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November 2018

TECHNICAL NOTE ON INSURANCE SECTOR REGULATION AND SUPERVISION

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TECHNICAL NOTE

INSURANCE SECTOR REGULATION AND SUPERVISION

Prepared By
Monetary and Capital Markets Department, IMF

This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Brazil during March 2018 led by Jodi Scarlata, IMF and Mariano Cortes, World Bank, and overseen by the Monetary and Capital Markets Department. IMF, and the Finance and Private Sector Development Vice Presidency, World Bank. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx.

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Glossary

ALM	Asset Liability Management
ANS	National Agency for Supplementary Health (Agencia Nacional de Saude)
BCB	Brazilian Central Bank (Banco Central do Brasil)
CMN	National Monetary Council
CMG	Crisis Management Group
CRNSP	Council of Resources of the Ministry of Finance
CNSP	National Council for Private Insurance (Conselho Nacional de Seguros Privados)
CVM	Securities and Exchange Commission of Brazil
ERM	Enterprise Risk Management
FSAP	Financial Sector Assessment Program
GAAP	Generally Accepted Accounting Principles
HLA	Higher Loss Absorbency capacity
IAIS	International Association of Insurance Supervisors
ICAAP	Internal Capital Adequacy Assessment Plan
ICPs	Insurance Core Principles
MCR	Minimum Capital Requirement
MMoU	Multilateral Memorandum of Understanding on Cooperation and Information Exchange
MOCE	Margin Over Current Estimate
MoF	Ministry of Finance
MoP	Ministry of Planning
MoU	Memorandum of Understanding
ORSA	Own Risk and Solvency Assessment
P&C	Property and Casualty
PGBL	Plano Gerador de Benefícios Livres (Retirement plan creator of free benefits; a type of 401K product)
PREVIC	National Supervisory Authority for Complementary Pension Plans (Superintendencia Nacional de Previdencia Complementar)
REIT	Real Estate Investment Trust
SCR	Solvency Capital Requirement
SUMEF	Subcommittee for Monitoring the Stability of the National Financial System
SUSEP	Superintendency of Private Insurance (Superintendencia de Seguros Privados)
T-VaR	Tail Value at Risk
VaR	Value at Risk
VGBL	Vida Gerador de Benefícios Livres (Life product creator of free benefits; a type of 401K product)

EXECUTIVE SUMMARY

The insurance sector has significant potential for expansion and to contribute to economic growth as an important part of the financial sector. While the insurance sector has grown at 10 percent annually over the last 5 years, on average, and remains profitable with high solvency ratios, the insurance penetration and density are lower than other emerging markets. Nevertheless, the insurance industry has the potential to reach to much higher levels of insurance penetration.

A few large conglomerate groups—composed of banks, insurers and investments funds—dominate the insurance sector. Conglomerate groups account for more than 75 percent of the market share. Reflecting very conservative regulations imposed by the Banco Central do Brasil (BCB) and the Superintendency of Private Insurance (SUSEP), the interlinkages between banks and insurers are limited. Nevertheless, material contagion may occur through a reputational channel, adversely impacting the profitability of the linked business.

Insurance regulations have been improved since the 2012 FSAP. The introduction of risk based supervision has enabled the SUSEP to shift from a compliance oriented culture to a risk based and outcome-focused approach. Risk based capital requirements are required and the adoption of the Liability Adequacy Test (LAT) has ensured the sufficiency of technical provisions under the evolving financial and demographic conditions. New risk management requirements, including governance and enterprise risk management, have been recently implemented, and at least large insurers are ready to implement the new requirements. The investment limit is set in a conservative manner, and the investment is concentrated on short-term central government bonds, with potential capacity to invest real economy through corporate bond and equity holdings.

However, significant gaps remain in the overall approach, particularly the lack of independence and resources of the supervisor. Superintendents have been dismissed without clear explanation of the reasons to the public. SUSEP staff lack the appropriate legal protection that should be a requirement for anybody of professional staff who are expected to be assertive and effective when using its legal powers. SUSEP's resources have eroded since the last FSAP, and it does not have the flexibility to hire experts from the industry, especially those with needed technical knowledge. The shortage of resources prevents proper implementation of new regulations, which hinders the potential growth of the industry and its contribution to the overall economy.

Group supervision should be established with enhanced coordination among supervisors and macroprudential surveillance. Large insurance groups in Brazil (most of which belong to conglomerate groups) have several subsidiaries even within the insurance sector, typically separate entities for life, health and non-life, which makes group supervision more important. Some of the new regulations, in particular enterprise risk management and governance requirements, should have an increased focus on groups. At present, the regulation and supervision by SUSEP and the National Agency for Supplementary Health (ANS) is solely focused at the entity level, without group level oversight. The implementation of group level supervision would require significant coordination among supervisory agencies, especially among SUSEP, ANS, Banco Central do Brasil

(BCB) and the Securities and Exchange Commission of Brazil (CVM). Given the significant share of the large conglomerate groups in Brazil's financial sector, macroprudential surveillance should be improved significantly.

Enhancement of conduct supervision would also be important for the insurance sector. SUSEP has continued to receive a significant number of complaints from policyholders related with non-payments of policy claims. The industry is facing high surrender rates in annuity products, which are supposed to be long term products. Anecdotal evidence suggests that some insurance products are sold as a requirement for loans, typically within the same financial group. Such evidence suggests a room for improvement in conduct. In 2018, SUSEP has a regulatory plan to impose a new standard to address the practices of tie-in sales. In a lower interest rate environment and a search for yield, policyholders need to be better informed and would need high quality advice in order to make informed decision before taking on more credit and market risk. Therefore, it would become more important to improve the transparency and quality of advice in the sales channel for the insurance products. This also highlights the need to clarify the current gap in the oversight responsibility for insurance sales through banking branches.

Table 1. Main Recommendations

Recommendation	Timing*	Priority**
SUSEP superintendent and directors should be protected by clear rules, e.g., in legislation, including fixed term, condition of dismissal, public disclosure of reasons for dismissal and qualification criteria for the new appointments. Legal protection of SUSEP staff should be enhanced by ensuring that proper legal support is provided.	I	H
Supervisory and specialist resources should be substantially enhanced to manage the continuing challenge of the implementation of new regulatory reforms.	MT	H
SUSEP should communicate to the public that reduced factors (and thus lower capital requirements) for the companies with higher governance and risk management are only for a short transitional period. SUSEP should require all insurers to meet some of those higher requirements once the short transitional period ends.	ST	M
SUSEP should communicate to the public that internal models would not be approved until SUSEP has obtained proper resources, and developed a robust and transparent validation standard for internal models	MT	M
SUSEP should take the lead in coordinating with the relevant authorities to facilitate the smooth and coordinated implementation of IFRS 17.	MT	L
BCB, ANS and SUSEP should implement consistent group-wide supervision that covers both insurance groups as well as conglomerate groups. These authorities should enhance coordination substantially by joint rule-making, joint implementation, joint on-site inspections and information sharing at the granular level for off-site monitoring.	MT	M
SUSEP, BCB and CVM should coordinate to improve market conduct by strengthening disclosure requirements. Oversight responsibility of insurance products, e.g., those sold at a bank branch, should be clarified.	MT	H

* C = continuous; I = Immediate (within one year); ST = Short Term (within 1- 2 years); MT = Medium Term (within 3-5 years)

** H= High; M= Medium; L=Low.

INTRODUCTION

A. Scope and Approach of this Note

1. **This technical note provides an update on the Brazil insurance sector and an analysis of certain key aspects of the regulatory and supervisory regime.** The note is part of the 2018 Financial Sector Assessment Program (FSAP). and has been prepared by Nobuyasu Sugimoto (IMF), drawing on discussions in Brazil from February 27 to March 21, 2018. The technical note references the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in October 2011, as revised in November 2017.

2. **The note analyzes the practice in relation to selected ICPs in the context of a wider discussion of key issues in regulation and supervision.** The note does not include a detailed assessment of observance of the ICPs.[1] (The most recent such assessment, conducted on the basis of the 2011 version of the ICPs, was carried out in 2012.) The focus of the note is on recent developments in the sector, including major reforms of solvency and risk management requirements (which took effect in full in January 2018), and key recommendations in the previous FSAP, such as governance, market conduct and group supervision.

3. **The note refers to laws, regulations and other supervisory requirements and practices in place at the time of the discussions in Brazil, as well as ongoing and planned regulatory reforms.** The note takes account of the major changes in regulations that took effect recently, including risk based capital requirements, enterprise risk management (ERM) as well as the recent development of risk based supervision. In respect to the 13 ICPs analyzed in the note, the authorities provided a full self-assessment, supported by anonymized examples of actual supervisory practices and assessments. The institutional arrangements for financial sector regulation and supervision are outlined in Section B in the main findings of this note.

4. **ICPs selected for review are broadly those with macrofinancial relevance and with material regulatory changes.** They include the ICPs on solvency requirements (valuation, investment and capital adequacy), supervisory approach (including supervisory authority, supervisory review, preventive and corrective measures) and cross-border cooperation. To avoid a departure from the IAIS ICP assessment methodology, under which regulation and supervision are normally evaluated as at the time of assessment, no scoring of the level of observance of the selected ICPs is given in this note. The detailed ICP analysis, including comments, is set out in the Annex to the note.

5. **The author is grateful to the authorities and private sector participants for their excellent cooperation**. The author benefitted greatly from the inputs and views expressed in

[1] The IAIS ICPs apply to all insurers, whether private or government-controlled. Specific principles apply to the supervision of intermediaries.

meetings with insurance regulators, supervisors, insurance companies, industry associations and professional organizations.

B. 2012 FSAP Recommendations and Implementation

6. The 2012 FSAP conducted a full detailed assessment of the ICPs and made recommendations to improve the compliance with the IAIS ICPs. Amongst other points, it identified some areas for improvement that are relevant to the scope of this Technical Note:

- The legal framework governing SUSEP contains elements that undermine the independence and capacity of the supervisor, such as limited technical input from SUSEP on regulation, necessity of the Ministry of Finance's (MoF) approval on the operational process of the budget allocation, and absence of a nomination framework for the Superintendent and Directors (ICP2);
- Governance and enterprise risk management practices need to be developed (ICP 7, 8 and 16);
- Consumer protection should be strengthened, such as requiring the disclosure of commissions and conflicts of interest that intermediaries may have when advising on the purchase of insurance (ICP 19);
- Group supervision framework is weak without a clear definition of financial group or conglomerate. ERM and capital requirements at group level need to be developed and implemented (ICP 9, 10, 14, 15, 17 and 23); and
- Cooperation and information sharing as well as macroprudential surveillance need to be developed (ICP 24 and 25)

7. Since the last assessment, insurance sector regulation has improved significantly. Implementation of risk based supervision and new capital requirements has addressed many gaps identified in the previous FSAP. Although supervisory and industry practices still need more time for full implementation, the regulatory reforms are very welcome steps forward.

C. Market Structure, Insurance Products and Industry Performance

8. The insurance industry in Brazil has been growing significantly to become an important part of the financial sector. Insurance premiums have grown consistently from 2012 to 2016 by about 10 percent annually. Total assets of the sector have reached BRL 900 billion as of the end 2016, composed of life insurers (BRL 749 billion), non-life (BRL 124 billion) and reinsurers (BRL 27 billion)[2], which is about 14 percent of the GDP and 6 percent of the total assets of overall financial sector. Yet, the growth potential of the insurance sector remains significant.

[2] Total assets of the banks and other deposit taking institutions are BRL 8,499 billion.

9. The insurance sector is highly concentrated. SUSEP supervises 154 insurers, of which the market share of the top 5 insurers is 85 percent for life, 74 percent for re-insurers, and the remainder of the sector is small. Total investments of insurers in 2016 were BRL 821 billion. While there are about 6.4 new entrants each year, the total number of insurers has declined since 2012, from 156 to 154. Although most of the decline occurred through mergers or takeovers, a few firms failed or were suspended by SUSEP every year.

10. In addition to insurers supervised by SUSEP, there are 1,261 health insurers supervised by ANS. The majority of health insurers are small with a regional or community focus. The market share of the top 21 health insurers is less than 50 percent. The sector is under a severe consolidation process. The number of health insurers has declined significantly from about 1,600 in 2012 to about 1,200 in 2016. Many of them are small health care providers and policyholders of those failed providers seem to suffer from significant losses of their contributions.

11. Insurance regulation at the entity level requires the separation of entities between health insurance providers and other insurance providers, although there is no requirement at the group level. Health insurers are prohibited from providing any other insurance products. However, there is no such requirement at the group level and thus there are some groups (mainly large insurance groups) that provide both health insurance and other insurance products.

12. The insurance industry remains profitable with high solvency ratios, although careful analysis is needed, especially in the case of life and health insurers. Average ROEs in the last five years are 30 percent for life, 10 percent for property and casualty (P&C) and 12 percent for reinsurers. The average solvency ratios at the end of 2016 were 200 percent for life insurers, 171 percent for P&C and 317 percent for reinsurers. However, some insurers have legacy insurance policies with long-term, high guaranteed rates with real term (guaranteed rate of return is indexed to the inflation) and exposed to other risk, such as longevity, interest rate and inflation risk. These long-term risks may not be reflected in the accounting figures and solvency ratios, particularly those of health insurers.

13. Insurance products are primarily investment linked products, and annuity products without minimum investment return guarantees dominate the life insurance market. Unlike insurance markets in other emerging markets, annuity products (so called "Vida Gerador de Beneficio Livre (VGBL[3])") without minimum guarantees of rate of investment return dominate the Brazilian insurance markets, but with the support of tax benefits. Universal life products have been recently approved and been growing fast, but the market share is still not high. Unit linked products are not significant yet. Non-life insurance is also dominated by traditional lines of business (such as motor, property and liability). The share of less traditional business lines, such as credit, mortgage

[3] VGBL is a flexible-premium deferred annuity product, which was introduced in 2002. The insurance liabilities from VGBL has grown about 300 percent in the last 5 years. One of the reason behind the growth is due to certain available tax exemptions.

and agricultural insurance, is not small and concentrated in a few large insurers, which are part of conglomerate groups.

14. The sector is highly interconnected with large banking groups. The three largest insurance groups have a market share over 60 percent of the insurance sector. Two of these groups belong to banking groups, and the other is a joint venture with the largest bank in Latin America.

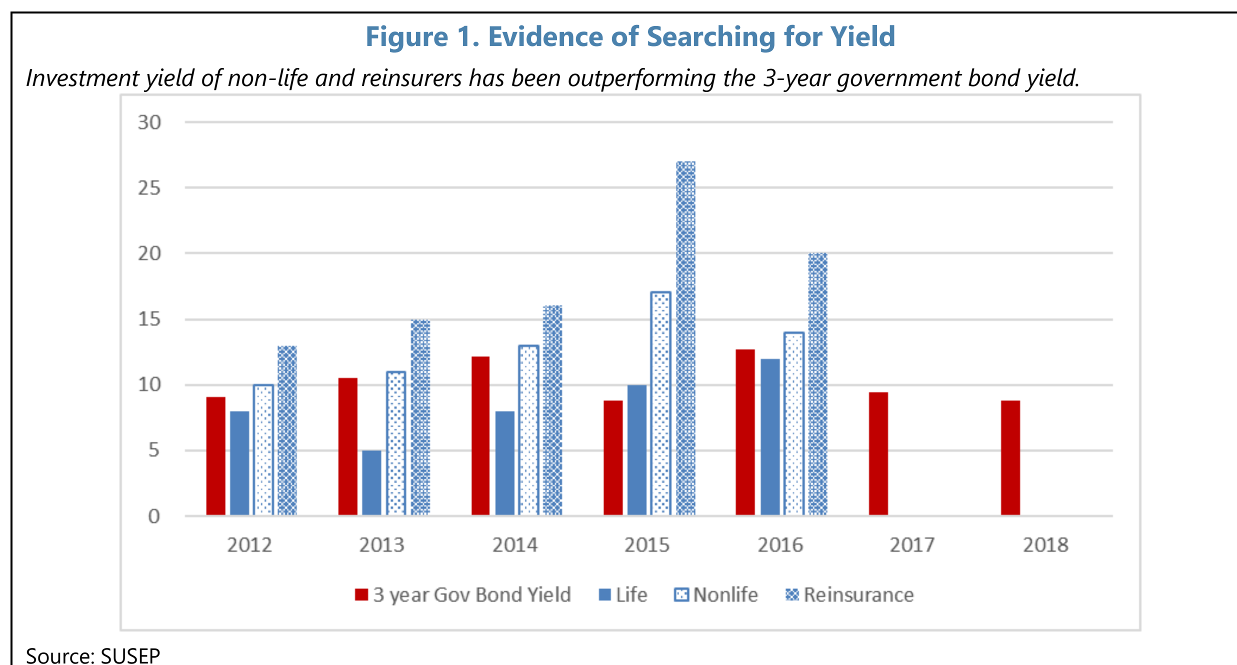
MAIN FINDINGS

A. Key Risks and Vulnerabilities

15. Despite a generally conservative investment profile, anecdotal evidence suggests insurers' increasing search for yield in the last few years. Supervisory data suggests that overall asset allocations remain conservative in both life and non-life insurers. The largest shares of life insurers' investments are allocated to government securities (21 percent for life general account, 79 percent for life separate account). Loans and real estate also account for small shares (mortgage loans 6 percent, other loans 6 percent and real estate 4 percent). However, due to the lack of granularity of the supervisory data, search for yield activities could be hidden in some reported items. For example, non-life insurers have increased the share of "other assets"[4] in total investments from 38 percent in 2011 to 42 percent in 2016. In life, substantial investments have been made in mutual funds, which cannot be looked through. Overall, the investment yield is outperforming the yields of 3-year government bonds, especially those of non-life and re-insurers. Therefore, some leveraged or risky investments could be hidden within the data available to SUSEP.

Figure 1. Evidence of Searching for Yield

Investment yield of non-life and reinsurers has been outperforming the 3-year government bond yield.



Source: SUSEP

[4] According to SUSEP, majority of the other assets would be premium receivables from brokers.

16. Brazilian insurers have also allocated a significant share of investments into funds. As of the end of 2016, life and non-life insurers allocated 10 and 5 percent of their assets to mutual funds, respectively, which cannot be looked through. Additionally, 29 percent of life and 11 percent of non-life insurer investments are allocated to specific funds (FIEs) that require more than 95 percent of the investment into Brazilian government bonds, and for which SUSEP has information of underling assets.[5] While SUSEP has occasional dialogue with the securities regulator (CVM), the cooperation does not include exchange of quantitative data (such as underlying assets and leverage of the funds invested by insurers). SUSEP does not have the power to oversee outsourced entities (including asset managers), and thus has difficulties monitoring the investment activities conducted under the asset management products invested by insurers.

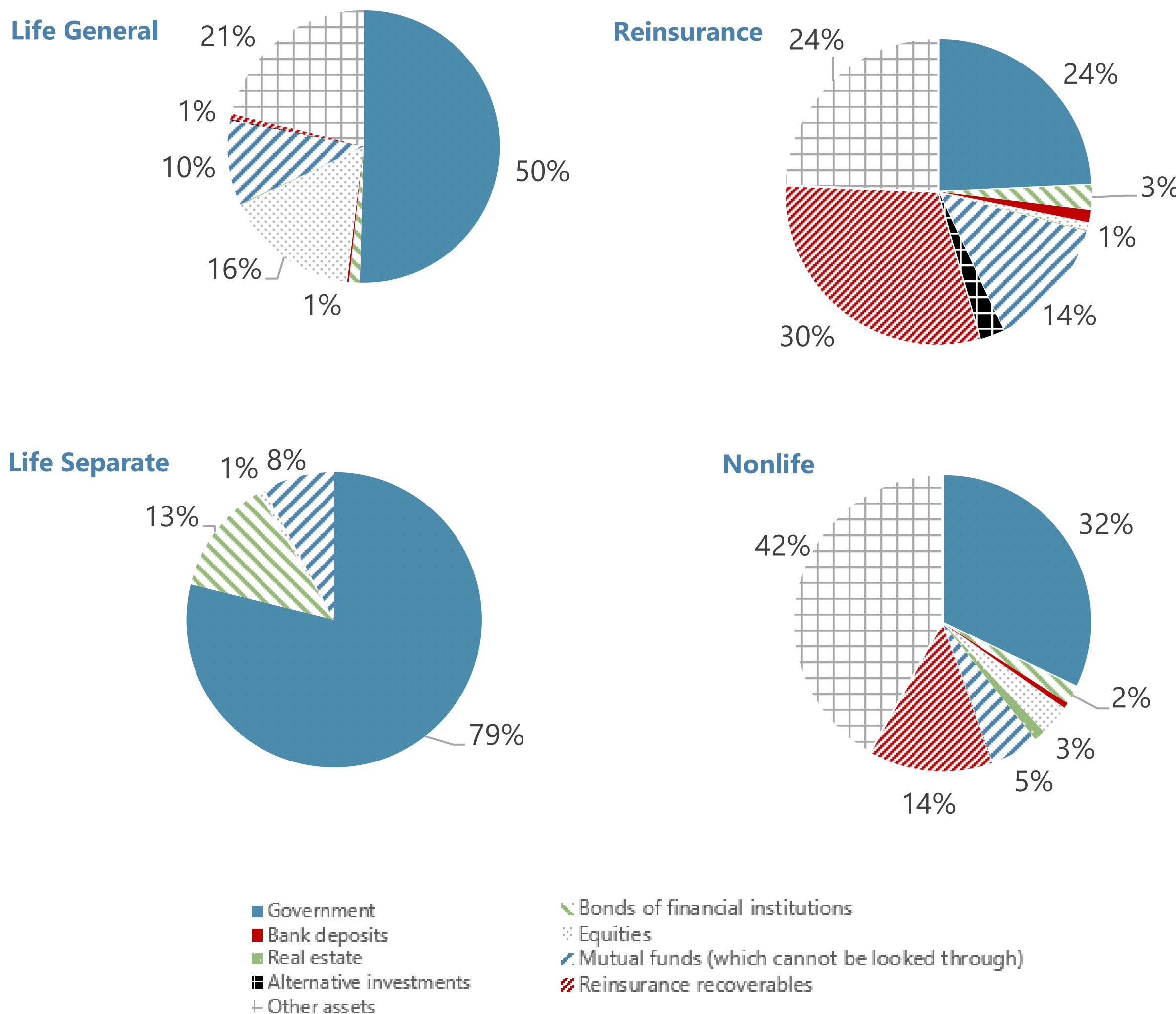
17. Life and health insurers could be exposed to the risks from offering significant guarantees on long-term policies. The average rate for existing products guaranteed by Brazilian insurers is about 6 percent. Although this is not high compared with available government bond yields, guarantees used to be provided in real terms in legacy policies. Individual health insurance is also long term without a premium adjustment. In addition, after normalization of high inflation periods, investment yields from safe assets (such as government bonds) have been dropping significantly. Future investment returns could continue to decrease further and Brazilian life insurers may suffer from negative spreads in the short term. In fact, a significant number of health insurance providers have failed and the policyholders of those providers have suffered a significant loss of their contributions.

18. Despite a significant share of large conglomerate groups, interlinkages between banks and insurers are limited. Large bank-related insurers dominate the insurance market and could be increasing their share further. Currently the interlinkages between banks and insurers are limited due to conservative regulation prohibiting intra-group transactions. The linkage is limited to short-term repo transactions backed by Brazilian Government Bonds.

19. SUSEP and the insurance industry are aware of cyber risks. Some market participants see a business opportunity for the insurance industry. The global cyber risk insurance market may now be worth some US$ 2 billion in annual premiums. Cyber risk also brings hidden exposures in general liability household insurance. For example, power outages due to a cyber-attack may be covered by such policies. Insurers are seeking to evaluate this exposure and reduce the risk by redesigning policy terms. Insurers are also seeking to improve their IT systems to strengthen their own resilience to cyber-attacks. SUSEP has carried out a monitoring study on cyber insurance. SUSEP has a plan to set up a dedicated team to better monitor these insurance contracts.

Figure 2. Investment in Funds by Brazilian Insurers

The investment share of funds that insurers cannot look through the assets reached to 10 percent.



Source: SUSEP

20. There are some new entrants from Insurtechs and SUSEP is monitoring the development carefully. Insurtechs, referring to the use of new technology innovations designed to improve the efficiency of the traditional insurance industry model, have been growing in the insurance market. While SUSEP is aware of such new players and is monitoring their development, the possible impact on the existing insurance sector and implications for policyholders' protection are still unknown, mainly due to the lack of quantitative information of the activities. SUSEP has established a committee on innovation and Insurtech to facilitate requests and clarifications of the regulations from the potential new entrants.

B. Independence and Resources

Institutional Setting and Independence

21. The National Council for Private Insurance (CNSP), which has the ultimate supervisory authority, delegates supervisory responsibilities to the Superintendency of Private Insurance (SUSEP). Regulatory authority is held by the CNSP, chaired by the Minister of Finance and MoF's representative. Representatives from other government bodies, including the Ministries of Justice and of Social Security, the Brazilian Central Bank and CVM. CNSP is responsible for establishing government policies, guidelines and directives. SUSEP acts as the CNSP's supervisory and enforcement arm.

22. SUSEP is headed by the Superintendent and accountable to the Minister of Finance and is responsible for the functioning of SUSEP. The Superintendent is supported in decisions by the Directors Council, which is comprised of the Superintendent and four private Directors. The Superintendent and the Directors of SUSEP are nominated and can at any time be dismissed by the President of the Republic.

23. Private health insurance is underwritten by separate health insurance companies and supervised by ANS. ANS has been established under the Ministry of Health to regulate and supervise the private health insurance and plans. The objective of ANS is to regulate and supervise the health insurance companies to protect the public interest of private health insurance and contribute to the development of health-related actions.

24. SUSEP has faced significant challenges in achieving consistent regulation and supervision due to frequent changes of its superintendents and lack of criteria for qualification for senior management positions. Since the last FSAP, SUSEP superintendents have been dismissed and replaced four times over 5 years, without explanation or disclosure of those dismissals. SUSEP's superintendents and four directors do not have fixed terms, and can be dismissed by the president of the country at any time. There are no qualification criteria for the superintendent and directors. Therefore, it is possible and even more common that a person with little operational experience in insurance supervision or the industry can be appointed. Regulatory reforms, including the introduction of risk based supervision, seem to be suffering from the instability of the management and changing views on priorities.

25. SUSEP continues to face significant constraints in its flexibility on its budget allocation. SUSEP's budget mainly stems from the fees imposed on the insurance industry (such as licensing fees, inspection fees and sanctions). However, its budget allocation is subject to significant constraints, similar to other governmental agencies. For example, the annual budget of SUSEP must be approved by the Ministry of Planning (MoP) and the National Congress, which take into

consideration the need for a primary surplus for the government as a whole. Day-to-day operation is also subject to strict constraints[5].

26. SUSEP staff are subject to lawsuits even for actions taken in good faith while discharging their duties. In some cases, SUSEP could not provide legal support in such lawsuits due to budgetary constraints and other reasons, and thus the staff have had to defend themselves in the court without SUSEP legal or financial support.

27. Industry has a significant presence throughout the appeal process, which combined with limited legal protection of staff, may prevent prompt regulatory action. A considerable number of penalties[6] have been appealed by the industry. The appeal is reviewed by the Council of Resources of the Ministry of Finance (CRSNSP). The council is chaired by one of the representatives appointed by the MoF, and constituted by an equal number of government and industry representatives. Appeal processes can last a substantial period of time (several months to years) and during the process the regulatory action remains ineffective. While this does not prevent SUSEP from taking other actions (such as imposing additional reporting requirement), it hinders prompt effective regulatory actions by SUSEP.

Resources

28. SUSEP is suffering from a severe shortage of its resources, partly due to its difficulty in hiring skilled staff from the industry. While this was one of the most important recommendations in the previous FSAP, the situation has worsened since the last FSAP. The number of staff has decreased from 462 in 2011 to 381, about a 20 percent decline. The main reason is that a number of staff have retired. When staff retire, SUSEP must hire the new staff who have passed SUSEP's examination within 2 years. However, the SUSEP examination has not been conducted since 2011. SUSEP has requested conducting the examinations every year. However, the request must be approved by a number of government agencies, including MoF and MoP, and the approval has not been made since 2011. Hence, SUSEP has not been able to hire any new staff since 2013 and the staffing level declines over the years. In addition, due to constraints that SUSEP has as part of the central government, SUSEP does not have a hiring process dedicated to mid-career experts from the outside. Therefore, it must rely on new incoming staff, typically recent university graduates, and develop their skills through internal training. Salary levels for skilled staff seems to be competitive enough to retain experts in SUSEP, however, SUSEP is legally constrained from offering competitive salaries to hire skilled staff from outside.

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[5] For example, any international travel of SUSEP staff needs ministerial approval by Ministry of Finance (MoF).

[6] The number of appeals used to be over 60 percent of all penalties and has been reduced, but is still. Between 2013 and 2017, about 47 percent of penalties are appealed by the subject insurer. Among the appeals presented, there are about 22 percent cases where SUSEP decisions had been totally reversed by the CRSNSP, about 19 percent where SUSEP decisions had partially maintained and about 59 percent where SUSEP decisions had fully maintained by the CRSNSP.

Recommendations

29. The SUSEP superintendent and directors should be protected by clear rules, e.g., in legislation, including fixed terms, conditions for dismissal, public disclosure of dismissal reasons and qualification criteria for the new appointments. Superintendents and directors could be dismissed anytime for any reason and have been dismissed without public disclosure of the reasons. This could have material impact on SUSEP's operational independence. This should be rectified as soon as possible by establishing legally binding rules and established fixed terms, clear conditions for dismissal, public disclosure of the dismissal reasons and qualification criteria for the new appointments.

30. Legal protection of SUSEP staff should be enhanced. The risk of legal action against supervisors could significantly impact the promptness of regulatory and enforcement actions by the staff. Therefore, it is critical to ensure that lawsuits against staff who acted in good faith are appropriately supported in terms of both the cost and legal process.

31. Accountability of regulatory actions should be ensured through well-defined and transparent procedures. While the mission supports due process to appeal SUSEP regulatory actions, the current appeal processes hinder timely action and effective protection of the policyholders. An equal number of industry representatives to governmental representatives in the Council of Resources of the Ministry of Finance (CRSNSP) seem to give undue power to the industry. The membership of CRSNSP, with an equal number of government and industry representatives, should be amended. Representation could be complemented by representatives of policyholders, and academics with proper knowledge of the insurance sector, etc. SUSEP should enhance accountability using various means, such as more disclosure of the internal guidelines, public consultation, and dialogue with the industry and policyholders.

32. SUSEP should endeavor to hire skilled experts for its emerging needs. Recent regulatory reforms, such as risk based supervision, internal model validation, implementation of ERM, and emerging Fintech and cyber risks require skilled experts. SUSEP may not be able to train such skilled experts solely with organic growth. SUSEP should find a way to hire a small number of skilled experts to acquire those necessary skills quickly from the industry or foreign regulators.

C. Solvency Standards

Valuation of Assets and Liabilities

33. The valuation of assets for solvency purposes is generally based on market value. Financial assets data are provided by the custodian houses, processed by SUSEP on a daily basis, and assessed on a monthly basis, in addition to the reporting from the insurance company. Other illiquid assets, such as real estate, are valued at acquisition cost or accounting book value. For these assets, provisions are made to reflect the impairment.

34. The valuation of liabilities is based on the best estimate for liabilities, without an explicit margin over current estimate (MOCE[7]). Three yield curves are specified for discounting insurance cash flows and updated monthly by SUSEP. In addition, two additional curves are calibrated with reference to an ANBIMA (Brazilian Association of Financial and Capital Markets Entities) model. Alternatively, insurers can submit alternative curves for approval to SUSEP. Some firms are using a curve derived from appropriate government bond yields up to the last liquid point (10 years), with specified extrapolation and the Ultimate Forward Rate (UFR). In addition, SUSEP approved different approaches upon insurers' requests, with some insurers using the average of observed yields as a proxy of the UFR. While there is no explicit margin, unrealized gains from the future premiums of long term policies are capped at zero and can be used only to offset the market risks associated with the future premiums. Therefore, such an adjustment comprises an implicit MOCE. No further capital adjustment is made beyond that of market risk, as described.

Capital Requirements

35. A revised insurance supervision legislation is in place. The Act to Modernize Financial Supervision of Insurance Undertakings, enacted in April 2015, sets out the new valuation requirements, own funds rules, provisions on the calculation of the Solvency Capital Requirement (SCR), governance requirements for insurers, etc. The requirement has been fully implemented since the end of 2017. Required capital is composed of credit, market, underwriting and operational risks.

36. The calibration of risk factors for the standardized approach differs among risk categories. For example, market risk is calibrated with Value at Risk (VaR) with a 99 percent confidence level over a 3-month horizon. Credit risk, except that which is against reinsurers and other insurers, is based on the Basel III standardized approach for the banking sector. Other factors are calibrated mainly based on Tail Value at Risk (T-VaR) with a 97.5 percent confidence level over a one-year horizon. Credit risk factors for reinsurance are calibrated differently among the types of reinsurers, with confidence intervals of 97.5 percent for domestic reinsurers, 99.5 percent for admitted reinsurers and 99.9 percent for other reinsurers. There is no single, consistent confidence level with capital requirement calibrations.

37. SUSEP has also introduced reduced risk factors with a lower confidence level for underwriting risks to give insurers a strong incentive to adopt governance and risk management requirements. SUSEP has struggled with the industries' lack of commitment to improve governance and risk management practices. To stimulate the improvement, SUSEP has introduced a reduced risk factor to underwriting risk with a 95 percent confidence level over a one-year horizon, which effectively reduces the risk factors by about 18–25 percent. To qualify for the reduced risk factors, an insurer must hire an external auditor to certify that the insurer meets the

[7] Margin Over Current Estimate (MOCE) is the additional cost of covering the uncertainty inherent in the insurance liabilities. Economic value of insurance liabilities exceeds the current estimate of the cost of meeting the insurance obligations by an amount covering this uncertainty. This excess is the MOCE. It is important to make the MOCE explicit, otherwise it becomes unclear even to the insurance supervisors the level of conservativeness of the solvency requirement.

conditions for SUSEP approval, such as presence of a board of directors, independence of the chairman, and formal and periodic communication from the risk management unit to the board. SUSEP can withhold approval if it finds deficiencies at an on-site inspection.

38. While an internal model is allowed for capital requirements, there is no validation requirement in place. If an internal model is allowed, ICP 17 requires three tests—the "statistical quality test", "calibration test" and "use test" (i.e., whether the model is used in key business decisions and controls)—ahead of the formal application process. However, such requirements have not yet been formalized, except as a high-level principle that internal models should be calibrated based on a 99 percent VaR with 1-year time horizon. While SUSEP has not officially communicated with the industry, there is no plan or capacity to approve any internal model in the near future. No partial internal model is allowed. It is also noted that the targeted calibration level is much higher than the target used to calibrate the standardized approach, and thus the incentive for the industry to apply to internal models is limited at this stage.

39. Even for the standardized approach, complex cash flows can be incorporated without restrictions. The input for the market risk of the standardized approach is cash inflow and outflow of all financial instruments, including derivatives and insurance policies. Some cashflows, especially those from derivatives, are subject to optimality, non-linearity and high volatility conditions, depending on the scenario. Derivative contracts for hedging could be short term and are subject to roll-over risk. Those unilinear and roll-over risks may not have been incorporated into the market risk. SUSEP is following up monthly or semi-annually and monitors the changes of the cashflow projections very closely.

Investment

40. The National Monetary Council (CMN) establishes rule-based requirements for the admitted investments of insurers. The investment rules are strict. For example, foreign investment is generally prohibited, with a few exceptions that are related to the currency matching instruments for policies issued in foreign currency. Securities lending is not allowed for the assets backing the technical provisions. For other assets, 100 percent collateral is required. Intra-group transactions are generally prohibited except repo and securities lending transactions from an insurer to the group bank. The use of derivatives is restricted solely for hedging purposes, if directly engaged by an insurer.

41. However, there are number of exceptions in the strict investment limit, including those through investment funds. Securities lending and repo transactions are allowed between group entities with certain conditions. The use of derivatives for leverage purposes is also allowed in investment funds up to their net asset values. There is a disincentive for insurers to invest in funds in which the underlying asset cannot be looked-through, as the market risk capital charge for the investment would be assigned the highest (about 20 percent which is equal to equity investment). SUSEP has a limited ability to monitor the investment activities conducted by investment funds as information exchanges with CVM are limited and no quantitative data has been exchanged.

Capital Resources

42. Only a high quality of capital resources is recognized. Insurers must deduct intangible assets from net capital, including real estate investments (REITs and other investments are excluded from the deduction), and investment in subsidiaries or affiliates. Subordinated debt or other innovative capital instruments are not recognized as capital, while preferred stock is recognized as a capital resource. Profits from unrecognized future premiums are not recognized as capital resources. Cross-shareholding (reciprocal participation) or investment into private securities issued by financial institutions within the same group is prohibited. Investment in public securities issued by financial institutions within the same group is allowed with certain conditions, such as index-linked investment through investment funds.

Recommendations

43. SUSEP should communicate to the public that reduced factors for the companies that have adopted higher governance and risk management practices are only for a transitional period. Reduced factors, which are applicable to underwriting risk, could compromise the protection of policyholders and thus should be granted to insurers only for a limited period. SUSEP should limit reduced factors' application for a very short term. In addition, it is also important to make public which companies are using the reduced factors and the impact of the subsequent reduction of the capital requirements. SUSEP should also prioritize on-site inspections of insurers, particularly for those that fail to meet the minimum capital requirements without the reduced factors, and to minimize any compromise of the protection of policyholders.

44. SUSEP should require all insurers to meet higher governance and risk management requirements once the transitional period ends. Robust governance and risk management are the most important prudential requirements. Although proportionate application is also important and the requirements should be tailored to the nature, scale and complexity of each insurer's business model, some of the requirements of higher governance and risk management (such as establishment of the board, requirement of the independence, risk and exposure reporting to the board, development of business continuity plan, etc.) should be implemented as minimum standards for all insurers.

45. SUSEP should communicate to the public that internal models would not be approved until SUSEP has obtained proper resources, and developed a robust and transparent validation standard for internal models. As this is a new and difficult challenge for SUSEP, it should seek advice from supervisors with experience and knowledge of model validation. This includes the model validation team for Internal Rating Based Approach of the Basel Accord in the BCB and foreign insurance regulators (such as European insurance regulators). Given the vulnerabilities of the independence of SUSEP, it is important to obtain proper resources and ensure a rigorous approval process for internal models, without undue external influence. SUSEP should also make the approval process as transparent as possible.

D. Groupwide Supervision

46. Insurance supervision is predominantly focused on the solo entity, with limited contagion risk analysis. There is no formal regulation and supervision imposed at the group level. Related party transactions (including between the insurance entity and its parent bank) are prohibited, except repo and securities lending and index-linked investment through investment funds. SUSEP and the BCB monitor the compliance with the regulations to ensure that contagion risk between banks and insurers is limited. SUSEP used to have a division dedicated to group and macroprudential supervision. However, the division was disbanded soon after its creation without producing any output.

47. SUSEP has limited power beyond its supervised entities, including outsourced entities. Brazilian insurers are heavily reliant on asset managers, typically within the same group, for their investments. Emerging digitalization, Fintech and Insurtech could accelerate this trend of outsourcing of IT and data management. Although SUSEP can supervise indirectly those outsourced functions through its supervised entities, it is not a high priority focus of its on-site and off-site practices.

48. The BCB monitors carefully any possible contagion risk from the insurance sector to the banking sector. While contagion risk is limited at this stage, the BCB requires its conglomerate banking groups to assess all material risks of the entire group, including underwriting and other risks in insurance subsidiaries, as part of their Internal Capital Adequacy Assessment Plan (ICAAP) and report it annually to the BCB. The BCB analyzes the adequacy of the capital and liquidity positions of the insurance entities and has also conducted capital and liquidity stress tests of the conglomerate groups. The exercise identified that the risks of the banking group to its capital and liquidity are limited at this stage, even under conservative assumptions and scenarios.

49. While SUSEP, the BCB and CVM coordinate their supervisory actions, there is room for improvement. Based on MoUs, the three institutions can exchange information with each other. SUSEP and the BCB meet regularly to assess risk both quantitatively and qualitatively, exchange key findings of their recent inspections, coordinate the scope and timing of future on-site inspections, and discuss how to improve the identification of risks. However, there are gaps in coordination. For example, SUSEP does not have access to the quantitative information of CVM, which is important to understand insurers' exposures to investment funds. Further, the cooperation protocol does not provide a clear demarcation of oversight responsibilities between agencies, for example there is no clear responsibility assigned to market conduct of insurance products sold by banks.

50. Inconsistent approaches among authorities could pose material challenges to the industry and create opportunities for regulatory arbitrage. An example is the adoption of IFRS standards. SUSEP has already implemented economic-based valuation for insurance liabilities, which includes IFRS 4 and some part of the upcoming IFRS 17 requirements, such as explicit, unbiased and probability-weighted estimates of the present value. ANS has not yet implemented either economic-based valuation of insurance liabilities or IFRS 4, and there seems no intention to implement IFRS

17 in the future, although some health insurers have voluntarily adopted some requirements of IFRS 4, such as the liability adequacy test. For general purpose accounting of listed companies, CVM is responsible for the implementation of the corresponding Brazilian accounting standard. Insurers need to have a consistent accounting framework between assets and liabilities. Therefore, IFRS 9 implementation which applies to the asset side, should be implemented at the same time as the IFRS 17 implementation, which applies to the liability side. While SUSEP is coordinating with the industry, there seems room for improvement in coordination among authorities and their accountability to the relevant industry and public.

Recommendations

51. SUSEP should work together with the BCB, ANS and CVM to establish and implement consistent group-based supervision. While conservative regulation limits the contagion risk between entities even within the same group, there is still significant contagion risk through the reputation channel. Many new regulations (such as ERM, governance requirements) will only become effective if they are appropriately implemented at the group level. Therefore, there is significant merit for SUSEP to implement group supervision and for the respective authorities to coordinate its implementation. Cooperation should be gradually expanded from information exchange to more coordinated actions (including joint-rule making, joint-reporting, joint-inspection and coordinated supervisory actions).

52. SUSEP should take the lead in coordinating with the relevant authorities to facilitate the smooth implementation of IFRS 17. SUSEP has significant expertise and experience in actuarial practices and is in the best position to take a leading role. Implementation of IFRS 17 could have a material impact on the insurance industry, especially through higher volatility of profits and losses. Thus, inconsistent implementation could cause material regulatory arbitrage. It is also recommended that SUSEP encourage the industry to improve its Asset and Liability Management (ALM) to mitigate the impact of IFRS 17.

53. SUSEP should also take a more active involvement in international discussions. It would provide the opportunity to convey their views on relevant international standards, such as the IAIS Insurance Capital Standard. Such international engagement would help SUSEP identify the best internationally acceptable approaches to address the high volatility of asset and liabilities, especially those of long-term insurance policies.

E. Macroprudential Surveillance

54. SUSEP established a special division for group and macroprudential supervision in 2013, but it was short-lived and with no output. However, SUSEP occasionally conducts surveillance at the industry wide level[8]. While bank and insurance regulations mitigate significant

[8] For example, in 2016, SUSEP identified the risk of unexpected losses from large construction projects. A number of construction companies was under scrutiny for their involvement in corruption scandals and some were facing solvency challenges. SUSEP collected information from the industry using ad-hoc reporting requirements and analyzed the potential impact of the industry.

contagion risk, the BCB has conducted stress tests of capital and liquidity with an assumption that banks will step-in and cover all capital and liquidity loss from their insurance subsidiaries. The exercise suggests that cooperation between BCB and SUSEP is effective (Box 1).

Box 1. Stress Test for Step-in Risk

The BCB conducts regular stress testing, cooperating with other authorities. Quarterly stress tests cover comprehensive risks of banking groups. In those exercises, the BCB examines the risks and potential contagion from insurance companies to the banking group, by quantifying step-in risks.

The BCB also monitors liquidity risk of the insurance sector. The BCB collects liquidity flow data of investment funds from CVM, and identifies episodes of increased volatility in the net inflows in insurance-related funds. Annuity products underlying those funds have high redemption rates, and the entire insurance industry faced a significant net outflow in June and July 2013. The higher outflows have been observed more frequently at the individual insurer's level, and the outflow at the company level reached several hundreds of million BRL.

The industry-wide liquidity outflow in July 2013 was due to a regulatory change and coincident interest rate hike in long-term sovereign bonds. In January 2, 2013, CMN Resolution 4176 was issued, which required a minimum duration of 5 years for the portfolios of pension, annuity and capitalization productions from May 31, 2013. In addition to this sudden regulatory change, the hike in interest rates in the first half of 2013 led to several long-term fixed income funds showing negative returns. This circumstance triggered a series of withdrawals from the annuity and capitalization products. SUSEP opposed the reform made in the CMN Resolution 4176. Recently, through CMN Resolution 4633 / 2018, part of the requirements has been amended.

Stress tests for step-in risk analyzed both the capital and liquidity impact on the parent banks. The BCB's stress test uses a stress test calibrated with about a 95 percent confidence level over one month, based on historical outflow data since 2000. This scenario includes up to 50 percent of NAV as a redemption shock in some funds. As insurers have a significant amount of high-quality liquid assets (HQLA) held in the insurers' investment funds, mainly Brazilian government bonds and reverse repos based on the bonds, a stressed redemption shock could be covered by ordinary sales of those assets. The BCB quantifies the step-in risk with the estimated amount of additional liquidity and capital that the parent banks need to provide to support the outflow of the insurers. The additional capital requirement is also calculated, assuming that banks would continue to hold the illiquid assets.

The analysis found that the impact of capital and liquidity of the banks is limited at present. While stressed redemptions exceed HQLA in some insurers, the LCR surplus of the parent bank is much higher than the redemptions. The capital impact to banks is also negligible.

It is recommended for the BCB to continue the stress tests regularly to monitor the liquidity risk of the insurance sector. The majority of the insurance products (VGBL) provides greater flexibility for policyholders to choose their asset allocation. In a lower interest rate scenario, policyholders are likely to choose riskier and less liquid asset allocation. This could have an adverse impact to the liquidity risk from insurance sector to the banking sector. It is important for the authorities to keep monitoring the liquidity risk and take regulatory actions if needed.

Recommendations

55. The BCB and SUSEP are encouraged to enhance their cooperation further to ensure prompt identification and analysis of emerging risks. The stress tests provide a useful picture of important contagion risks between banks and the insurance sector. However, further input from SUSEP into the BCB's stress testing exercise will enrich the analysis. For example, a deeper analysis of the reasons behind high redemptions and cash outflows of the insurance products could be conducted with more granular data sharing from SUSEP. The focus could be usefully expanded to cover other material risks (such as interest rate risk) of the entire conglomerate groups. Regular stress testing or scenario analysis of large conglomerate groups with close cooperation between the BCB and SUSEP could be useful for the vulnerability analysis of the entire Brazilian financial sector.

F. Governance and Market Conduct

Governance and Risk Management

56. While minimum corporate governance requirements are in place based on the general companies act, material gaps still exist. The board of directors is not mandatory for all companies, and there are no specific rules regarding the composition of the board. While for listed companies, the board of directors is mandatory with additional qualification criteria, qualification criteria are not sufficient for non-listed companies. SUSEP recently issued a circular to create an incentive for insurers to set up a board of directors, by reducing the capital charge for those companies which meet the criteria including those for corporate governance.

57. SUSEP recently introduced Enterprise Risk Management (ERM) in addition to the minimum risk management requirements. Basic risk management requirements have been in place since 2004. In addition, SUSEP circular 517/15, which regulates the implementation of ERM, became effective as of January 2018, and SUSEP is monitoring its implementation by requiring a self-assessment of the compliance for all insurers. SUSEP is also in close dialogue with the industry about the new regulation and how to expand the requirements to cover Own Risk and Solvency Assessment (ORSA). The industry seems to be supportive of the new regulation. Depending on the outcome of the questionnaire, SUSEP would follow up the compliance with off-site monitoring and on-site inspections.

Complaint Handling and Fair Treatment of Policyholders

58. The Brazilian insurance industry has been receiving a considerable number of complaints from policyholders. SUSEP requires each insurer to (i) establish administrative procedures to address policyholders' complaints; and (ii) have an ombudsman, who handles cases involving claims up to BRL 30,000 per event. SUSEP has also established a consumer orientation and protection program (PROCON) that receives policyholders' complaints and intermediates with the insurer to resolve the issues. Since 2015, SUSEP has received over 25,000 complaints annually. This figure does not include the number of complaints that PROCON or insurer's ombudsman office have

received from the policyholders[9]. In addition, among the complaints, a significant number of cases (over 400 cases in each year) has resulted in some kind of regulatory action (typically on-site inspections). The complaints received by SUSEP are sent to the insurer's ombudsman office, which needs to address the case within fifteen days.

59. Complaints from policyholders suggest material risk in market conduct in the insurance and conglomerate sectors. There is a wide range of complaints, including issues pertaining to payment procedures and amounts, non-payment, inappropriate procedures in claim handlings and issues related to portability of annuity products. SUSEP requires a maximum period of 30 days for claim settlement. In addition, there seems to be increasing complaints regarding the sales practices related to banks' lending activities. Specifically, banks and other financial entities that provide loans and credits require the potential borrowers to buy insurance products as a condition of the loan, but these products are sold without a clear explanation of the features or level of fees associated with the products. In 2018, SUSEP proposed regulation to impose a new standard to address the practices of tie-in sales as well as to foster the market competitiveness. The proposed standard includes, (i) determining that the insurance documents are different and separate from the instruments used for contracting the related obligations; (ii) stating in the proposal that the credit insurance is optional contracting; and (iii) prohibiting the credit approval or the effectiveness of the contract related to the obligation to contracting the insurance.

60. Complaint handlings are requiring significant resources of SUSEP. Partly due to the seriousness of the situation of the complaints, SUSEP allocates a significant number of staff to handle policyholders' complaints, including 30 inspectors and 20 general staff to respond to the calls from the policyholders. SUSEP is outsourcing some functions but its resources are still limited.

Product Approval Approach

61. SUSEP has the power to approve contract conditions. SUSEP requires approval of new insurance products[10] and the process is utilized for the following objectives: i) to ensure their compliance with legal requirements, ii) to promote fair treatment of policyholders, taking into account the level of consumer education, iii) to check the technical capacity of insurers, their in-house product development, and market conduct of business, iv) to check the suitability of the distribution channels, v) to encourage innovations, and vi) to enhance access to all segments of the society. SUSEP evaluates the complexity of the products and discusses with the insurer the sales materials, which helps the sales representatives explain the key features of the product to the policyholders.

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[9] The total number of complaints received by PROCON and the insurers' ombudsman offices is estimated about 60,000 annually.

[10] Prior approval is required for most of the life products. For other products, such as non-life products, although SUSEP does not approve the products, it can suspend the sales of the products.

Regulation and Supervision of Brokers

62. SUSEP requires brokers to register, however, brokers are subject to very limited regulation and supervision. Sales of insurance products (except annuity products) need to be conducted by brokers, who negotiate the premium, and receive the premium and claims on behalf of policyholders. In addition, the commission charged is not regulated by SUSEP. As of end-2016, there were more than 100,000 brokers registered with SUSEP. SUSEP has conducted on-site inspections of a small number of brokers but mainly to address complaints.

63. Non-life insurers have high premium receivables on their balance sheets. While there is a legal requirement for brokers to send the premium received from the policyholders to the insurer immediately, insurers still have premium receivables from the policyholders. In addition, there is a limited requirement for the broker to safeguard the client's money from credit and other risks arising from brokers. Partly due to such lack of regulation by SUSEP, non-life insurers seem to have a significant amount of premium receivables. As is described in the risk and vulnerabilities section, non-life insurers have more than 40 percent of their total assets in "other assets", and most seem to be premium receivables. However, SUSEP does not have quantitative information on how much of "other assets" are premium receivables. Some receivables are due to a wide-ranging industry practice of installment payments by the policyholders.

Risk Based Supervision of Conduct

64. SUSEP is in the process of introducing risk based supervision for market conduct. Historically and currently, SUSEP has relied heavily on the information in the complaints obtained directly from policyholders and the complaints database of insurers. Recently, SUSEP has developed quantitative indicators for market conduct and they are in the process of implementation. Collection of more quantitative information not only of complaints but other indicators, such as surrender rates and loss ratios of each business line, would help SUSEP to act in a more forward-looking manner to address market conduct risk.

Disclosure

65. SUSEP has imposed limited disclosure requirements on the brokers. CNSP Resolution 117/2004 and SUSEP circular 256/2004, etc. require minimum elements that contractual details should be made available to the policyholders when the contract is made. However, there is no such requirement during the sale process and the quality of the information made available to the policyholders needs improvement. Brokers are not required to disclose either conflicts of interest or commissions. Policyholders' complaints suggest that brokers tend to offer products not based on the best interest of the customers but more motivated by higher sales commission.

Recommendations

66. The collection of more granular information would make SUSEP's risk based supervision more effective. SUSEP has collected information on complaints by itself and from

insurers. However, the data are not comprehensive, granular or timely. It is important for SUSEP to collect more granular information relevant to market conduct, such as lapse / surrender rates, and more comprehensive and timely data about complaints, commission levels, sales growth rates by products, etc. Such information will help SUSEP to prioritize its focus on off-site monitoring and on-site inspections.

67. Prior to all sales, SUSEP should require all intermediaries to disclose information that is clear and understandable for the policyholder, as well as conflicts of interest and commissions sales. The 2012 FSAP noted the challenging environment to address conflicts of interest arising from large conglomerates, and recommended enhancing the disclosure of conflicts of interest, as well as requirements to disclose commissions and fees. This would become even more important as insurance products are expected to become more complex, such as the introduction of unit-linked products.

68. SUSEP, in close cooperation with the BCB and CVM, should make improving the quality of advice of insurance intermediaries a priority. The lower interest rate environment is likely to encourage policyholders to take more risk in their annuity products and unit-linked products. This would require insurance intermediaries to provide advice about investment opportunities and the riskiness of assets. The establishment of qualification criteria for intermediaries who can sell investment linked products (including VGBL) is recommended. To improve the quality of advice as soon as possible, thematic inspections targeting training programs for intermediaries should be conducted for insurers with high share of investment linked products. In addition, SUSEP could consider conducting anonymous inquiries (so called “mystery shopping”) to evaluate the quality of advice.

69. The oversight responsibility with regard to market conduct of insurance products sold at bank branches could be clarified further. Annuity products sold by bank branches are exempted from brokerage requirements. As CNSP or SUSEP has not yet imposed any regulation to the sale channel, SUSEP does not have the legal enforcement power over sales staff in bank branches. The BCB can take enforcement actions for the mis-selling of insurance products conducted at a bank branch, if it involves any banking activities (for example, the payment of the premium has been made through a checking account). However, its legal power against purely insurance sales at a bank branch is unclear. It should be clarified further that CNSP and SUSEP are responsible for the oversight of the mis-selling of insurance products at a bank branch. In addition, the identified authority should impose proper requirements (such as licensing, qualifications, disclosure, governance) on the intermediaries and take appropriate actions if necessary. SUSEP is in advanced negotiations with the BCB to implement several actions such as: sharing remote supervision system, internship at the BCB and conducting joint supervision. In addition, SUSEP is in the process of enhancing its coordination with PREVIC and ANS.

Annex I. Detailed Analysis of Selected ICPs

<table>
<tr><th colspan="2">Detailed Comments on the ICPs</th></tr>
<tr><td>ICP 2</td><td>Supervisor
The supervisor, in the exercise of its functions and powers:
• Is operationally independent, accountable and transparent;
• Protects confidential information;
• Has appropriate legal protection;
• Has adequate resources; and
• Meets high professional standards.</td></tr>
<tr><td>Description</td><td>Operational Independence
The chairman of the CNSP is the Minister of Finance or his representative, and its vice-chairman is the Superintendent of SUSEP. In practice it is the Executive Secretary of the Ministry of Finance that chairs the CNSP meetings as the presence of the minister is not usual. Representatives from the following government bodies also have a seat on the CNSP: The Ministry of Justice; the Ministry of Social Security; the Brazilian Central Bank—BCB (Banco Central do Brasil); and the Securities Commission—CVM (Comissão de Valores Mobiliários).
SUSEP has faced significant challenges of consistent regulation and supervision due to frequent changes of their superintendents and lack of a qualification criteria for the senior management. Since the last FSAP, SUSEP superintendents have been dismissed and replaced four times over 5 years, without explanation or disclosure of those dismissals. SUSEP's superintendents and four directors do not have fixed terms, and can be dismissed by the president of the country at any time. There are no qualification criteria for the superintendent and directors. Therefore, it is possible and even more common that a person with little operational experience in insurance supervision or the industry can be appointed. Regulatory reforms, including the introduction of risk based supervision, seem to be suffering from the instability of the management and changing views on priorities.
SUSEP continues to face significant constraints in its flexibility on its budget allocation. SUSEP's budget mainly stems from the fees imposed on the insurance industry (such as licensing fees, inspection fees and sanctions). However, its budget allocation is subject to significant constraints, similar to other governmental agencies. For example, the annual budget of SUSEP must be approved by the Ministry of Planning (MoP) and the National Congress, which take into consideration the need for a primary surplus for the government as a whole. Day-to-day operation is also subject to strict constraints.</td></tr>
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	Legal Protection SUSEP is also under severe industry influence with limited legal protection, which may prevent prompt regulatory action. A considerable number of penalties have been appealed by the industry. The appeal is reviewed by the Council of Resources of the Ministry of Finance (CRSNSP). The council is chaired by one of the representatives appointed by the MoF, and constituted by an equal number of government and industry representatives. SUSEP staff are subject to lawsuits even for actions taken in good faith while discharging their duties. In some cases, SUSEP could not provide legal support in such lawsuits due to budgetary constraints and other reasons, and thus the staff have had to defend themselves in the court without SUSEP legal or financial support. Appeal processes could last a substantial period (several months to years) and during the process the regulatory action remains ineffective. While this does not prevent SUSEP from taking other actions (such as imposing additional reporting requirement) it hinders prompt regulatory actions by SUSEP. **Resources** SUSEP is suffering from a severe shortage of its resources, partly due to its constraint to hire skilled staff from the industry. While this is one of the most important recommendations in the previous FSAP, the situation has worsened since the last FSAP. The number of staff has decreased from 462 in 2011 to 381, about a 20 percent decline. The main reason is that number of staff have been retired. When staff retired, SUSEP has to hire the new staff who have passed SUSEP's examination within 2 years. However, SUSEP examination has not been conducted since 2011. SUSEP has requested to conduct the examinations every year. However, the request must be approved by a number of government agencies, including MoF and Ministry of Planning (MoP), and the approval has not been made since 2011. Hence, SUSEP has not hired any new staff since 2013 and the staffing level declines over the years. In addition, due to constraints that SUSEP has as part of the central government, SUSEP has not hired mid-career experts from the outside, and must rely on new incoming staff, typically recent university graduates, and develop their skills through internal training. Salary levels for skilled staff seems to be competitive enough to retain experts in SUSEP, however, SUSEP cannot offer competitive salaries to hire skilled staff from outside due to its limitation as a part of the Brazilian government agencies. **Source of Financing** SUSEP's main source of financing is the inspection fee, which is prescribed by Law No. 12.249 of 2010. In 2017, the fees and fines collected by SUSEP were BRL 242 million and the expense limit was BRL 226 million, while the actual expenses were BRL 220 million. The annual budget of SUSEP must be approved by the MOP and the National Congress, which take into consideration the need for a primary surplus for the government as a whole. Depending on the amounts involved, additional resources or the reallocation by SUSEP of already approved resources might require the approval of the Ministry of Planning or the National Congress. Currently the number of staff positions approved by Congress is on the order of 800; however, only around 500 positions have been

	confirmed by the MoP. Any international trip needs ministerial approval and is published in the Official Gazette.
Comments	The SUSEP superintendent and directors should be protected by clear rules such as the law, including fixed terms, conditions for dismissal, public disclosure of dismissal reasons and qualification criteria for the new appointments. Superintendents and directors could be dismissed anytime for any reason and have been dismissed without public disclosure of the reasons. This could have material impact on SUSEP's operational independence. This should be rectified as soon as possible by establishing legally binding rules and established fixed terms, clear conditions for dismissal, public disclosure of the dismissal reasons and qualification criteria for the new appointments. Legal protection of SUSEP staff should be enhanced. The risk of legal action against supervisors could significantly impact the promptness of regulatory and enforcement actions by the staff. Therefore, it is critical to ensure that lawsuits against staff who acted in good faith are appropriately supported in terms of both the cost and legal process. SUSEP should endeavor to hire skilled experts for its emerging needs. Recent regulatory reforms, such as risk based supervision, internal model validation, implementation of ERM, and emerging Fintech and cyber risks require skilled experts. SUSEP may not be able to train such skilled experts solely with organic growth. SUSEP should find the way to hire a small number of skilled experts to acquire those necessary skills quickly from the industry or foreign regulators.
ICP 7	**Corporate Governance** The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognises and protects the interests of policyholders.
Description	**General Framework** There are minimum corporate governance requirements applicable to insurers in Brazil expressed in a few CNSP resolutions in addition to those set out in the Companies' Act. An applicant for a license must provide information regarding the corporate governance standards it intends to follow. SUSEP Circular No. 249 of 2004 and CNSP Resolution No. 118 of 2004 set out the responsibilities of the board of directors for internal controls. Such responsibilities include: • providing oversight of risk management and internal controls; • ensuring there is a reliable financial reporting process; • ensuring there is appropriate, timely, and effective communications with the supervisor and relevant stakeholders on the governance of the insurer; and • ensuring senior management carries out its responsibilities in an effective manner. **Board of Directors** The board of directors is not mandatory for all companies, and there are no specific rules regarding the composition of the board. While for listed companies, the board of directors is mandatory with additional qualification criteria, in the case of non-listed companies, qualification criteria are limited to good reputation and some management

	experience, etc. and not sufficient enough. SUSEP recently issued a circular to create an incentive for insurers to set up the board of directors, by reducing the capital charge for those companies which meet criteria including those of corporate governance. **Reliable Financial Reporting Process** An audit committee is required for companies having one of the following characteristics, either adjusted capital in excess of BRL 500 million or technical reserves in excess of BRL 700 million. Senior managements are required to provide all data, and information to the audit committee. Insurers can only hire independent external auditors, registered with the CVM, and need to change the auditor every 5 years.
Comments	SUSEP should communicate to the public that reduced factors for the companies that have adopted higher governance practices are only for a transitional period. Reduced factors could compromise the protection of policyholders and thus should be granted to insurers only for a limited period. SUSEP should limit reduced factors' application for a very short term. In addition, it is also important to make public which companies are using the reduced factors and the impact of reduction of the capital requirements. SUSEP should also prioritize on-site inspections for the insurers, if those fail to meet the minimum capital requirements without the reduced factors, to minimize any compromise of the protection of policyholders. SUSEP should require all insurers to meet some governance requirements once the transitional period ends. Robust governance and risk management are the most important prudential requirements. Although proportionate application is also important and the requirements should be tailored to the nature, scale and complexity of each insurer's business model, some requirements of higher governance and risk management (such as establishment of the board, requirement of the independence, risk and exposure reporting to the board, development of business continuity plan, etc.) should be implemented as minimum standards for all insurers.
ICP 8	**Risk Management and Internal Controls** The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions of risk management, compliance, actuarial matters and internal controls.
Description	**Effective Risk Management System** SUSEP Circular 517/15 requires the risk management framework, including identification, evaluation and measurement of all material risks both quantitatively and qualitatively. The requirements have become effective since January 2018, thus the compliance by the industry and supervisory follow up are still in the early process. However, to encourage proper implementation of the requirements, SUSEP has issued a questionnaire to all insurers. SUSEP monitors the implementation of the framework through on-site and off-site inspections, including e documentation of the relevant processes. The ERM requirement is imposed at the insurance solo entity level, thus there is no specific requirement on how to incorporate group risk in the current framework.

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Compliance Function

SUSEP Circular No. 249 of 2004 prescribes that insurance entities must have internal controls over their activities, information systems, and compliance with legal requirements, which includes the nature, independence, and resources of the control functions; the responsibility of the board to establish a function to ensure compliance with legal requirements, and the need for an internal audit function, which must report directly to the board.

Actuarial Function

CNSP Resolution No. 321 of 2015 requires each entity to have an actuarial function to advise the board and senior management. In practice, the responsibilities of the actuaries vary considerably from one entity to another. CNSP resolution 311/2014 requires an independent actuarial audit. In addition, annual reports require an actuarial statement on the sufficiency of the provisions. Moreover, an actuary must sign the technical actuarial note which is required for the product approval.

Supervisory Practices

SUSEP, among the modules of on-site inspection, has a module aiming at inspecting the internal control systems of supervised entities. This type of supervision focuses on the adequacy of an insurer's internal control systems, considering the independence of its control functions, the sufficiency of its resources and the effectiveness of its work. In the case of non-conformities, SUSEP establishes a Deficiency Table, where deadlines and actions are defined for the improvement of identified problems. Outsourced control functions are permitted, under insurer responsibility, and SUSEP's inspection may extend to these functions.

In general, the inspections focus on accounting issues. If problems in accounting issues were linked to non-conformities in internal controls, the approach to inspections would be more comprehensive, where the internal control, accounting and solvency modules are simultaneously verified in the entities submitted to the inspection. Regarding risk management systems, its evaluation during inspections is still being developed together with the off-site monitoring department through guidance manuals for supervision, since only recently SUSEP has regulated this issue.

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<tr><td>Comments</td><td>While SUSEP has enhanced the risk management requirement at the introduction of the ERM framework, actual supervision for the ERM implementation will be in place in the future. Close dialogue with the industry and relevant supervisors (such as home supervisors of foreign groups) would provide useful insights, such as common challenges and weakness, which would guide SUSEP the priority area for follow up.</td></tr>
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ICP 9	**Supervisory Review and Reporting** The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.
Description	**Legal Authorities and Powers** CNSP Resolutions No. 321 of 2015, along with SUSEP Circulars No. 522 of 2015 and No. 517 of 2015, set out the requirements and procedures for supervisory reporting, which include financial and statistical information, actuarial reports, and reports on the adequacy of liabilities. Comprehensive audited information is reported bi-annually. Some financial, actuarial and statistical information is also reported monthly, and SUSEP can request additional information as needed. Monthly reporting is done in electronic format, and the information can be readily accessed for analysis and comparative reporting. Off-balance sheet exposures are required to be reported. DL 73, CL 109, and CL 126 empower SUSEP to require the submission of reports and materials, and to conduct onsite inspections. They do not require SUSEP to give advance notice of an inspection, although SUSEP rarely conducts an onsite inspection without doing so. There is a limitation on supervisory actions, including on-site inspection, to outsourced entities. **Framework of Risk Based Supervision** SUSEP assesses the risks of insurers and other supervised entities using information obtained from off-site monitoring and onsite inspections, and its communications with other local supervisors, such as the BCB and CVM. SUSEP has a risk assessment methodology to rate insurers according to their risk profile. The system uses the inputs from on-site inspections and off-site monitoring and other sources of information. Insurers are required to send detail data of operational, accounting, actuarial and statistical information (by line of business, states, policy and claims) to the SUSEP IT system, the so called Periodic Information Form or FIP. The system is equipped with automated validation and insurers need to check the accuracy before submitting the data to SUSEP. SUSEP takes the results of its assessments into account when determining its supervisory program, timing and scope of on-site inspection for each insurer. The use of the rating methodology is the main input for planning and scheduling inspections, but onsite inspections can also be required by new findings or other form of intelligence. **Supervisory Review and Plan for On-site Inspection** SUSEP reviews its reporting requirements regularly and revises them as appropriate through issuing circulars. A comprehensive Inspection Manual does not exist. **On-site Inspection** SUSEP verifies information in financial and statistical reports as part of its onsite inspections, through specific inspection modules. Verification includes the assessment of systems and controls, as well as the testing of transactions and calculations on a sampling basis. Claims reserves are also verified against actual claims files. The inspectors

	regularly discuss matters with internal auditors and the appointed ombudsman. SUSEP reviews the results of external audits and has access to the external auditor working papers. SUSEP also meets with the external auditors, ensuring that the auditor's requirement to maintain confidentiality has been waived before doing so. At the end of an onsite inspection, the inspection team discusses its findings with the insurer and issues a notice of any deficiencies that have been identified, to the insurer. SUSEP requires the insurer to submit a plan for correcting the deficiencies, and follows up to ensure that the plan is being implemented. A formal report is prepared in respect of each inspection.
Comments	SUSEP should be granted the power to conduct onsite inspection to the outsourced functions. Alternatively, SUSEP should ensure that insurers evaluate the risks associated with outsourcing arrangements, develop a process to monitor the risks, and ensure that the board or senior managements receive sufficient information of the risks, and manage the risks if necessary.
ICP 10	**Preventive and Corrective Measures** The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.
Description	**Action against Unlicensed Insurance Activities** DL 73 Article 113 provides that a legal or natural person who conducts insurance business without authorization can be banned from doing so and subjected to a fine in an amount equal to the amount at risk. In a recent public audience, the Superintendent commented on a fine (in dispute) on the order of USD six billion issued to an offshore insurer operating in Brazil without a license. **Availability of Corrective Measures** Legislation empowers SUSEP to take various administrative actions, including issuing a warning letter, requiring an insurer to submit a plan to correct governance or control deficiencies, administrative fine (up to BRL 1 million), suspension of a part or the entire business (up to 180 days), withdrawal of the license, blocking the ability of the insurer to dispose of its assets backing its insurance liabilities, etc. Actions could be imposed to individual or group of the managers and include a declaration of unsuitability for a period from 2 to 10 years for any insurance companies' management function. **Supervisory Ladder of Intervention** Resolution CNSP 321/2015 sets out the rules for the solvency recovery plans in cases where capital insufficiency or liquidity stress have been observed as follows: • When the shortage of capital resources against capital reequipment has reached to 50 percent, or liquid assets become below 20 percent of the capital requirement, then insurers must present a solvency recovery plan; • When the shortage of capital resources against capital reequipment has reached between 50 percent and 70 percent, insurers would be subject to special supervision; and

	• When the shortage of capital resources against capital reequipment has reached over 70 percent, then insurers will be subject to cancelation of the license, resolution and/or liquidation. **Timely Action** A considerable number of penalties have been appealed by the industry. The appeal is reviewed by the Council of Resources of the Ministry of Finance (CRSNSP). The council is chaired by one of the representatives appointed by the MoF, and constituted by an equal number of government and industry representatives. Appeal processes could last a substantial period (several months to years) and during the process the regulatory action remains ineffective. While this does not prevent SUSEP from taking other actions (such as imposing additional reporting requirement), it hinders prompt effective regulatory actions by SUSEP.
Comments	Accountability of regulatory actions should be ensured through well-defined and transparent procedures and public disclosure. While the mission supports due process to appeal SUSEP regulatory actions, the current appeal processes hinder timely action and effective protection of the policyholders. An equal number of industry representatives to governmental representatives in CRSNSP seem to give undue power to the industry. Representation could be complemented by representatives of policyholders, and academics with proper knowledge of the insurance sector, etc. SUSEP should enhance accountability with different approaches, such as more disclosure of the internal guidelines, public consultation, and dialogue with the industry and policyholders. Public disclosure of sanctions should be considered if the sanctions are directly related to protect policyholders.
ICP 14	**Valuation** The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.
Description	**General Framework** The valuation standards of asset and liabilities are established in the Resolution CNSP 321/2015. The methods used for the valuation of assets and liabilities have been specified by Brazilian Accounting Pronouncements Committee (CPC). One of the aims of the CPC is the convergence of the Brazilian standards with IFRS and thus the Brazilian standards basically reflect IFRS, including IFRS 4 for insurance liabilities. SUSEP established a chart of accounts to be used by insurers to help ensure a consistent measurement of the financial and solvency positions. These methods address the recognition, de-recognition, and measurement of assets and liabilities. CNSP Resolution 321 of 2015 determines the rules to calculating admitted assets for solvency purposes, intra-group investments are excluded as well as any tax credits, or assets with doubtful valuation like objects of art. **Economic Valuation** In general, consistent and objective bases are used for the valuations of assets and liabilities. The valuation of assets and liabilities is largely an economic valuation. Financial

	assets are valued at market value through the direct access to the custodian houses of these assets on a monthly basis. Real estate is valued exclusively at acquisition cost. Illiquid assets, including derivatives are valued at notional value or using the latest market transactions. In addition, if the book value of an asset is materially higher than its market value, a provision for impairment must be established. **Technical Provisions** Long term life and pension liabilities are calculated using the contractual conditions when the policy was issued, and the valuation of technical provisions does not include explicit margins over the current estimates. However, SUSEP Circular No. 517 of 2015 requires the Liability Adequacy Test (LAT) and any deficiency recognized. Each insurer must submit monthly a database that facilitates testing the value of technical provisions under alternative scenarios and assumptions. Cash flows are discounted by an interest rate term structure set by SUSEP, which is updated monthly and is available on SUSEP's website. Insurers are required to consider embedded options and guarantees when calculating the technical provisions and testing their adequacy. However, very few products having embedded guarantees are sold. **MOCE** There is no requirement to recognize explicit MOCE, however, profit from unrecognized future premiums is prohibited from being recognized as capital resources. Such profit is only used to offset the market risk capital charge associated with the future premium cash flows. **Own Credit Standing** The valuation of technical provisions and other liabilities does not reflect the insurer's own credit standing. Technical provisions do not include an explicit risk margin.
Comments	The valuation of assets and liabilities are based on an economic valuation. Explicit MOCE and its proper recognition in the capital calculation would be recommended. More active engagement into the international standard setting activities, such as those of the IAIS Insurance Capital Standard would help the informed decisions on new reforms, such as internationally acceptable approach to address the high volatility of asset and liabilities, especially those of long term insurance policies.
ICP 15	**Investment** The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.
Description	**Rule Based Investment Limit** Investment requirements have been established in the rules-based manner by Resolution CMN 4444/2015, CNSP Resolution 321/2015, and SUSEP Circular 517/2015. The assets of an insurer are divided into free and collateral assets. Collateral assets are those to cover technical provisions, over which trading SUSEP has greater control, including the ability to block selling, etc. The CMN uses technical input from SUSEP when establishing the

	investment requirements. The requirements are transparent and their objectives include safety, profitability, solvency, and liquidity. **Security, Liquidity and Diversification** These rules state in which assets and at which limits an insurance company may or may not invest, as well as concentration limits by class of investment (fixed income – 100 percent, equity – 49 percent and property – 20 percent) and by subcategory (government – 100 percent, publicly offered fixed income instruments – 75 percent, fixed income instruments issued by commercial banks – 50 percent, securitization products – 25 percent). **Domestic and Foreign Investment** Foreign investment is largely prohibited, with a few exceptions that are related to the currency matching instruments for policies issue in foreign currency, and for investments made by investment funds. **Intra-Group Transaction** Intra-group transactions are prohibited except for when investing in an index that contains shares of a related party. There are some exemptions, for example, insurers can lend securities to the parent bank for the liquidity. **Derivatives, Securities Lending, Off-Balance Sheet Transactions** Derivatives are allowed only for portfolio hedging purposes. Securities lending is not allowed with respect to assets backing the technical provisions and, for other assets, 100 percent collateral is required. Admitted investment funds cannot hold derivatives in excess of their total value. CNSP Resolution No. 321 of 2015 limits the total exposure to derivatives to 100 percent of the total assets. SUSEP is working on a new regulation with the purpose of introducing margin requirements on derivative exposures to mitigate the risk of leverage through derivatives. **Supervisory Review** Insurers should invest in a manner that is appropriate considering the nature of the liabilities. SUSEP assesses monthly the appropriateness and the current market value of the investments through the direct access to the custodian and clearing houses of these assets. Admitted investment funds need to be approved by the CVM and at SUSEP's request the underlying assets need to be disclosed. However, the investment limits set for investment in funds do not take into consideration the quality or nature of their underlying assets. SUSEP takes an action if an insurer invests in assets that it cannot appropriately assess, requiring its immediate replacement with admitted assets.
Comments	The investment requirement is transparent and conservative. The objectives include safety, profitability, and liquidity. To address potential searching for yield behavior under lower interest rate environment, closer monitoring is recommended to the off-balance exposures and leverage, such as derivatives, repo and securities lending transactions, conducted in the investment funds. Current investment requirement is solely focused on entity level and this may create regulatory arbitrage opportunities among the group entities in the long term. Group level investment requirement is also recommended to

	address possible arbitrage.
ICP 16	**Enterprise Risk Management for Solvency Purposes** The supervisor establishes enterprise risk management requirements for solvency purposes that requires insurers to address all relevant and material risks.
Description	**ERM Framework** SUSEP Circular 517/2015 requires the risk management framework, including identification, evaluation and measurement of all material risks both quantitatively and qualitatively. The requirements have become effective since January 2018, thus the compliance by the industry and supervisory follow up are still in the early process. The requirement does not specifically cover the documentation requirement. However, to encourage proper implementation of the requirements, SUSEP has issued a questionnaire to all insurers. SUSEP would monitor the implementation of the framework through on-site and off-site inspections, including the documentations of the relevant processes. The ERM requirement is imposed at the insurance solo entity level, thus there is no specific requirement how to incorporate group risk in the current framework. **ORSA** While SUSEP Circular 517/2015 does not include the ORSA and its reporting to SUSEP, SUSEP began its dialogue with the industry in 2015 on how to expand the ERM requirements into ORSA. A follow-up questionnaire of ERM implementation will create important opportunities for both SUSEP and the industry on how to implement ORSA without undue compliance cost for the industry.
Comments	While SUSEP has implemented the requirement of the ERM framework, actual supervision will be in place in the future. Close dialogue with the industry and relevant supervisors (such as home supervisors of foreign groups) would provide useful insights, such as common challenges and weakness, which would guide SUSEP in the priority areas for follow up. Emerging risks that have not been incorporated into capital and investment requirements, such as liquidity risk, concentration risk, step-in risk and cyber risk, could be important to follow up more closely by SUSEP. SUSEP should coordinate with the BCB, ANS and CVM, to develop the ERM framework at the insurance group and conglomerate level.
ICP 17	**Capital Adequacy** The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.
Description	**Framework** Revised insurance supervision legislation is in place. The Act to Modernize Financial Supervision of Insurance Undertakings, enacted in April 2015, sets out the new valuation requirements, own funds rules, provisions on the calculation of the Solvency Capital Requirement (SCR), governance requirements for insurers, etc. The requirement has been

fully implemented from the end of 2017, with a short transition period when 50 percent of market risk capital charge was waived in 2016. Required capital is composed of credit risk, market risk, underwriting risk and operational risk. The requirement is based on solo entity focus, although prohibition, limitation and conservative capital charges to intra-group transactions address major group risks in the framework. The standardized approach provides specified risk factors, while internal models are allowed upon SUSEP approval. Diversification is recognized with a square root formula among three risk categories (market, credit and underwriting risk), as well as within the risk categories. The effective diversification effect was 27 percent for life insurers as of the end 2016.

Target Criteria

Risk factors for the standardized approach are calibrated differently among risk categories. Calibration targets are different among risk categories. For example, market risk is calibrated with Value at Risk (VaR) with 99 percent confidence level over 3-month horizon. Credit risk except those against reinsurers, etc. is based on the Basel II standardized approach of the banking sector. Other factors are calibrated mainly based on Tail Value at Risk (T-VaR) with a 97.5 percent confidence level over 1-year horizon. Credit risk factors for reinsurance are calibrated differently among the types of reinsurers, with 97.5 percent for domestic reinsurers, 99.5 percent for admitted reinsurers and 99.9 percent for other reinsurers. There is no single, consistent confidence level with capital requirement calibration.

Reduced Factors for Insurers with Governance and Risk Management Compliance

SUSEP introduced reduced risk factors with lower confidence level for underwriting risks to give insurers a strong incentive to adopt higher governance and risk management requirements. SUSEP has suffered from industries' commitment to improve governance and risk management practices. To stimulate improvement, SUSEP has introduced a reduced risk factor with a 95 percent confidence level over 1-year horizon, which effectively reduce the risk factors by about 18 - 25 percent. To qualify for the reduced risk factors, an insurer must hire an external auditor to certify that the insurer meets the conditions for SUSEP approval, such as presence of board of directors, independence of the chairman, formal and periodic communication from the risk management to the board. SUSEP can reject the request if it finds deficiencies at an on-site inspection.

Internal Model

While an internal model is allowed for capital requirements, there is no validation requirement in place. If an internal model is allowed, ICP requires three tests—"statistically quality test", "calibration test" and "use test" (whether the model is used in key business decisions and controls)—ahead of the formal application process. However, such requirements have not yet been formalized, except a high-level principle that internal models should be calibrated based on 99 percent VaR with 1-year time horizon. SUSEP has communicated with the industry that there is no expectation that SUSEP would approve any internal model in the near future and no partial internal model is allowed. It is also noted that the targeted calibration level is much higher than the target

	used to calibrate that standardized approach, and thus the incentive for the industry to apply to internal models is limited at this stage. **Risk Mitigation** Insurers using the standardized approach are allowed to use and recognize hedging with derivatives, and there is no minimum requirement for those hedging instruments, such as minimum credit quality or length of the transactions. The input for the market risk of standardized approach is cash inflow and outflow of all financial instruments, including derivatives, and insurance policies. Those are subject to optimality and high volatility, depending on the scenario. Derivative contracts for hedging could be short term and are subject to roll-over risk. Those risks may not have been incorporated into the market risk. SUSEP is following up monthly or semiannually and monitoring the changes of the cashflow projections very closely. **Investment Funds** Insurers are required to look through their investment funds to derive capital requirements of the investments. When insurers cannot access the underlying assets of their investing funds, the investment is subject to the highest capital charge, which is the charge for equity (about a 20 percent risk charge). **Credit Risk** The credit risk capital surcharge consists of two types of counterparty risk: exposure to reinsurance and exposure to the other counterparties. The reinsurance exposure uses a model developed by SUSEP to allocate the probability of default based on the rating and type of the reinsurer. Credit risk factors for reinsurance are calibrated differently among the types of reinsurers, with 97.5 percent for domestic reinsurers, 99.5 percent for admitted reinsurers and 99.9 percent for other reinsurers. In addition, the risk factor for domestic reinsurance is a fixed percentage (1.9 percent) regardless of its credit rating, while that of foreign reinsurance can reach over 13 percent, depending on its credit rating. The credit risk exposure on other counterparties is equivalent to the BCB model for the same risk thus avoiding regulatory arbitrage. This module contains 45 different parameters. The reinsurance and the financial assets counter party risks are added using a correlation matrix. **Capital Resources** Only high-quality capital resources (common equity and preferred equity) can be recognized as such. Insurers must deduct intangible assets, real estate investments (REIT and other investments are excluded from the deduction), and investment in subsidiaries or affiliates from the net capital. Subordinated debt or other innovative capital instruments are not recognized as a capital resources. Profit from unrecognized future premiums is prohibited to be recognized as capital resources. Cross-shareholding (reciprocal participation) or investment into private securities issued by financial institutions within the same group is prohibited. Investment in public securities issued by financial institutions within the same group is allowed within certain conditions, such as

	index investment through investment funds. SUSEP monitors the source of capital by requiring a reliable business plan from the parent company.
Comments	Inconsistent target criteria among risk factors could encourage insurers to take more risk in less conservatively calibrated risk factors, such as counterparty risk to domestic reinsurance companies. The overall level of calibration is less conservative than best practices in many developed countries. SUSEP is encouraged to consider a granular increase of the confidence level comparable to foreign regulation in the medium term. It is also recommended for SUSEP to follow up risk mitigation practices of the insurers, to ensure that hedging instruments are reliable in terms of counterparties' credit quality and given the nature of long term liabilities. SUSEP should continue to monitor intragroup transactions among group entities (especially between insurance entity supervised by SUSEP and health insurers supervised by ANS) to avoid material regulatory arbitrage transactions. Group capital for insurance groups should be considered in the long term. As was stated in 2012 FSAP, a cautious approach is recommended before internal models can be used for solvency calculation purposes. Nonetheless, SUSEP should develop a robust validation standard for internal models and make the process as transparent as possible. As this is a new and difficult challenge for SUSEP, it should seek advice from supervisors with experience and knowledge of model validation. This includes the model validation team for Internal Rating Based Approach of the Basel Accord in the BCB and foreign insurance regulators (such as European insurance regulators). Given the vulnerabilities of the independence of SUSEP, it is important to ensure a rigorous approval process for internal models, without undue external influence. Therefore, it is recommended that SUSEP make the approval as transparent as possible.
ICP 19	**Conduct of Business** The supervisor requires that insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.
Description	**Due Skill, Care and Diligence** There is no legal provision which requires insurers and insurance intermediaries to act with due skill, care and diligence when dealing with policyholders. However, the Consumer Protection Code 8.078 of 1990 supports the rights of customers, including insurance policyholders. In recent years, SUSEP has given increased emphasis to consumer protection, which has included setting up ombudsman centers at its head office and regional offices. Further, to protect consumers, Brazil has established a consumer orientation and protection program (PROCON) that deals with general consumer protection complaints and consumer rights orientation. **Claim Payment** Insurers are required to pay claims within 30 days or are subject to fines as set up in Circular 256 of 2004. The 30 days can be suspended during the period when the claimed insurer requests justified additional information. Through onsite inspection, SUSEP

reviews with high priority the claims payment internal controls and processes. SUSEP enforces penalties in case of a violation of the 30 days payment requirement and requires insurers to strengthen their claims-payment processes if needed.

Complaint Handling

CNSP Resolution No. 110 of 2004 requires each insurer to have an ombudsman and sets out minimum rules and criteria for such ombudsmen. Their main objectives are to explain and clarify the rights of customers and to act to prevent and resolve conflicts. Ombudsman centers handle cases involving amounts up to BRL 30,000 per event, and will hear complaints from insurers, beneficiaries, insurance brokers and third parties.

Timely, Clear and Adequate Information to Policyholders

SUSEP Circular No. 292 of 2005 stipulates the administrative procedures and requirements for dealing with consumers. It indicates that an applicant must sign a declaration acknowledging receipt of the information needed to enter into the insurance contract with sufficient knowledge of its provisions. It also sets out the criteria used by SUSEP to analyse potentially deceptive advertisements and marketing materials. In addition, SUSEP approves a new product and in the process, the sales materials are reviewed to make sure that clear and adequate information is provided to the policyholders. However, there are no requirements on the type of information consumers should receive before during and after the insurance intermediation except for open pension plans.

Conflicts of Interest

There is no disclosure requirement of commissions and conflict of interest of intermediaries when advising for the purchase of insurance. The large conglomerates create a challenging environment and should be supported by clear regulation and supervision by the relevant authorities to prevent and properly manage the conflicts of interest of intermediaries.

Protection and Use of Information on Customers

The Consumer Protection Code 8.078 of 1990 has provisions to ensure that personal information is not used for purposes other than their business activities and that it is not divulged, lost or impaired by third parties to which the management of customer information has been outsourced. This applies to insurers and intermediaries. SUSEP will act on any complaint received related to violation of confidentiality of personal information.

Public Disclosure from SUSEP

SUSEP's web site provides various types of information that support the fair treatment of customers. For example, it issues warning notices regarding unauthorized solicitation, publishes consumer education leaflets. SUSEP also supports public education of financial services by sending staff to speak at meetings and conferences. At the government level, financial education has been launched at school (mainly middle and high school). SUSEP has been involved in providing the material for the insurance education module.

	However, there is no disclosure of penalties or other regulatory actions applied to supervised entities, useful statistics about complains received by SUSEP. **Supervisory Activities** Partly due to the seriousness of the situation of the complains, SUSEP allocates a substantial number of staff to handle policyholders' complaints, including 30 inspectors and 20 general staff to respond to the calls from the policyholders. SUSEP is outsourcing some functions but it is still limited. As of end-2016, there are more than 100,000 brokers who registered with SUSEP. The commission level is not regulated by SUSEP. SUSEP has conducted on-site inspections to small number of brokers mainly to address complaints. SUSEP is in the process of introducing risk based supervision for market conduct.
Comments	SUSEP should collect more granular information to make risk based supervision effective. SUSEP has collected information on complaints by itself and from insurers. However, the data are not comprehensive, granular or timely. It is important for SUSEP to collect more granular information relevant to market conduct, such as lapse / surrender rates, more comprehensive and timely data about complaints, commission level, sales growth rate by products, etc. Such information will help SUSEP to prioritize its focus on off-site monitoring and on-site inspections. Summary of the statistics could be useful information to be disclosed to the public. It is also recommended that SUSEP publish regulatory actions, if the action is related with policyholders' protection. SUSEP should require all intermediaries to disclose clear and simple information, conflicts of interest and commissions before sales. The 2012 FSAP pointed out the challenging environment for addressing conflicts of interest arising from large conglomerates, and recommended enhancing disclosure of conflicts of interest, and requirements to disclose commission / fee. This would become even more important when the insurance products are likely to become more complex, such as the introduction of unit-linked products. SUSEP, in close cooperation with the BCB and CVM, should prioritize the work to improve the quality of advices of insurance intermediaries. Lower interest rate environment is likely to encourage policyholders to take more risk in their annuity products and unit linked products. This should require insurance intermediaries to provide advice about investment opportunities and the riskiness of assets. The establishment of qualification criteria for intermediaries who can sell investment linked products (including VGBL) is recommended. To improve the quality of advice as soon as possible, thematic inspections targeting training program for intermediaries are recommended to be conducted for insurers with a high share of investment linked products. In addition, SUSEP could consider conducting "mystery shopping" to evaluate the quality of advice more in detail. The oversight responsibility with regard to market conduct of insurance products sold at bank branches could be clarified further. Annuity products sold by bank branches are exempted from brokerage requirement. As CNSP or SUSEP has not imposed any regulation to the sale channel yet, SUSEP does not have a legal enforcement power against sales persons in bank branches. The BCB can take enforcement actions for the mis-selling of insurance products conducted at a bank branch, if it involves any banking activities (for example, the payment of the premium has been made through a checking account). However, its legal power against purely insurance sales at a bank branch is

	unclear. It should be clarified further that CNSP and SUSEP are responsible for the oversight of the mis-selling of insurance products at a bank branch. In addition, the identified authority should impose proper requirements (such as licensing, qualifications, disclosure, governance) for the intermediaries and take regulatory action if necessary.
ICP 23	**Group-wide Supervision** The group-wide supervisor, in cooperation and coordination with other involved supervisors, identifies the insurance group and determines the scope of the group supervision.
Description	**Conglomerate Supervision** SUSEP meets with the BCB annually to exchange information on the conglomerate groups which have both bank and insurance entities, backed by the MoU. The main objective of the meeting is to assess the risks of the insurance entities within the conglomerate groups. Such analysis is used for SUSEP to determine the group and scope of the plan for on-site inspections. However, the cooperation seems to be limited to qualitative information exchange. **Group Supervision for Insurance Groups** Definition of a financial group or conglomerate does not exist in current legislation for supervision. SUSEP considers possible double counting of related parties' investments by deducting from the qualified assets for solvency purposes. Such conservative regulation on the intragroup transactions keeps the group risk limited and thus supervision is carried out only at the solo level. However, some large insurance groups have several insurance entities (including health insurance) and many of them are part of the financial conglomerate groups. Domestic insurers are also gradually expanding their international operations. SUSEP neither requires insurers to provide group structure nor approve the group structure. SUSEP circular 508/2015 requires insurers to provide their consolidated financial statements. **Group Supervision Working Group** SUSEP established a special division for group and macroprudential supervision in 2013, and worked to make a plan of action with the definition of groups for supervisory purposes. The division also has conducted an impact analysis of group capital requirement. However, the division was short-lived and with no output.
Comments	SUSEP should work together with the BCB, ANS and CVM to establish and implement consistent group-based supervision. While conservative regulation limits the contagion risk between entities even within the same group, there is still significant contagion risk through the reputation channel. Many new regulations (such as ERM, governance requirements) will only become effective if they are appropriately implemented at the group level. Therefore, there is significant merit for SUSEP to implement group supervision and for the respective authorities to coordinate its implementation. Cooperation should be gradually expanded from information exchange to more coordinated actions (including joint-rule making, joint-reporting, joint-inspection and coordinated supervisory actions).

ICP 24	**Macroprudential Surveillance and Insurance Supervision** The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilize information from, and insights gained by, other national authorities.
Description	**Macroprudential Policy System** The CMN is responsible for formulating the overarching monetary and credit policy. Together with the BCB, the CMN takes a vital role in shaping macroprudential policies, working with MoF and the other financial regulators. These agencies are CVM for the securities market participants, SUSEP for insurance companies, and the National Superintendence of Complementary Pension (PREVIC) for pension funds. A high level consultative forum has been created for the coordination of supervisory policies among the financial regulatory agencies. This is the Committee of Regulation and Supervision of Financial, Securities, Insurance, and Complementary Pension Markets (COREMEC). COREMEC is composed of the four financial regulatory authorities (BCB, CVM, SUSEP, and PREVIC) who share a rotating presidency. COREMEC provides a space for the coordination of multi-agency supervisory and regulatory actions and information-sharing, though members' recommendations and advice are not binding on each other. The BCB, CVM, SUSEP and PREVIC, as financial supervisors, are responsible for macro-prudential surveillance. However, the BCB takes a leadership position because of its capacity for receiving, processing and analyzing a significant amount of data, the bank-centric nature of Brazil's financial system and is widely perceived to have a financial stability mandate. **Macroprudential Supervision by SUSEP** SUSEP established a special division for group and macroprudential supervision in 2013, but it was short-lived and with no output. However, SUSEP occasionally conducts surveillance at the industry wide level. While bank and insurance regulation mitigate significant contagion risk, the BCB has conducted stress test of capital and liquidity with an assumption that banks will step-in and cover all capital and liquidity loss from their insurance subsidiaries. The exercise suggests that cooperation between BCB and SUSEP are effective
Comments	The BCB and SUSEP are encouraged to enhance their cooperation further to ensure prompt identification and analysis of emerging risks. The stress tests provide a useful picture of important contagion risks between banks and the insurance sector. Further input from SUSEP into the BCB's stress testing exercise will enrich the analysis. For example, a deeper analysis of the reasons behind high redemptions and cash outflows of the insurance products could be conducted with more granular data sharing from SUSEP. The focus could be usefully expanded to cover other material risks (such as interest rate risk) of the entire conglomerate groups. Regular stress testing or scenario

	analysis of large conglomerate groups with close cooperation between the BCB and SUSEP could be useful for the vulnerability analysis of the entire Brazilian financial sector.
ICP 25	**Supervisory Cooperation and Coordination** The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.
Description	**Coordination Arrangement** Article 25 of Complementary Law 126 empowers SUSEP to enter into agreements to exchange information with other regulators, supervisors, and self-regulatory organizations, both local and foreign. SUSEP has entered into bilateral agreements with some foreign authorities, such as the U.S. Federal Insurance Office and the Argentina Authority. SUSEP is also a signatory member of the IAIS Multilateral Memorandum of Understanding. SUSEP has also participated in the process of recognition of equivalence of supervision with the European authorities and had granted a provisional equivalency in 2015. **Supervisory Colleges** SUSEP occasionally participates in colleges of supervisors for foreign insurers that operate in Brazil, but has not established colleges for Brazilian insurers with foreign operations. **Working Group for Group Supervision** In 2013, SUSEP established a working group to assess the status of the implementation of group wide supervision, develop action plan to fulfil the gap of group supervision, and conduct impact analysis of the SUSEP operation. However, the working group has been disbanded without any concrete outcome.
Comments	SUSEP should enhance the supervisory cooperation with the BCB, ANS and CVM. Current cooperation is limited to qualitative information exchange. Information exchange should be expanded to the exchange of quantitative data, for example, the underlying assets and off-balance sheet activities of investment funds that insurers are investing between SUSEP and CVM. Supervisory coordination could be expanded to more coordinated actions, including joint-inspections, joint supervisory follow up and joint-regulatory actions.