction, to underwrite domestic and international reinsurance in the sectors they intend to operate in Brazil, they should have commenced those operations more than five years prior to their application in Brazil and they must be complying with the solvency ratio imposed by the monitoring authorities in their home jurisdictions;
- (ii) their financial and economic capacity must not be lower than the minimum requirement established by CNSP/SUSEP that is of: (a) not less than US\$ 100,000,000.00 (One hundred million American dollars) for “admitted reinsurer” and (b) not less than US\$ 150,000,000,00 (One hundred and fifty million American dollars for “occasional reinsurer”;

(iii) they shall maintain, at least, the minimum rating established by CNSP/SUSEP relative to their capacity to pay risk on claims, with such rating to be granted by rating agencies, as follows:

“Admitted Reinsurer”

Rating Agencies	Minimum
Standard & Poors	BBB-
Fitch	BBB-
Moody’s	Baa3
AM Best	B+

“Occasional Reinsurer”

Rating Agencies	Minimum
Standard & Poors	BBB
Fitch	BBB
Moody’s	Baa2
AM Best	B++

(iv) they shall maintain an attorney-in-fact resident in Brazil with powers to receive service of process and notifications in Brazil.

Additionally, “admitted reinsurers” must, amongst other things:

(v) maintain, as collateral for their operations in Brazil, a minimum deposit in a bank account in foreign currency (linked to SUSEP) with a bank authorised to deal with exchanges in Brazil, of (a) US\$ 5,000,000.00 (Five million American dollars) for reinsurers operating in all lines of business and (b) US\$ 1,000,000.00 (One million American dollars) for reinsurers acting in personal insurance; and

(vi) provide SUSEP annually with copies of their fiscal year balance sheets and financial statements.

Conclusion

The potential for growth of the Brazilian insurance and reinsurance market does not have any precedents. Global companies now operating in Brazil will be able to buy reinsurance locally without the restrictions and limited options which were offered by the IRB.

The new legislation and rules attempt to ensure the export of the risk located in Brazil, as well as to submit the local market to international insurance standards, and enhance the terms of coverage.

It appears to be a small change but, it is not. The whole insurance market will have to deal with changes to its daily routine, such as risk control, improvement on the risk analysis and the increase role of the actuary's expertise as well as the emergence of several insurance companies' IPO's in order to increase their share in the market. But the overall capacity of the market will be much higher. For all those interested in this market, the work has just begun. This is good news at last!