



A report based on the the international  
conference convened by CEBRI  
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# BRAZIL'S

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IN A MORE CHALLENGING GLOBAL  
ECONOMIC ENVIRONMENT:  
**TOWARDS SUSTAINABLE  
AND LONG TERM POLICIES**

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# RISK

# EXPOSURE

The present report is a direct product from the International Conference “Brazil’s Risk Exposure in a More Challenging Global Economic Environment: Towards sustainable and long term policies” convened by the Brazilian Center for International Relations (CEBRI). It proposed a discussion on the current Brazilian market and analysed how the domestic reinsurance framework presents a great challenge and also opportunity.



## Introduction

In recent times, Brazil has been passing through a process of evaluation as it is set to host major international events, mostly sportive ones, in the next few years. Due to the realization of extensive infrastructure work, occurrence of natural disasters and existence of nuclear power plants, the debate surrounding the reinsurance topic has been growing.

The main reason for this debate growth is that, after seventy years of monopoly in the country, under the aegis of IRB (Brazilian Institute of Reinsurance), a joint capital company, the reinsurance market is now open, due to the effect of the complementary Law nº 126, of 15/01/2007, that authorized private companies to act on national reinsurance sector, in equal conditions to the IRB (now called "IRB - Brasil Resseguros S.A.").

However, passing approximately 4 years of the sector market opening, relevant interventions on the Brazilian regulation structure relight the discussion over the course of the topic. Even if there is no room for doubt regarding the benefits harvested as effect of the changes occurred in 2007 or the significant capacity of the market growth, it is undeniable the necessity of adjusts, with especial attention not only to the legislative field, but also to the very own adequacy of professionals that will act in this field in Brazil.

Thus, to reflect upon the current scenario and analyze the national market of reinsurance presents itself as a great challenge and an opportunity. Moreover, the Brazilian Center for International Relations (CEBRI) held on November 11, 2013, in Rio de Janeiro, the international conference "Brazil's Exposure Risk in a More Challenging Global Economic Environment: Towards sustainable and long term policies".

The event aimed to discuss the current situation of the reinsurance market in the country, taking as a starting point the end of the monopoly of IRB in 2007, and the recent resolutions issued by the National Council of Private Insurance (CNSP) - In 2011, the reinsurance market, which was internationalized four years before, became restricted to foreign companies.

Opportunities in the public and private perspectives for the reinsurance sector were discussed, outlining the key challenges and charting a diagnosis to overcome them in order to create a more reliable and competitive market, through two following lines of discussion: A) prospects of public and private sector on reinsurance; B) challenges for a competitive and reliable market.

## About the Reinsurance

Despite of not being exactly a recent activity, the figure of reinsurance still casts doubt



amongst the general public – that usually can't differ them of the widely known activity of insurance. As a brief explanation, we can say that reinsurance is the operation that consists in the transference, from an insurer to another, of a risk considered to be excessive, passing to the other party the said responsibility – and thus, the received prize.

Technically, reinsurance is a contract that has the objective of maintaining the solvency of insurers' through the dilution of the risk. That occurs whenever there is a too high accident probability – like the occurrence of great tragedies – or under the influence of contractual determination or regulator. For this purpose, reinsurance companies dispose of operational retrocession that allows the assignment of the prize and the sharing of the risk.

There is a multitude of classifications for the juridical nature of the reinsurance, ranging according to the evolution of the institute; the more important ones are those who face the reinsurance as a) a guarantee agreement; b) A form of association; c) an insurance agreement and d) an chain contract.

## The History of the Reinsurance Market in Brazil

In Brazil, the evolution of the reinsurance market went according to the historical context. Initially – during the period between 1901 and the 1930s – the document that regulated this activity was the Murinho

Regulation (Decree n. 4,270, of December 10, 1901), which the purpose was to establish some control over the market security. Since it was published in a scenario of expansion of the navigation routes with Europe and Brazilian dependency of Great Britain concerning structural issues, the regulation did not represent restrictions to the foreign companies activities in the country; thus, its higher capacity of risk absorption resulted in the dominance of the national market.

In the 1930s a new reality was presented, as a result of both the country's economic scenario – a significant exporter of primary goods- and the political context of the decade. The necessity of increase the capacity of the Insurance companies in the national market, with a larger retention of business for the internal economy, motivated the creation of an specific entity; In 1932 the Instituto de Resseguros do Brasil (IRB – as it was established in 1940) was born. The institute had as an agenda the protection of the Brazilian market from the presence, so far very dominating, of foreign companies and, as an operational challenge, the regulation of the reinsurance and promotion of insurance operations in general.

However, through the years this monopoly models revealed to be weakened and insufficient once it did not attend to the necessities of the market and at the same time exceeded its ordinary functions. In this sense, during the 60s, new institutions diluted of IRB: the National Council of Private



Insurance (CNSP), with the function to regulate de Insurance activities, and the Superintendence of Private Insurances (SUSEP) with a surveillance function.

This moment of Market reaction, developed both by political actions and national economic performance, found impediment to climbing inflation, a marking characteristic of the 80s. In this context, the Insurance activity began to be used an instrument of fund-raising that allowed financial wins.

In the 90s the IRB was facing negative results and a result, in the context of privatizations of the time, initiated its most sensitive reform. The Constitutional Amendment Number 13, which amended Article 192, item II of the Federal Constitution by deleting the expression "reinsurer official organ", determined the decline of the state monopoly. Subsequently, the Provisional Measure number 1578, converted into Law n. 9.482/97, the IRB became a society of shares named IRB - Brazil Reinsurance S/A.

Still in 1997, the year of legislative innovations referred above, the IRB was included in the "National Privatization Program" (Decree n. 2.423/97). Of course it wasn't just a coincidence – there were a series of elements that determined this path. Amongst then, we can highlight the consolidation of the Reinsurance market and the overcoming of the state monopoly and the privatization of the organization, In practical terms it meant the actual opening of

the market which started in 2000 – by the advent of an Ordinary Law, object of an direct action of unconstitutionality lawsuit (b. 2223 - founded no place in the normative type adopted) – and was completed only in January 2007.

## The Opening of the Brazilian Market

Until 2006 Brazil was one of the few countries in the world that still had Reinsurance activities under State monopoly – held by IRB. With the advent of Complementary Law 126 (January 15, 2007) and Resolution 168 SUSEP (17 December 2007), was promoted to the opening of the Brazilian reinsurance market, admitting even the operation of foreign reinsurers. Both the legal instruments intended to increase the capacity of Insurance companies to concede insurance internally, which inevitably generated expectations for new products and external resources. With this action, IRB became to be part of the economic structure where it competes with other reinsurers entities, both domestic and foreign.

The LC 126/2007 and Resolution 168 of SUSEP determined important changes in the Brazilian regulatory framework. Not only promoted the opening of reinsurances and allowed the activities of foreign reinsurers in Brazil, but also established rules to guide this



activity. Thus, foreign reinsurance companies can operate in the country under two names: "Allowed" or "Eventual" reinsurers.

"Allowed" reinsurers are the ones foreign based but with a physical office in Brazil. "Eventual" reinsurers, on other hand, are foreign companies based outside Brazil, without a representative office in the country, but that obtained a registration with SUSEP to perform reinsurance and retrocession operations. In this last case, however, register is forbidden in SUSEP to eventual reinsurers that are based in tax havens. Nevertheless, it is allowed in this case that foreign companies of reinsurance act in Brazil through subsidiaries – in this scenario, those subsidiaries are considered local reinsurance companies, Brazil-based, constituted in the form of S/A, with the sole purpose to carry out reinsurance and retrocession operations.

What differs local reinsurers – Brazilian companies – from foreign ones - "allowed" or "eventual"- is the right of preference for the reinsurance subscription. This is because the LC 126/2007 provides that the first three (3) years after its entry in the market local reinsurers have priority to subscribe for 60% (sixty percent) of reinsurance operations in the country. After this period, this percentage drops to 40% (forty) of contracted reinsurances. Other exclusivity of the local reinsurance companies it's the risk subscription that come from life insurances and private pension plans.

Since the advent of those legislative innovation what was observed was the constitution of Brazilian reinsurance companies as well as well as the entry of foreign companies in this market, dismantling an market that once were an monopoly.

## Restriction of Brazilian Market

In favor of the mentioned end of monopoly and the consolidation of a national market, new measures befallen: The National Council of Private Insurance (CNSP) issued a series of resolutions in that sense, among which are: a) CNSP Resolution 224/2010 - prohibits the transfer of reinsurance contracts between companies of the same group, b) CNSP Resolution 225/2010 - requires that 40% (forty percent) of the contract must be placed with local reinsurance companies, i.e. established as open companies in the country.

The market reaction was immediate. The criticisms were that, beside those actions being restrictive to the sector and a step back in the opening of the market, Resolutions 225 and 232 supposedly were written, breaking a tradition without prior discussion by all participants. Thus, the imposed restrictions in 2011 by the CNSP to the participation of the participation of foreign reinsurance companies to the national market are in current process of governmental review. Various representatives' entities from the national and foreign insurance companies



have already sent their bids for new legal formats.

We can observe that the adequacy of the market to the new resolutions has been continuously postponed. Besides that, those much criticized measures already passed to a softening process. After complaints, CNSP revoked Resolution 224/2010 and issued Resolution 232/2011, which limits the reinsurance and retrocession transactions between companies of the same group - referred to as intra-group transactions - 20% (twenty percent) of the contracted coverage corresponding to each prize. Reinsurance contracts belonging for holdings of insurers could be automatically renewed until March 31, 2012. The optional reinsurance, generally related matters of big risks would have to respect the 40% rule. However, the biggest share lies in the form of a contract backlog.

Despite of the fears expressed by the market as it faced the imposed restrictions; there isn't so far a cooling off of the boom experienced by the segment since the breakdown of the state monopoly. Nowadays, Brazil is one of the few large scale countries that are able to coordinate a vast investment program in infrastructure: it is economically stabilized, stable um fiscal terms and do not share the traumas of the debit crisis of the European continent.

## Perspectives

Facing the possibility of the Reinsurance market to double its size in 2 or 3 years and demonstrating to have an aligned thought with Brazil's reinsurance market tendencies – the transfer of the activity to the private sector, while the state remains being responsible to its regulation and supervision – the Brazilian Centre of International Relations (CEBRI) organized, in 11 November of 2012, in the city of Rio de Janeiro, an international conference titled “Brazil's Risk Exposure in a More Challenging Global Economic Environment: Towards sustainable and long term policies”. The event aggregated public and private specialists in the reinsurance sector in order to outline the main challenges and chart a diagnosis to overcome them in order to create a more reliable and competitive market.

*[...] Facing the possibility of the Reinsurance market to double its size in 2 or 3 years and demonstrating to have an aligned thought with Brazil's reinsurance market tendencies [...]*

The debates were oriented by two main cores, organized by the following panels: 1) Public and Private Perspectives of the Reinsurance Sector; e 2) Challenges for a Credible and Competitive Market. The first one raised questions as what is current scenario of the reinsurance sector and which are its perspectives?; Is the country apt to absolve the associated costs of great



projects and/or catastrophes? Is Brazil isolating itself in the process of dealing with catastrophes/crisis as opposed to other countries? The following panel focused on problematic topics as the legal perspectives of the internalization of the reinsurance sector, how to understand the logic behind the sector changes, and which is the script to surpass the challenges of the market.

During the first panel it was asserted that the Brazilian risk exposure is inserted in a general manner in the international market, due to the reinsurance activity being already very integrated globally. In that sense, it's pretty unusual to find an exclusively local reinsurance market.

Besides that, it was observed that "Germany's biggest industrial city is not in Germany but in São Paulo", considering that much of the exposures of global companies is currently in Brazil. On the other hand, there are already Brazilian companies that operate in diverse countries and have meaningful assets abroad and seek to be insured.

Also, it was highlighted that it is visible a great effort and investment from national companies to create a Latin America Market hub in Brazil. This effectuation is tied to our ability to retain and work with our optimized arrays capital, subject to the Market reserves.

Still during the panel, results were presented from a recent research carried on by KPMG. The research reveals the appearance of other players in the market, finding that there was a great movement of new entrants (by late 2012 they were authorized by SUSEP 106 and 36, reinsurers and reinsurance companies respectively). In the same way that the number of entities raised, also did the number of business deals: after five years the reinsurance market have grown over 196%, while the insurance market got 177% bigger in the same period.

According to KPMG specialists, there is a series of market achievements that can be taken on account: Significant increase of market regulation (until June of 2013, twenty - 20- CNSP's resolutions and six - 6 - SUSEP's memos were issued); The reduction on the market concentration (big reinsurance companies are not necessarily the leader in the purchase of prizes in the insurance market); the consistent raise of the market (that have grown around 14% per year, the prognostic is to keep growing until it reaches 25%, surpassing the countries development standards). Generally speaking, insurers and reinsurers have become more profitable those past few years as well as they became solvents.



On the other hand, a scathing challenge was called upon attention: the holding of risks in Brazil did not follow the growing of the market; the limitation between groups' results in the generation of new ways to companies to assign those risks to their respective parent companies. The sector regulation do not creates a stable environment, the current established scenario made itself hard to validate operations, what may cause a systemic risk. The most expressive challenge identified by the ones interviewed for the research was related to the professional formation of insurers and reinsurers: it was an consensus that the labor force in the country wasn't at the same level as the one the market needs and that the training and capacitation of teams should be focused, as well as systemic solutions to optimize it's processes.

It was also discussed the opening of Brazilian market of reinsurance. In this case, it was argued that the opening was opted to be as complete as possible. However, as the International crisis developed, it has been found that the reallocation of the prizes to outside of the country was way too quick , what might have damaged the development of the reinsurance market in brazil and placed national reinsurances in disadvantage. That would have been the alleged reason that the government used to take a step back, restricting the opening of the market.

Still, despite of government adjusts, some bad practices were identified right after the

opening – like the remittance of profits abroad under the guise of insurance - the time shows the success of the measure: it has not prevented the entry of new reinsurers in Brazil; there was retention of expertise in the country, taxes and jobs.

Regarding the market performance ever since, it is believed that the growth of the reinsurance sector in Brazil has not resulted in an increase in prices, and the large number of investments that Brazil is facing (the bulk of them being connected to the Pre-Salt) will require much insurance and reinsurance protection. Also, it was argued that with the rise of some millions of Brazilians to the middle class, the need for new products in the insurance market will occur.

In terms of challenges, it was pointed out that topics like margins, profitability, capital formation and future claims are concerns worldwide. With regard to Brazil specifically, it was argued that perhaps too many people already have entered in the market, so the growth of local reinsurers could shift global reinsurers, due to the reduction in profitability.

Another important topic discussed was the recent creation of the Brazilian Agency for Guaranteeing Management Funds and Guarantees (ABGF). In this sense, it was debated the competence of the Agency. in essence, their activity would mitigate market failures (is a state owned company, not a regulatory agency), with the function to support investment projects in infrastructure at this early stage. It was stressed that the



activity of ABGF not necessarily mix with the surety bond – in highway concessions , for example, one of its main scopes, the ABGF guarantees the so called unmanageable insurances (controllable costs are already guaranteed by the market). Thus, the fundamental function of ABGF is to be a complementary to the market, as a partner, and not dispute it.

Regarding the reinsurer environment, apparently, Brazil would be fully prepared to absorb the insurgents business but a simplification of processes, claims handling and cleaned / automated and qualification of workforce are essential prerequisites.

The last of the first panel discussion addressed the vision of international reinsurers. About the benefits of global reinsurance group, it was stated that it increases the ability of insurers to reduces the risk of the ceding, diversifies the risk of reinsurers and that after a disaster, the foreign capital that enters helps rehabilitate the domestic economy. Regarding the coalition of reinsurers, it is pointed out that it allows for diversification of portfolio risk, increases the ability to absorb other risks, optimizes asset management and retrocession, among others.

The second panel began with a brief recapitulation of the first, therefore, it was identified that two themes were perennial in any discussion until that time: a regulatory issue and the issue of human capital formation.

Following the second panel, it was discussed that a possible reason for the current interest of the Brazilian government for the subject of reinsurance derives from the enormous importance of the financial sector has to the development of a country (and this includes insurance). It was pointed that factors for growth of the insurance market were economic growth, institutional credibility and government intervention.

In this case, access to international markets, in the case of reinsurance, not only has the function of reducing costs, by pooling risks, as also to enable innovation / generation of new products. Also, it was considered that, although it has undergone significant growth, spending in Brazil with insurance is low compared to other countries, and it has a lot of potential to be developed.

In this occasion, three points that draw attention in the discussions were presented: a) why the reinsurance market is not well developed in Brazil, even after seven years of market opening, b) limitations on intergroup practices – are we trying to resolve a problem with the incorrect tools?; c) creation of ABGF - the rules are helping or hindering the development?

Also in the second panel it was reasoned that there is a general mistaken impression that the Brazilian market would be small, with opportunities to grow, but a broader view allows us to foresee that there is some difficulty in penetrating the private sector in



some areas, considering the existence of a range of activities that serve the population and remain in the realm of the public sector.

*[...] our biggest challenge today is the “second takeoff” the country toward modernity, globalization and the distribution of the national product [...]*

Still on the matter of reinsurance in Brazil, it was examined that the challenge is an institutional one: There are three (3) agencies, operating under three (3) ministries, with little integration between them - which complicates the launch of integrated products. On the recent legislative changes implemented in Brazil, one has to suppose that they do not seem to be understood even by consumers or by the government.

By last, the process of social inclusion that pervades Brazil was discussed: it was argued that there is now a structure of power / desire for products that is totally different from ten years ago. It was explained also that there was a significant change due to demographic matters: active seniors in the society, greater female empowerment, increasingly urban population. For all that, there is an opportunity to market insurance and reinsurance to launch new products for the new middle class (“class C”).

The closing speech was given by Marcílio Marques Moreira, Former Minister of Finance and Ambassador of Brazil in the United

States, which stated that our biggest challenge today is the “second takeoff” the country toward modernity, globalization and the distribution of the national product. Although it's a long way, he said that he remains optimistic in view of the competitiveness of our agribusiness, despite of logistical shortcomings.

The minister pointed out the existence of two realities: a) Brazil has faced many crises and eventually learned to deal with them, but this is not true when it comes to taking chances b) the country do not see itself as threatened by any economic, social or political catastrophe: Our biggest risk is that we remain resigned with a low rise and a slow improvement, and only find the solution when it's too late.

Luiz Augusto de Castro Neves, Chairman of the Board of the Brazilian Center for International Relations (CEBRI) concluded that the Brazilian economy is, nowadays, much more complex and diverse, and as a result, not only the challenge but the risks as well. Castro Neves leaves open a question: how do we deal with this risk exposure of Brazil that is constantly growing, and face regulatory problems, qualification problems, among others?

## Final Remarks

In the wake of the discussions reported above, one can understand that the dismantling of the reinsurance market, given

the recent legislative changes in Brazil, although seen as a positive step - after all, it is more attractive to insurers have access to reinsurance with various reinsurers, stimulating competition between them and developing a more stable long-term relationship - caused huge controversy when the government imposed market reserves to local reinsurers in order to encourage the domestic market.

After two years, however, the decision showed results: the number of local reinsurers doubled. That is, despite the criticism, there was great interest from new companies. Besides encouraging the local market, the obligation to put the risks in local companies ended up correcting a distortion that was in the market: prior to the change, local reinsurers had preference in placement (i.e., insurers had to submit the risk for quotation by sites, but was required to close the deal with them). With this, many admitted reinsurers and any worked as local in practice, but did not bring capital into the country.

What we can look forward in a few years, is the actions national association of businesses, not only among themselves and with large foreign reinsurers. We still await the definitive entry of multinational companies, consolidating a new reality of reinsurance. The development of the reinsurance market should also promote growth in the supply of products and competitiveness, leading to reduced prices for consumers.



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## About CEBRI

The Brazilian Center for International Relations (CEBRI) is a civil society organization of public interest. It is widely recognized for the studies and debates of crucial themes relating to Brazilian foreign policy and international relations. Created in 1998, CEBRI has become one of Brazil's top think tanks on international issues and, since its foundation, has developed projects and initiatives with renowned institutions, such as: the Inter-American Development Bank (IDB), the Ford Foundation, Konrad Adenauer Foundation (KAS), the UK Department for International Development (DFID), the Swiss Agency for Development and Cooperation (SDC), the Council of the Americas, the Centre for International Governance Innovation (CIGI), the International Development Research Centre (IDRC), Chatham House, among others.







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