Brazil: Latin America's Largest Insurance Market Slows with Global Economic Downturn, But Continues to Grow with Positive Signs for the Future

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Brazil is by far the largest insurance market in Latin America, representing more than 40% of the gross written premiums in the region. Brazil also has the largest population in South America, the 10th largest economy in the world by GDP and a low insurance penetration rate. These factors indicate that, despite the relatively impressive size of the Brazilian insurance market, it still has tremendous growth potential, estimated by some to be the third best in the world behind China and India. Not surprisingly, therefore, although the growth of the insurance market has slowed in 2009 with the global economic crisis, industry growth is widely expected to break double digits in both 2008 and 2009.

Market Trends and Characteristics

Like the rest of Latin America, the Brazilian economy has struggled in the face of the global economic downturn. This overall stagnation has negatively impacted the Brazilian insurance market, reducing the predicted industry growth rate to 4.9% for 2009, from the average 13% growth experienced annually between 2003 and 2008. Nonetheless, the insurance industry has outperformed and is expected to continue to outperform GDP. The anticipated economic recovery, coupled with low insurance penetration and the development of the nation’s reinsurance market, has sustained optimism about future growth.

In May 2009, Brazilian insurance regulator Susep released a report finding that total insurance premiums were 7.9% higher in the first quarter 2009 than the first quarter 2008. The report further maintained Susep’s projection of 4.9% insurance premium growth in 2009, despite revising downward from 1.5% to -.5% its assumption about GDP growth for the year. Such growth in 2009 would result in total premiums in Brazil of approximately US$35.5 billion. The report’s projections for premium growth in 2010 and 2011 were down only slightly, with Susep predicting 10.6% growth in 2010 and 10.4% in 2011. Such growth would result in total premiums of approximately US$39 billion in 2010 and US$43B in 2011.

In July 2009, Fitch released a report on the Brazilian insurance market that balanced bad news about the Brazilian economy with continued optimism as to the country’s insurance industry. The report found that, despite an expectation of continued negative pressure from the struggling economy in the near-term, continued low insurance penetration rates (3.3% of GDP in 2008 and 3.5% for the first four months of 2009) combined with relative economic stability, a growing consumer class and the opening of the reinsurance market indicate that the insurance market has substantial potential for growth in the coming years.

The First 16 Months Since the Reinsurance Market Opening

One of the reasons that industry observers remain positive about the future of the Brazilian insurance market is the recent opening of the country’s reinsurance market to private and foreign competition. After many years of debate and an “impending” opening that had lasted some ten years, on April 19, 2008, Brazil’s government-sponsored monopoly over the reinsurance market was brought to an end.

Since the opening of the Brazilian reinsurance market, more than 60 foreign reinsurers have obtained authorization to sell reinsurance for Brazilian risks as either local reinsurers (*resseguradores locales*) (reinsurers organized under Brazilian law as Brazilian corporations); admitted reinsurers (*resseguradores admitidos*) (reinsurers incorporated under the law of foreign jurisdictions that maintain a representative office in Brazil); and (3) occasional reinsurers (*resseguradores eventuais*) (reinsurers incorporated in foreign jurisdictions that do not have a representative office in Brazil, but are registered with Susep).

In the midst of the rush to gain a share of the Brazilian reinsurance market, however, a number of issues have emerged, among them: (1) what role will the former monopoly-holder, IRB-Brasil Re, take in the new market? (2) Will the Brazilian regulators continue to liberalize the reinsurance market or will barriers to truly open competition be maintained, erected and/or strengthened? (3) Is the Brazilian (re)insurance market sufficiently developed to support true competition among in excess of 60 reinsurers?

The Role of IRB-Brasil Re

Any possible misconception that IRB-Brasil Re, the partially-government owned, former monopoly holder over the Brazilian reinsurance industry, would simply cede its dominant market position to foreign reinsurers was dispelled in May 2009 when an IRB-Brasil Re spokesman proudly announced in a BN Americas interview that the regulatory change had caused less impact than expected and the company had retained 90% of its business since the market opening in April 2008. Indeed, the spokesman reportedly further stated that IRB-Brasil Re intended to maintain its position by leveraging its significant market advantage based upon its history and experience in the market and actively competing with recent foreign entrants to the market by improving customer service and developing new and tailored solutions.

IRB-Brasil Re has followed through on these promises, seeking to maintain its historical business and competing for new business in the country, largely successfully. The company has released several new products in the health area and indicated plans for other new products in the near future, including in growing commercial areas such as D&O, energy, mortgage lending and agriculture. Through its efforts, IRB-Re Brasil has been able to retain more than 80% of the nation's local reinsurance business, which totaled earned premiums of R$1.3 billion (approximately US$661 million) for the period January 2009 to April 2009. By comparison, foreign reinsurers with local affiliates made up less than 15% of the local reinsurance market (Munich Re (8.8%), XL Re (4.1%) and Mapfre Re (.3%)).

It should be noted that IRB-Re Brasil's ability to maintain its dominant market share to date may have been aided in no small part by an advantage included in the liberalizing regulations, which now no longer exists. That is, although the market was technically opened in April 2008, IRB-Re Brasil was permitted to retrocede to any foreign reinsurer up through December 2008, while other market participants could only cede/retrocede to reinsurers authorized by the Brazilian regulator. Whether the elimination of this advantage has played a role in the 10% decrease in IRB-Re Brasil's market share between 2008 and the first four months of 2009 and will continue to play such a role remains to be seen.

Regulatory Liberalization/Regression

Although significantly liberalized by the new reinsurance statute and regulations, Brazil's reinsurance market is not yet entirely unfettered, instead having opted for an "orderly opening of the market" reflected in several significant limitations on the role of foreign reinsurers.

- **"Right of First Refusal"**: Ceding companies must offer local reinsurers the right of first refusal on at least 60% of the premiums ceded until January 16, 2010 (and 40% for at least three years thereafter). This vetting requirement permits a ceding company to first obtain quotes from foreign reinsurers and then present a quote to local reinsurers, who will have either five days (facultative reinsurance) or ten days (treaty reinsurance) to match such quote. The vetting requirement will be fulfilled when local reinsurers either accept 60% of the risk or when all local reinsurers have refused or partially refused to match the foreign reinsurer's quote.

  It is the sole responsibility of the local insurer, not the reinsurer, to comply with this vetting requirement. How this requirement can and will be enforced has been the source of considerable debate among commentators and market participants.

- ***Cession Limits***: Cessions to occasional reinsurers by a Brazilian insurer may not exceed 10% of the insurer's total annual premiums ceded to reinsurers. Furthermore, no Brazilian insurer or local reinsurer may cede more than 50% of the risk it underwrites annually to admitted or occasional reinsurers. Compliance with this requirement is also the sole responsibility of the local insurer or reinsurer and has likewise caused significant debate as to its manageability and enforceability.

On April 27, 2009, Susep made an interesting selective departure from this limitation, raising the cession limit to occasional foreign reinsurers to 25% for surety and petroleum risk business. Although the relevant resolution did not indicate the reason for the special treatment of the surety and petroleum risk lines or indicate whether or not any similar relaxation of the cession limit can be expected in any other lines, it was widely seen as an acknowledgement that the local market lacked sufficient reinsurance capacity in the areas of petroleum risk and surety.

- ***"Tax Haven" Restriction for Occasional Reinsurers***: No foreign reinsurer may register as an occasional reinsurer if it is incorporated in a "tax haven," a term defined to mean any jurisdiction in which income tax is levied at less than 20% and/or where reinsurance companies are subject to excessively strict rules of confidentiality regarding their constitution and composition. This limitation clearly applies to companies domiciled in Bermuda and poses some concern for companies located in other jurisdictions that might be found to satisfy the definition of "tax haven," such as Delaware. Nevertheless, international companies may use companies organized in acceptable jurisdictions, so long as they meet the other requirements for registration as an occasional reinsurer, and then retrocede to companies based in Bermuda or other "tax havens."

Although significant concerns have existed, and remain, that these and other regulatory impediments might be used to erect roadblocks to foreign participation in the otherwise opened Brazilian reinsurance market, little has occurred (other than perhaps the extension of IRB-Re Brasil's retrocession advantage through December 2008) to substantiate these concerns. Particularly in a troubled economy, however, this remains an appropriate area of attention for companies that have expended the resources necessary to enter the market.

Cooperative Arrangements Between Local and Foreign Companies

An interesting result of the limitations maintained by Susep over the liberalization of the Brazilian reinsurance market has been the establishment of cooperative agreements between local and foreign players in an attempt to work around such issues. For example, local Brazilian reinsurer JMalucelli Re and foreign admitted reinsurer Hannover Life Re announced in early 2009 that they had entered into a cooperation agreement to offer life and health reinsurance in the Brazilian market. The move had reciprocal benefits for the two companies: (1) Hannover Life Re can now, through the relationship, overcome certain of the market share limitations imposed by Brazilian regulations in the form of cession limits for foreign reinsurers and a "right of first refusal" in favor of local reinsurers; and (2) JMalucelli Re, which previously operated only in the area of guarantee reinsurance, will receive substantial know-how and technical support from Hannover Life Re in developing its life and health reinsurance business.

Likewise, Maritima, Brazil's tenth largest insurer and one of the few remaining large independent Brazilian insurers active in multiple lines, reportedly recently entered into an agreement with Japanese insurer Yasuda under which Yasuda would take a $200 million stake in Maritima. Maritima, which brought in R$1.1 billion (approximately US$480 million) in premiums in 2008 (an 18% increase over 2007), reportedly sought a partner in order to meet heightened minimum capital requirements imposed by Susep to fund desired expansion that the company hopes will make it the fifth largest Brazilian reinsurer within the next five years and to benefit from the experience of a foreign company.

Remaining Questions

Foreign reinsurers continue to struggle with indefinite tax regulations in Brazil, with little regulatory guidance and conflicting advice from local lawyers on appropriate payment of taxes on reinsurance premiums under municipal and federal Brazilian law. Furthermore, although business prospects for foreign reinsurers willing to negotiate the discussed regulatory hurdles appear bright, it remains to be seen whether: (1) the Brazilian reinsurance market, even if it grows as predicted, is of a size sufficient to support the recent influx of foreign reinsurers; and (2) can enough qualified personnel be found in Brazil and/or brought in from abroad to properly staff branch and representative offices of foreign reinsurers? So long as these issues can be appropriately managed, however, Brazil appears to be an attractive (re)insurance market for years to come.