



BRAZILIAN REGULATORY CHANGES GOOD FOR INTERNATIONAL REINSURERS

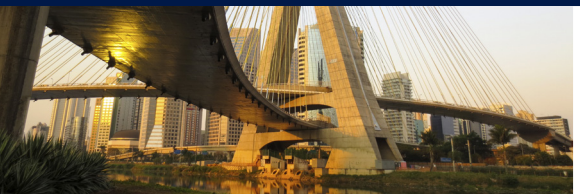
35 out of 40 of the world's largest reinsurers have a licence to write business in Brazil. It will therefore be of great interest to the local and international market that on 20 July 2015, in a sudden move that was unexpected by most players, the Brazilian National Council of Private Insurance (CNSP) issued resolution 322, which provides a five year timeframe for the step-by-step relaxation of the mandatory cession rule and the intra-group prohibition. This article examines the genesis of the changes, describes the new rules, provides some commentary on how they are being received and speculates on why they came about.

For 70 years, the state controlled IRB-Brasil Resseguros (**IRB**) had a monopoly over the Brazilian reinsurance market. The IRB maintained its monopoly until 2007 when, through Complementary Law 126 of 15 January 2007, Congress 'opened' the market to international reinsurers, classifying the IRB as a local reinsurer. Since the 'opening', insurers and reinsurers in Brazil have been operating in an environment of partial liberalisation.

Licensing under the current regime

Under the current regime (Law 126/07 as implemented by CNSP Resolution 168), reinsurers are required to obtain one of the three licenses in order to write business:

- Local reinsurers are incorporated under Brazilian law as Brazilian corporations registered by Superintendência de Seguros Privados (**SUSEP**) to carry out reinsurance and retrocession transactions. They are subject to all local laws and regulations generally applicable to Brazilian insurers, including registration requirements, save for those that do not apply for contractual or operational reasons.
- Admitted reinsurers are non-resident (i.e. foreign) reinsurers that maintain a representative office in Brazil and are registered by SUSEP. To be eligible, the company must have, among other things, certain minimum solvency ratings, a net equity of not less than US\$100 million, and a bank account in Brazil linked to SUSEP with



a minimum amount e.g. US\$5 million for reinsurers conducting transactions in all lines of business.

- Occasional reinsurers are non-resident reinsurers without a representative office in Brazil but also registered by SUSEP. Foreign companies based in “tax havens” (those countries which do not tax income or tax it at a rate lower than 20%) or in countries whose domestic legislation imposes secrecy regarding the identity of the shareholders are not eligible. As above, there are minimum solvency ratings and companies must have a net equity of not less than US\$150 million.

Each license is subject to different entry and operational requirements and restrictions, which limit the volume of business which can be ceded to reinsurers depending on the type of licence held. The principle restrictions concerning the transfer of risk by insurance and reinsurance companies are set out below.

Partial liberalisation of the reinsurance market

In December 2010, the CNSP published Resolutions 224 and 225, which came into force on 31 January and 31 March 2011 respectively, and provide as follows:

- Pursuant to Resolution 224, local insurers - including foreign insurers operating in Brazil - and local reinsurers were prohibited from reinsuring or retroceding their business within their own financial group located outside of Brazil (the **intra-group prohibition**).
- Pursuant to Resolution 225, local insurance companies must place at least 40% of each facultative or treaty reinsurance cession with local reinsurers (the **mandatory cession rule**). The 40% requirement was a

reduction from 60% which was the benchmark for three years following the opening of the market.

These resolutions were met with substantial opposition by local insurers and foreign reinsurers. Both resolutions were viewed as protectionist measures aimed at creating a partial monopoly for the benefit of local reinsurers. Objectors also argued that these rules were contrary to the Brazilian constitutional principle of freedom of contract and a set back to the development of the Brazilian reinsurance market in line with other international markets.

Resistance from overseas reinsurers

As a result of the strong lobbying by foreign reinsurers, although the mandatory cession rule (Resolution 225) was maintained, Resolution 224 was revoked and replaced by Resolution 232. Resolution 232, which came into force on 31 March 2011, watered down the intra-group prohibition by providing that an insurance company or local reinsurer may not transfer more than 20% of the premium applicable to a contract to related companies, or to companies belonging to the same financial conglomerate.

For these purposes, a ‘related company’ or a ‘company belonging to the same financial conglomerate’ is defined as a set of directly or indirectly related legal persons, with either:

- A shareholding of 10% or more in capital in the company.
- Active operational control of the company, to be characterised by the company’s management or joint management, or by its activity in the market under the same brand or trading name.

The 20% cap does not apply to surety, export and domestic credit, rural and nuclear risks insurance. From a Lloyd’s market perspective, companies with reinsurance operations in Brazil are limited in ceding reinsurance to related party syndicates, although they are permitted to cede reinsurance to other non-related syndicates.

In addition to the above rules Brazilian insurance companies cannot, with some exceptions, cede more than 50% of the total amount of premium earned during their operations in a calendar year. They are also prohibited from ceding to occasional reinsurers more than 10% of the aggregate value ceded in reinsurance during the calendar year.

Unexpected developments

This remains the status quo, however on 20 July 2015, CNSP issued Resolution 332 which provides a five year timeframe for scaling down the intra-group prohibition and the mandatory cession rule.

- Under the revised rules on intra-group prohibition, the maximum limit for intra-group transfers (i.e. from an insurer or local reinsurer to a company belonging to the same financial conglomerate) is to be increased on the following basis:
 - 20% (as per the status quo) until 31 December 2016.
 - 30% from 1 January 2017.
 - 45% from 1 January 2018.
 - 60% from 1 January 2019.
 - 75% from 1 January 2020.
- Under the revised mandatory cession rule, the applicable percentage of each facultative or treaty reinsurance cession to be placed by insurers with local reinsurers is to be reduced on the following basis:



- 40% (as per the status quo) until 31 December 2016.
- 30% from 1 January 2017.
- 25% from 1 January 2018.
- 20% from 1 January 2019.
- 15% from 1 January 2020.

■ Resolution 332 also sets up an advisory committee with the objective of proposing measures focused on correcting asymmetry between Brazilian reinsurance regulations and best global practices. The committee will be comprised of representatives from CNSP, two consumer representatives and two representatives from the reinsurance market. It will be chaired by a representative from the treasury. There is no express reference to the attendance of broker representatives. In 120 days, the committee will submit to CNSP a report containing the results of its work and its future recommendations.

Winners and losers

The new rules represent a significant step towards a further liberalisation of the Brazilian insurance and reinsurance market. At the time of the monopoly, local retention of reinsurance premium in Brazil was about 50%. According to local experts, about 35% of reinsurance premium is now retained in Brazil and about 65% is sent overseas, directly by insurers or via retrocession from overseas reinsurers, however reinsurance capacity has tripled since the end of the monopoly. Local commentators are of the view that more premium is likely to end up overseas as a result of the new rules.

The changes to the mandatory cession rule will be welcomed by more than 100 admitted or occasional



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reinsurers operating in the Brazilian market. The main beneficiaries are admitted reinsurers - which include syndicates underwriting through the Lloyd's platform in Rio - who will have less fettered access to reinsurance cessions. Occasional reinsurers will also benefit however, as stated above, Brazilian insurance companies are prohibited from ceding to occasional reinsurers more than 10% of the aggregate value ceded in reinsurance during the calendar year.

Admitted and occasional reinsurers and new entrants may, as a result of the changes, reconsider incurring the high capital and operational costs of obtaining local reinsurer status, if that was on their agenda in the first place. It will also be interesting to see whether, as time progresses, any local reinsurers will relinquish their "local" status in favour of admitted or occasional licences for the same reasons.

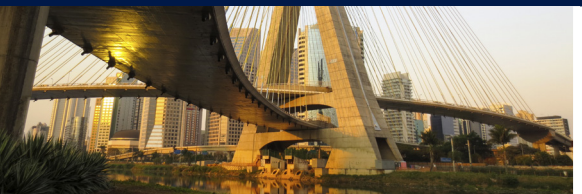
The changes to the intra-group prohibition will be welcomed by those who are part of a wider international reinsurance group, since they will be able to retrocede more and more risk directly back into their own financial

conglomerate. This includes most local reinsurers operating in the Brazilian market. "Local local" reinsurers without an international framework and who are the main beneficiaries of the current intra-group prohibition will not welcome the change.

What is on the horizon?

There has been quite a lot of speculation over the reasons for the new rules. One potential trigger is the fact that the IRB is due to make an IPO in the second half of this year. According to some local commentators, the changes are likely to depress the share price because the IRB will no longer be able to rely on the substantial protection it received under the old rules. Others say that the changes have been made in advance of the IPO to bring greater certainty to a more liberal market. In our view, the new rules are likely to attract greater overseas interest in the IPO at a time when analysts predict the local Brazilian economy to contract by 1.5% this year and for inflation to reach 9.04%.

There are still uncertainties under the new rules. For example, it is unclear whether the revised intra-group rule will apply to the lines of business which are currently exempted (i.e. surety, export and domestic credit, rural and nuclear risks insurance). Emergency meetings are being held in Rio and further clarification will be sought from CNSP. The changes are also likely to result in a process of further heavy lobbying by all sides and, if history is to repeat itself, the likelihood that the recent revisions will form the first chapter in another series of regulatory changes should not be ruled out.



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