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Insurance & Reinsurance in Brazil: Overview & Up-Date

Presentation at the Brazilian Chamber

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Brazilian Market Overview

BRAZIL REMAINS A MAJOR INVESTMENT DESTINATION

- Considered one of the world's ten largest economies, Brazil is a major producer of commodities and one of the world's largest agribusiness hubs. The country has also a strong domestic market, large national companies and a respected business structure. This makes it a major investment destination for both financial investors and global companies

- Several indicators show that Brazil remains a strong and attractive country to do business with and this spurs economic growth and fosters its development:

  - According to projections by the National Agriculture Confederation (CNA), by **2020**, for example, Brazil will displace the United States as the largest agricultural exporter in the globe and become a leader in renewable fuels

  - Another economic asset is the Brazilian domestic market with **200 million consumers**. Currently, we are one of the world's **ten** largest consumer markets for retailers, car manufacturers, electronics, cosmetics, food, and beverages

  - In 2015, investors and entrepreneurs from around the world continued to take an interest in Brazil. During the year, there were **742 mergers and acquisitions** in the country, most of which were deals involving foreign investors

POLITICAL AND ECONOMIC CHALLENGES

- Brazil is emerging from a political uncertainty. Brazil's new President Michel Temer took over the presidency on an interim basis in May 2016, when his predecessor Dilma Roussef was suspended to face impeachment charges. In August 2016, Mr. Temer was sworn in as President and is expected to remain in office until the end of the current term in 2018

- Besides the political turmoil, one of the main challenges faced by Brazil's President is the economy. Mr. Temer vows to revive the economy by implementing the following main economic changes: **(i) limits on public spending, (ii) pension system reform and (iii) privatization of public companies**

  - Although some of the initiatives may seem unpopular, Brazil's President has great support in the Congress and is a wily political operator

  - As an effort to rebalance the public accounts and control debt levels, Brazilian current government proposed a constitution amendment bill, setting a ceiling for public spending for **20 years**. Pursuant to such amendment bill, any growth of public spending shall be limited to the previous year's inflation rate and may only be revised in ten years. The constitution amendment bill has been passed by on **December 15, 2016** and became enforceable.

POLITICAL AND ECONOMIC CHALLENGES

- Despite the current difficult political outlook, President Temer's initiatives have been received with optimism by both Brazilian an foreign investors and there have been signs of a recovery of economic confidence

  - Some economists estimate the inflation rate to stand at **5.4%** in a short-term and to trend around **3.6%** in the long-term

  - GDP Growth Rate is projected to trend around **1.5%** in the long-term

  - Brazil Interest Rate is expected to stand at **11.75%** in a short-term and to trend around **10%** in the long-term

INFRASTRUCTURE – CURRENT STATUS

- **Huge** infrastructure **gap**
- Fiscal crisis imposes **budget constraints** on federal, state and local governments
- Difficulties in obtaining **financing**
- **Lack of quality** in engineering projects
- **Precariousness** in the planning and inspection of infrastructure works
- **Stagnation** of works
- Costs of works much **above the bid price**

INFRASTRUCTURE DEVELOPMENT

- The Federal Government recently created the Investment Partnerships Program ("IPP"): a legal plan with the goal to better integrate public and private sectors and foster investments

- Projects included in the IPP by choice of the President should be subject to extensive guidelines and long-term regulatory planning

  - Among others, IPP's guidelines set forth: (i) need for technical quality for regulation issued by State agents and for stability of rules provided by contracts and bidding documents; (ii) coordination between government agents; and (iii) need for governmental entities to issue long-term sector-specific policy

- Dozens of new projects were announced for 2017 and 2018, including, among others: (i) lease of port terminals in Santarém and Rio de Janeiro; and (ii) new concessions for international airports in Porto Alegre, Salvador, Florianópolis and Fortaleza (**bidding auction scheduled for March 2017**)

CURRENT HOT TOPICS

- **Healthcare legislation boosts private investment**

- Some initiatives undertaken by the Brazilian authorities have boosted the country's healthcare segment. One such initiative was the passing of Law No. 13,097/2015, which allows foreign capital in the provision of health services bringing new investment opportunities to the country

- **Anti-corruption law spurs compliance programs**

- Enacted in August 2013, the Anti-corruption Law (Law No. 12,846/2013) establishes administrative and civil liabilities to companies engaged in illegal acts and encourages companies to strengthen ethical behavior among their employees, partners and suppliers. In addition to fines, a company may lose assets and tax incentives or have its activities suspended by the court. The Anti-corruption Law, together with the investigation and involvement of companies in the Car Wash Investigation, are creating a new corporate culture in Brazil

CURRENT HOT TOPICS

- **Data Protection Bill currently under discussion in the Brazilian Congress**

- There are two drafts of bills of law currently under discussion in the House of Representatives (Draft Bill 5,276/2016) and in the Senate (Draft Bill 330), intended to comprehensively regulate data protection in Brazil.

- Key provisions include:

  - Definition of key concepts such as “Personal Information” and “Sensitive Personal Information”
  - Introduction of the requirements for the collection of personal data, including, among others, “free and unambiguous consent” and “legitimate interest”
  - Definition of the hypothesis for the international transfer of data
  - The creation of the National Council for Data and Privacy Protection, which will assist relevant agencies to guarantee the effectiveness of the data protection rights of individuals

CURRENT HOT TOPICS

- **Gaming in Brazil – A new bet for foreign investors**

- There are two bills under discussion in the Brazilian House of Representatives and the Senate with the purpose of regulating and authorizing the exploitation of gaming activities such as bingo, online sports betting and casinos, by licensed companies

Up-Date on the Insurance & Reinsurance Market in Brazil

Hot Topics in the Brazilian (Re)Insurance Industry

1. Recent business trends
2. Claims challenges
3. Proposed changes in performance bonds’ regulation
4. Changes in D&O insurance regulation
5. Universal life
6. Ceding restrictions in reinsurance
7. Potential reinsurance hub
8. Liquidation of the ceding insurer – consequences for the reinsurer

Recent business trends

Recent business trends

- Concentration of the large risks business in some players (Ace/Chubb/Itaú; Bradesco/Swiss Re; Tokio Marine; Allianz; Zurich; AXA, etc.)
- Banks getting out of large risks
- Bancassurance still an important business for banks (despite economic crisis)
- Highly competitive affinity/retail (non-bank) business (recent changes on anti-trust rules)
- Boom on judicial bonds (recent discussions on the effects of judicial recoveries)
- Lack of infrastructure projects and its effects on performance bonds and engineering insurance businesses
- Recent sales of portfolios (Sul America, Chubb and AIG) and M&As in the region (RSA Brazil, Pan Seguros, Austral, Bradesco, AIG except for Brazil, etc)
- New accounting rules under discussions may affect capital requirements and result in new M&As; risk management structure to be in place by December 31, 2017 (Circular SUSEP no. 521/2015)

Claims Challenges

Claims Challenges

- **Car wash operation. Impacts:**
  - Increase in loss ratio in financial lines, such as D&O, arising mostly from criminal investigations
  - Increase in the number surety bond claims (most affected sectors: oil & gas, construction, hydro & wind power, shipbuilding)
  - Hard market

- **Main issues:**
  - Lack of regulation on claims handling in Brazil
  - Lack of personnel in claims departments
  - Inexperienced courts and paternalistic approach

- **Performance bond**
  - Failure to manage the underlying contract. Informal relationship between the constructor and the insured as far as the performance of the contract is concerned
  - Misunderstanding regarding the concept of "Indemnifiable Losses"
  - Secured contracts and/or insureds involved in corruption scandals. Should the insurer indemnify?
  - Legal actions between the constructor and the insured. Should the insurer indemnify?
  - Recovery. Weak counter guarantees

Claims Challenges

- **D&O**
  - Plea Bargain and Leniency Agreement. Should the insurer interrupt the payment of defense costs?
  - Corruption. Should the insurer pay defense costs?
  - Imprisonment before a final decision. Should the insurer interrupt the payment of defense costs?

- **Judicial Bonds**
  - No claims handling. Payment must be made in 15 - 30 days.
  - Judicial recovery. Suspension and early termination of the bonds?

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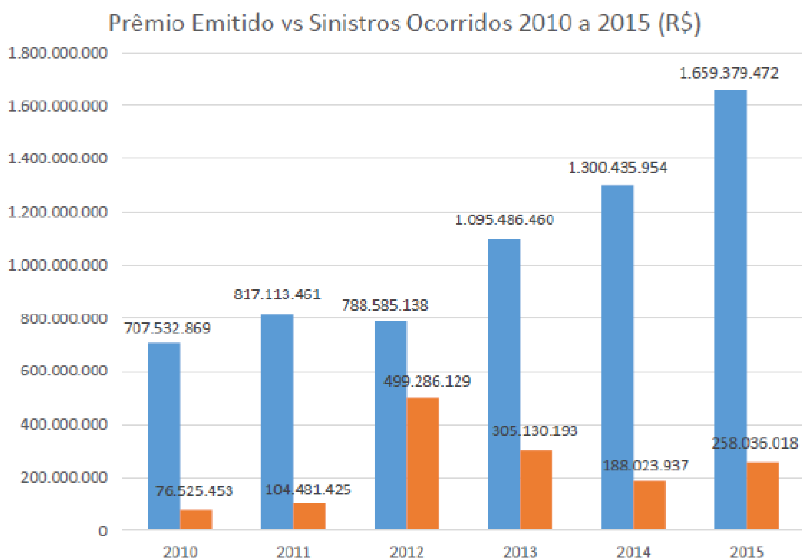
Proposed changes in performance bonds' regulation

Surety bond market from 2010 to 2015

Panorâma do Mercado de Seguro Garantia



Fonte: SUSEP

- ← Premiums issued vs. Losses occurred from 2010 to 2015
- Average 20% market growth in 5 years
- Loss ratio did not follow market growth
- Entrance of new players
- Enhancement of credit analysis after Car-Wash
- Until 2010, 4 insurance companies had almost 70% of the market
- In 2016 it is no longer possible to identify an outstanding leader in terms of market share

Surety bonds – current scenario and proposed changes

- Growth of judicial bonds in view of change in law

- Limited growth of performance bonds

- Government’s interest in having insurance companies playing a more important role in infrastructure project

- Discussions on legal/regulatory changes to protect insurance companies when playing such role:

  - Increase in the percentage of the guarantee – currently 10% (30-100%?)
  - Enhancement of counter-guarantee documents and mechanics (concession revenues?)
  - Freedom to hire anyone the insurance companies considers fit to finalize the project
  - Establishing clear rules on step-in rights and their consequences (labor, tax and otherwise)
  - Creation of special credit rights when the principal is insolvent

Performance bond prospective regulation – main draft bills

Draft Bill 559/2013	Draft Bill 174/2016	Draft Bill 268/2016
• Modification of the Law on Bids and Contracts (Federal Law 8.666/93); • Scope: large infrastructure projects; • Performance bond as an option, non-mandatory; • The insurer would be required to comply with the object of the contract; • Up to 100% guarantee for major works; • Guarantee of 10% to 50% for other works; • Inspired by the US model (Heard / Miller Act)	• Insurer as interested third party • Extensive monitoring power • Mandatory for contracts above R$ 10MM • Insurer becomes contract manager	• Amends Article 56 of Law 8666/93 to make performance bond mandatory in public contracts; • Minimum of 25% - maximum of 100% guarantee

Changes in D&O insurance regulation

New D&O Insurance regulation - Circular SUSEP nº. 541/2016

- Provides **list of definitions** which is neither clear nor correct; i.e., it gives the idea that coverage is triggered by fault
- Contracting only by **legal entities** for the benefit of individuals (Brazilian market currently offers products to be purchased by individuals)
- Insurance policies issued on a **claims made basis only** (instead of occurrence basis)
- **Defense costs and attorney's fees**, which were part of the main coverage of D&O insurance, must now be offered as **additional coverage**
- **Reimbursement policy**, but the insurer may decide to pay to the third party
- Coverage for **fines and penalties** is authorized
- Mandatory **arbitration** clause (not clear to what extent)
- **Prohibition** of references to any type of foreign legislation
- New products must be filed with SUSEP by **February 28, 2017**
- On and after **June 1, 2017**, only new policies should be offered

Universal life

Universal life

- Brazilian market is dominated by simple death and pension products mostly offered through banks
- Regulators have been working for a while on a regulation for Universal Life, combining features of Brazilian VGBL / PGBL products with traditional life insurance
- New regulation issued on December 23, 2016 (Resolution CNSP No. 344/16), effective in 120 days
- Minimum term of five years

Ceding restrictions in reinsurance

Summary of Ceding Restrictions - until July 21, 2015

(Resolução CNSP No. 168, of December 17, 2015)

- **50% - Mandatory Minimum Retention**: **Brazilian insurers and local reinsurers** are not allowed to transfer in reinsurance or retrocession, as the case may be, more than **50%** of the premium issued in relation to risks underwritten by the insurance or reinsurance company, on a calendar year basis.

- **40% - Local Reinsurance Cession**: **Brazilian insurers** were obliged to offer at least **40%** of each reinsurance cession in treaties or facultatives reinsurances to local reinsurers.

- **20% - Intragroup Reinsurance Cession**: **Brazilian insurers and local reinsurers** in cross-border intragroup cessions were limited to **20%** of the premium of each contracted coverage.

- **10% - Occasional Reinsurance Cession**: **Brazilian insurers** are not allowed to cede to occasional reinsurers more than **10%** of the total amount of the premium annually ceded in reinsurance, considering all its operations in each calendar year.

  Exception! This limitation of 10% is expanded to **25%** in case of surety bonds related to obligations towards governmental entities and insurance policies to oil & gas risks *(Resolução CNSP No. 203, of April 27, 2009).*

Changes Effective - as of July 21, 2015

(Resolução CNSP No. 322, of July 20, 2015)

Changes in Local Reinsurance Cession

- Brazilian insurance companies must contract and offer, on a *preferential* basis, at least **40%** to local reinsurers.

- Progressive annual decrease to the minimum percentage that shall be mandatorily offered to local reinsurers:

- 40% of its reinsurance cession until December 31, 2016;
- 30% as of January 1st, 2017;
- 25% as of January 1st, 2018;
- 20% as of January 1st, 2019; and
- 15% as of January 1st, 2020.

Changes in Intragroup Reinsurance Cession

- Progressive annual increase to the limitation to the intragroup reinsurance cession:

- 20% of until December 31, 2016;
- 30% as of January 1st, 2017;
- 45% as of January 1st, 2018;
- 60% as of January 1st, 2019; and
- 75% as of January 1st, 2020.

- Applicable to each treaty or FAC, proportional or non proportional; applicable layer by layer according to regulator. This concept has been further defined by Circular SUSEP No. 542, of December 6, 2016.

Potential reinsurance hub

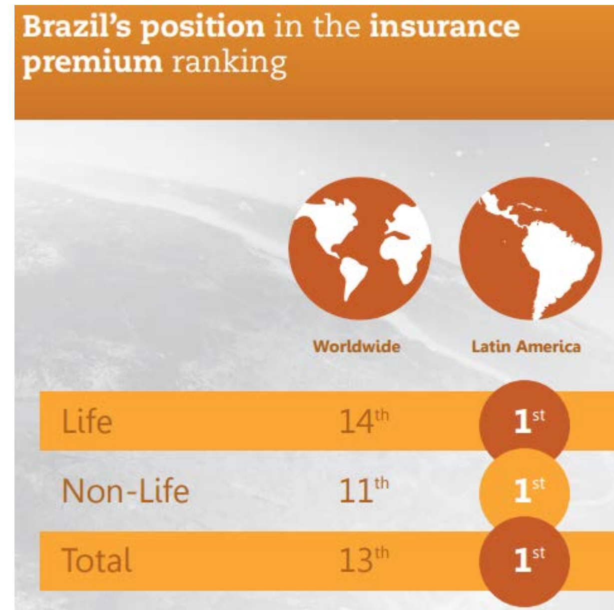
Brazil as LATAM reinsurance hub

- The **<u>traditional powerhouses</u>** for reinsurance of global risks have been centred in global financial centres such as London, New York, Paris, Zurich and Munich. The traditional centres have a concentration of capital, technical expertise and first-world business standards

- Brazil is becoming a reinsurance leader in the LATAM region → **potential regional hub**

- Local companies are accepting risks from other countries in LATAM and opening local offices (IRB, Terra Brasis, etc); foreign players are acting regionally

- Reinsurance hub plan was presented at the **Brazilian Insurance Confederation – CNseg annual event** in Rio de Janeiro (April 2016)



Source: CNSeg, The institutional representation of the insurance market, 2015.

Brazil as LATAM reinsurance hub

- **Not** geographically located (contrary to initial expectations; no grounds to justify federal tax incentives to Rio)
- Construed as a **general tax benefit** to the **export** of reinsurance capacity (federal taxes basically)
- Applicable to **any** local reinsurance company; no need to create a new company
- Serves to provide certain **equalization** to competition due to Brazilian high taxation
- Benefits local reinsurers to make the **best use** of their local structure in Brazil
- Need to be **recognized and accepted** by neighboring jurisdictions
- Local insurance rules must be **consistent** with insurance rules of the ceding company
- Brazilian investment rules for local reinsurers must be more **flexible**
- Possible **new immigration regime** for these local reinsurers

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Liquidation of ceding companies – consequences for the reinsurer

Liquidation of ceding companies

- Usually, in a scenario of extra-judicial liquidation of ceding companies, reinsurers' concerns under Brazilian laws and regulations are the following:

  - whether the reinsurance agreements are **facs or treaties** (as under fac agreements, the insured has, by statute, a direct claim right against the reinsurer, whereas under treaties the statutory/automatic cut-though in case of insolvency of the cedant does not apply);

  - whether reinsurance agreement may be **terminated**; and

  - whether and when credits and debts between the cedant and the reinsurer may be **set-off**, especially because under Brazilian law the reinsurer cannot argue that the cedant is insolvent to deny payment to it (mandatory insolvency clause).

Liquidation of ceding companies - consequences

- Reinsurers must **carefully** analyze the consequence of providing fac coverage
- When an insurance company becomes insolvent, it may not accept any other risks and no new claims (after the date of liquidation) may be reported; in short, the insured **must** purchase another insurance coverage and **claim** proportional reimbursement of the premium paid
- This limits reinsurers' exposures; so, for the reinsurer, the question is whether it may get out of the agreement **before** the liquidation of the cedant
- Set-off rights are not clearly regulated in Brazil and are currently being analyzed by the regulator; we believe that set-off of existing credits and debits are possible; afterwards, it is not; this is however **controversial** and regulator may have restrictive views due to the universality of bankruptcy processes

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