

CURRENT FLOODS IN THE SOUTH OF BRAZIL: A QUICK OVERVIEW OF THE LARGEST NATURAL CATASTROPHE IN THE COUNTRY'S HISTORY AND ITS IMPLICATIONS FOR THE INSURANCE AND REINSURANCE MARKETS

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Torrential rain in the very south of Brazil since the end of April 2024 has caused massive flooding across hundreds of cities in the state of Rio Grande do Sul. In terms of affected area and economic losses, whilst the latter amount cannot yet be calculated, the floods in the State of Rio Grande do Sul are already the most catastrophic event to ever occur in Brazil. This tragic event is putting societal resilience to test and shall intensify the debate over how to manage risks of catastrophic incidents, including through private and public insurances.

Experience of previous large losses in Brazil suggests that claims have the potential to develop adversely over time. Control of claims is an important issue for reinsurers, particularly in the case of government-backed infrastructure projects.

To date, 173 people have died as a result of the floods, many are still missing and almost a thousand are injured, while more than half a million people have been displaced from their homes. Well over a million inhabitants have been affected; hundreds of cities remain under water as the rain continues to fall. Dams have collapsed and basic infrastructure (water supply, energy facilities, etc.) has been dismantled. The few cities in the state that were not hit by the floods are now isolated as the roads leading to them, that allow supplies to come in and out, are still blocked.

Prior to such tragic event, Rio Grande do Sul was the 4th largest state in terms of gross domestic product (GDP) and economic output, after São Paulo, Rio de Janeiro and Minas Gerais only.

INSURANCE SECTORS

The unmatched destruction caused by the floods severely impacted numerous insurance lines including, for example, auto insurance, homeowners' and mortgage insurance, comprehensive business insurance, contractors all risk and rural insurance among others.

The floodings and heavy rains have not ceased. As a result, insurers and reinsurers do not have an accurate understanding of the covered losses to date, let alone those yet to be incurred. Up until last week, 23.4 thousand claims had been reported to insurers.

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According to some estimates, such claims alone could lead to payments in excess of BRL 1.67 billion (303 million Euros or USD 334 million). Brazilians are still heavily uninsured – both at the individual level and at the company level.

AUTO INSURANCE

Auto insurance should be one of the most affected lines of business. Over 200 thousand vehicles are estimated to have suffered total damage in the floods. However, the most optimistic experts estimate that only around 30% of them were insured against flood (typically, only comprehensive auto insurance provides insurance against flooding).

Regardless, this will likely be the most impactful single event in the history of motor vehicle insurance in Brazil. To deal with such major challenges, auto insurers have implemented extensive fast-track (simplified) operations to handle claims and aid clients.

In addition to privately owned vehicles, thousands of brand-new vehicles, parked at factory parking lots, have also been damaged in the floods. Previously, this type of damage to new vehicles has been a source of substantial loss to international markets following both man-made and natural catastrophes elsewhere. The ‘brand protection clause’ contained in many automotive policies allows motor manufacturers to withdraw from the sale of even very slightly damaged vehicles (to protect their brand identity) and to claim ‘total losses’ from insurers, creating a much greater risk to reinsurers. However, car-makers’ policies often allow (re)insurers very little say over loss mitigation.

Shopping malls, airports, hotels and other places which charge clients to safekeep their vehicles are already facing claims from car owners for their losses. Typically, courts in Brazil would hold that, for this type of business loss, the exclusions of ‘acts of God’ or ‘force majeure’ do not apply and, therefore, are not valid excuses to decline cover, finding insurers liable to their insureds. However, given the unprecedented magnitude of the current catastrophe, it is difficult to predict whether the courts will hold the same position in future coverage disputes in connection with the extreme floods in question.

PROPERTY AND MORTGAGE INSURANCE

Sophisticated property insurance policies purchased by large companies (nominated perils policies) and industrial conglomerates (operational risk policies) will usually also respond to the floods, as well as contractors all risk policies. A case-by-case analysis is needed in any event, including whether the policy shall provide for a 168-hour clause for floods and the specifics for the business interruption endorsement.

Mortgage insurance, which is a mandatory insurance product for those who obtain a Federal Housing Financing System (SFH) loan, must cover against waterlogging and inundation. Upon the occurrence of the loss, the insurance covers either the repayment of the mortgagor’s debt towards the bank (mortgagee) or the rebuilding of the property.

However, homeowner's insurance policies, comprehensive business insurances, as well as those multiline insurances designed specifically to condominiums will rarely contemplate floods as covered perils as a default.

All such products are framed as nominated perils policies and coverage for floods, waterlogging and/or inundation are sold as add-ons, requiring separate endorsements to the basic coverage (fire, lightning, explosion and, sometimes, aircraft damage) in exchange for additional premium.

Homeowner's insurance has very little penetration in the country in general, and in the south region of Brazil the scenario is no different – the rate of houses covered by any type of insurance is less than 20%, and the insured sums contemplated for such types of perils tend to be fairly low, typically around BRL 15k or 30k (roughly USD 3k or USD6k).

The little demand for coverage against floods and similar phenomena can be explained. Historically, Rio Grande do Sul was a rail-prone area, yet drought was a much more common natural event in state and affected much more people than floods. Besides in the last 7 years only 1 person died as a result of floods and inundation in Rio Grande do Sul while 5 were killed by windstorms and 2 by tornadoes, according to a study conducted by the Planning and Management Secretary of the State of Rio Grande do Sul in 2022.

<https://www.estado.rs.gov.br/upload/arquivos/desastres-naturais-no-rio-grande-do-sul-1.pdf>.

Discussions concerning coverage, exclusions and the specific terminology contained in some of those types of property policies, sometimes differentiating technically floods (*enchente*) from waterlogging (*alagamento*) and inundation, as well as other nuances, may still emerge in the disputes arising out of this natural catastrophe.

Direct insurers are currently under a lot of pressure by the public opinion to step-up and respond granting coverage more generally to insureds. Political and image considerations of course come into play. Such decisions go into the heart of the cedant-reinsurer relationship.

REINSURERS

At this point, reinsurance treaty and facultative contract languages are under careful analysis. Cedants and reinsurers must keep an open dialogue on the perspectives of existing and upcoming insurance claims and what still lies ahead of them as a result of this extreme and unparalleled catastrophic event in the history of Brazil.

Experience has tended to show that it is particularly difficult for international reinsurers to get a grip on the adjustment of large losses in Brazil (and in South America more widely).

Treaties are often subject to local law and, in practice, even full claims control clauses can be difficult to enforce. In particular, infrastructure projects are often under the influence of local politicians and the timing and application of resources to loss mitigation can be very difficult for (re)insurers to control.

In terms of aggregation, the prolonged rainfall and the unprecedented duration of the flooding are likely to lead to debate whether all such losses can be aggregated together as a single 'catastrophe' (depending on treaty wordings). The application of hours clauses in local policies will be mirrored by further debates as to relevant hours periods in Cat XL treaties.

FUTURE RISK MODELLING

If there might be one positive aspect out of such a tragic disaster is that awareness may raise, and more attention shall be drawn to insurance and its critical role in helping mitigate disrupting effects of natural catastrophes. Other methods of spreading such risks, including cat bonds through insured-linked securities and other means, parametric insurance modelling, etc., may come to the centre of this much needed debate.

If the long-term impact is improved insurance penetration, this will result in increased opportunity for international (re)insurance markets but matched by increased exposure to claims inflation and thus the potential for ever-increasing catastrophe risk when viewed in monetary terms. Reinsurers will thus need to exercise increasing influence over risk modelling, control of policy wordings and more sophisticated management of claims.

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