Brazil's insurance sector is tipped to grow and consolidate say investors and analysts, who would like to see more direct ways of playing the sector. **By Ben Miller**

Extending coverage

When Banco do Brasil raised $5.74 billion from the IPO of its insurance business in April, it did more than just push aside doubts about the Brazilian equity issuance market. The carve-out of the bank's insurance business, priced at the top of its range and with its overallotment options fully sold, also clearly underscored several trends in Brazil's growing insurance business.

Insurers have extended their reach across Brazil as a decade of strong GDP growth and rising incomes has given Brazilians a few extra reais each to spend on coverage. As incomes rise, the insurance industry is expected to continue growing, particularly the life segment, which is undersubscribed when compared to other areas of coverage in Brazil.

At the same time, the heft of Banco do Brasil's insurance business is a function of the bank's presence across the country: its vast branch network gives it an advantage over smaller providers. Bradesco, Itaú and Santander enjoy similar advantages of what is known as the bancassurance model.

What's different about BB Seguridade's listing is that it provides a rare opportunity to directly invest in the Brazilian insurance sector. Someone wanting to invest in Bradesco's insurance business, for example, needs to buy the bank's shares.

Bradesco Seguros

Potential for growth and consolidation in this market were among the expectations reflected in responses to the Bradesco Seguros Investor Perception Survey on the 2014 outlook for the Brazilian life insurance sector, prepared by Management & Excellence in cooperation with *LatinFinance*. The survey drew participation from 64 investors, analysts and senior executives from Europe, Latin America and the US. Complete responses were submitted by 28.

Regulations bite

Of three major trends, respondents gave particularly strong marks – indicating a higher likelihood – to continued consolidation in the life insurance industry. With an average score of 7.4 out of 10, respondents marked it ahead of a tendency for banks to outperform insurance companies – which received 6.8 – and a trend for locals to outcompete foreign providers, 5.5.

Tougher regulations, tighter margins and higher capital adequacy requirements for financial institutions mean consolidation is likely for the more than 200 insurers in Brazil. Already, the top 10 control about 80% of the market. Higher costs, such as IT expenses, will also squeeze the smaller players.

With such concentration, secondary players may find it increasingly difficult to produce acceptable margins. Recent regulations reducing life insurance fees levied by insurers have put further pressure on net gains.

Domestic banks dominate

Given the advantages in distribution, big banks are expected to continue their dominance, according to the survey respondents. This will also come at the expense of foreign players, even those attached to large groups.

"The bancassurance business is more profitable," says Francisco Kops, equity analyst at J. Safra Corretora. "There is lower competition and higher entry barriers. You also have products with lower penetration, so you should have products that should grow more than products commercialized by brokers."

Banks' branches give them direct points of sales, in addition to networks of agents and distribution companies. Customers that bank with an institution might be more likely to buy other products from it. Banks are more dominant in life and pension products, while brokers tend to specialize in health and auto insurance.

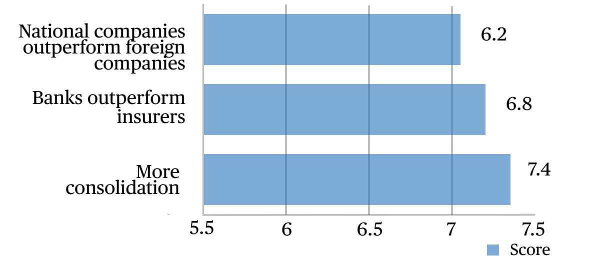
The insurance business at Bradesco is generating increasing income. While Bradesco's banking services income grew by a 26.7% between 2010 and 2012, the bank's insurance business increased by 69.7%. The insurance business at Bradesco has gone from being 52% as large as the banking business in terms of gross revenue, to 58.7% in 2012.

WILLIAM COX, M&E

"ALL ELSE BEING EQUAL, LARGE BANKS ENJOY THE ADVANTAGE OF A NATIONAL PRESENCE, DISTRIBUTION CHANNELS, PROFESSIONALISM, AND EFFICIENCY. THE ASSETS ARE STACKED IN THEIR FAVOR"

Consolidation ahead

Responses to: Which other major developments in the Brazilian life insurance sector do you expect for 2014?



Source: Bradesco Seguros Investor Survey on the 2014 Outlook for the Brazilian Life Insurance Sector

"All else being equal, large banks enjoy the advantage of a national presence, distribution channels, professionalism, and efficiency," says William Cox, chief executive of Management & Excellence. "The assets are stacked in their favor."

The barriers also extend to foreign companies, who find it difficult to enter areas such as life insurance. One area in which foreigners did have a toehold was in reinsurance, where it was initially easier for them to offer expertise in a market with little local know-how. This is changing, as the government has made it more difficult for foreigners.

Last year, Brazil adopted regulations that limit the degree to which foreign companies can reinsure Brazilian risks. Under the regulations, which took effect in March, 40% of reinsurance business must be placed with local firms. Reinsurers are prohibited from ceding more than 20% of premiums to affiliated, intragroup reinsurers located abroad.

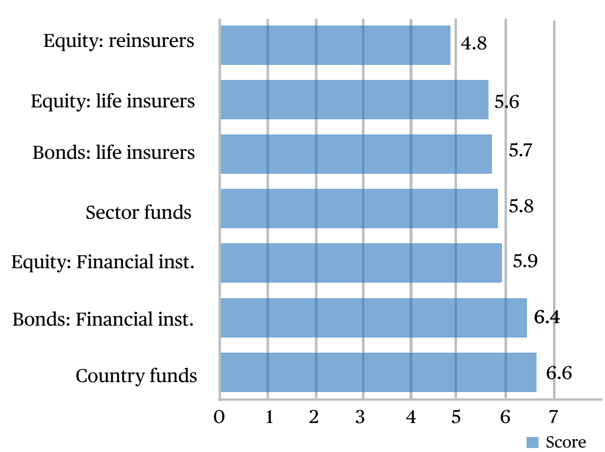
This approach assures that IRB-Brasil Re, the state-controlled reinsurer that formerly had a monopoly, can survive and adapt to the new environment, Standard & Poor's says in a report warning about elusive profitability in Brazil's reinsurance market.

Low penetration

Brazil's insurance penetration of about 3% is paltry compared to the global leaders, which have as much as 18%. About 70% of the country's employed population is uninsured, according to Research

Country funds for exposure

Responses to: Rate your preference for each investment instrument for the Brazilian life insurance sector in 2014



Source: Bradesco Seguros Investor Survey on the 2014 Outlook for the Brazilian Life Insurance Sector

FRANCISCO KOPS, J SAFRA CORRETORA

“THE BANCASSURANCE MODEL IS MORE PROFITABLE. THERE IS LOWER COMPETITION AND HIGHER ENTRY BARRIERS”

& Markets, which judges Brazil as the world’s 17th largest insurance market. Munich Re estimates Brazil could be the world’s eighth largest market by 2020.

Opportunities for life insurance appear across the social spectrum. Among Banco do Brasil clients, only 12% of those with incomes in the A class, 22% of the B class and 18% of the C class had life insurance products in 2012. This compares to less than 11% and 3% of the C and D income classes, respectively.

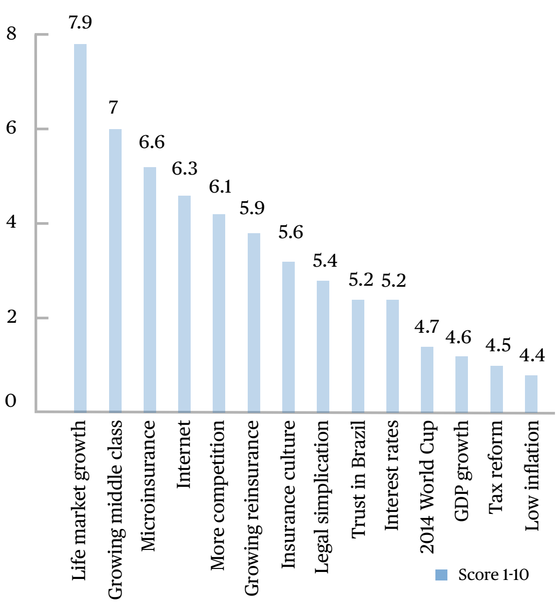
“Penetration is still low compared with developed countries,” Kops says. “But if you compare with developing countries, penetration is similar to other countries.” Consumers are much more likely to take out health or auto insurance than they are pensions or life insurance, however.

Voluntary and personal life insurance reached a portfolio volume of 357.3 billion reais ($174.3 billion), according to Research & Markets. Life insurance, with its stable revenue from premium payments over many years, appears to be the most favored.

Respondents expected term policies – insurance without an investment component which is paid at death to beneficiaries – to be the most popular in 2014 according to the survey. This was followed by cash value life insurance, which includes investment. Respondents were positive broadly on life insurance, though: outlooks for all product types in the survey, including universal,

Growth expectations high

Responses to: What will be the main opportunities for the Brazilian life insurance sector in 2014?



Source: Bradesco Seguros Investor Survey on the 2014 Outlook for the Brazilian Life Insurance Sector

universal variable, whole life and variable life, registered an average of more than five on a scale of 1 to 10.

New opportunities for distribution of policies were seen as the main factor that would improve the performance of life insurers in 2014. That topped improvements in training, marketing and client relations, which followed in that order. Mergers and acquisitions ranked lowest as a likely value driver next year, although still scored five out of 10.

Life expectancies are also growing – a statistic insurers like to see. Out of 14 factors that may influence the Brazilian life insurance sector, respondents pegged the low penetration of life insurance as the main opportunity for the industry next year. That was followed by the growth of the middle class, the possibilities of offering microinsurance to the poor, and the potential of the internet as a platform to reach customers.

Microinsurance – insurance products that are designed to address the risks and special needs of low-income clients – is in its infancy globally. It is growing along with microfinance. Given the low tickets involved, it is seen as best suited for banks to provide.

Given the rise of incomes at the bottom of Brazil’s pyramid, the country offers tremendous potential – perhaps more than $2 billion worth, according to a study from the University of São Paulo. In the last few years, the government has begun regulating this market.

Rare chance

Beyond BB Seguridade, investors have few options to invest in Brazil’s life insurance sector directly. The closest possibility would be a Brazilian fund including only national financial institutions with large and growing footprints in life insurance.

The top three preferred investment instruments in the sector are, consequently, indirect – country funds rated 6.4 on the 10-point scale. Debt or stocks from financial institutions with insurance arms followed, rated 6.4 and 5.5. Sector funds were in fourth place, rated the highest among insurance-specific investments. Life insurer and reinsurer equities were less popular – likely because there are so few companies of that type listed.

“If you want to invest in insurance in Brazil you don’t have any specific ETF or a unique vehicle, you basically have to go stock-picking,” Kops says. “The sector is not as represented in the stock market as it is in the real economy.”

One option is to invest in publicly traded broker firms, which are small caps by sector standards. Rio de Janeiro-based Brasil Insurance is a listed broker, which has made 20 acquisitions since its 2010 IPO. It is the amalgamation of more than 40 brokers in 11 states, and offers all products. Qualicorp is another publicly-traded broker, focused on health insurance.

For standalone insurance companies Porto Seguro and SulAmérica, life offerings represent a small part of the business dominated by auto, home and other types of insurance. Itaú owns 30% of Porto Seguro.

Reinsurers were seen as the least preferable way of investing in Brazil’s life insurance industry, perhaps partly because of the high degree of competition, low margins and high regulatory risk. Yet, unlike insurers, most of these largely foreign groups have liquid equity and debt. However, their presence is global, not just Brazilian. **LF**

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