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New Brazilian Reinsurance Rules – A significant change of course

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NEW BRAZILIAN INSURANCE AND REINSURANCE RULES – ANOTHER CHANGE IN COURSE AS OF AUG. 3, 2015

When regulatory environments progress, they do so with uncertainty taking some steps forward, some back, and having periods of silence. The publication of National Council of Private Insurance (CNSP) Resolutions Nos. 321 and 322 (the last one was replaced by the CNSP Resolution No. 325) seem to duly fit this scenario.

In this context, to understand the impacts of the new rules and their relevance, we will make

some comments about the Brazilian reinsurance regulation, including a brief historical introduction to the reinsurance activity in Brazil and information about the most important events since the opening of the Brazilian reinsurance market.

I. THE REINSURANCE MONOPOLY

The first major watershed for the Brazilian insurance market was the creation of the former Reinsurance Institute of Brazil (IRB) in 1939. That was a very important time for the country's economy in which strong industrialization and modernization of social relationships demanded a larger supply of insurance and reinsurance as instruments of protection.

Within this context, the IRB's operation as a regulator and monopolistic reinsurer was fundamental for the Brazilian insurance market and for strengthening the companies that operated on it. This occurred through the channeling of the state's efforts to encourage and direct insurance activities.

In 1967 an independent government agency was created whose function was to regulate and supervise the Brazilian insurance market, named SUSEP (in Portuguese "Superintendência de Seguros Privados"), the Private Insurance Oversight Office, while regulation of the reinsurance market remained with the IRB. Separation began between the functions of economic agent and those of regulatory agent and supervisor of private enterprise, though SUSEP had actually integrated into a structure in which state administration predominated.

By the 1980s, it became evident that change was necessary, because Brazilian society only had access to expensive products that were strictly regulated, even in terms of pricing. The negative effects were clearly felt of a closed insurance market both for the participation of foreign capital and for direct contact with the international reinsurance market.

At the end of the 1980s, the regulation underwent two major transformations. There was first a surge of deregulation (with the freeing up of premium charges and brokerage commissions, among other measures), SUSEP increased in importance, and the growing

modernization of the insurance business became more evident (i) the archaic vision in which regulation was confused with state planning of economic activities, and (ii) the inadequacy of a reinsurance monopoly.

In fact, the legal framework and existence of a self-regulating monopolistic IRB represented an artifact from the time in which the state "was" the economy and occasionally allowed private agents to operate in partnerships and under its close supervision.

In this context, transformations accelerated the following changes:

- 1997 – foreign capital was allowed on the insurance market;
- 1999 – the first, unsuccessful, attempt to privatize IRB Brasil Resseguros SA, with the passage of Law 9932;
- 2003 – the start of an intense process to adopt international regulatory and supervision standards, which ended with the passage of new rules for capital in 2006;
- 2005 – a bill of law was sent to Congress to open the reinsurance market;
- 2007 – Supplementary Law 126 was passed and its regulation finalized the first part of the history of an insurance market that was (i) strictly regulated, and (ii) closed off to foreign capital and to the international reinsurance market.



In 2008, finally the insurance market included the reinsurance business.

II. OPENING OF THE MARKET

The opening of the Brazilian reinsurance market was based on the Supplementary Law No. 126/2007 and the legislation arising therefrom. Such rules, though not perfect, did the job of creating an environment reliable and attractive to international investments, and capable, to some extent, of fostering the local reinsurance market.

The structure established at that time was of Brazilian companies (local reinsurers) and foreign companies (admitted and occasional) operating in the same market. Under the rules published, local companies had the advantage of preferential offering (initially 60 percent of the risks ceded, currently 40 percent), while cessions to occasional reinsurers were limited. This resulted in a model that both attracted international groups to the local market and opened the doors for the reinsurance market to effectively become the driving force behind the development of the Brazilian insurance market.

Three years after the opening, naturally, imperfections and need for changes arose, and the response to it, which came up incorrect in its form, content and strength, was the enactment of CNSP Resolutions Nos. 225 and 232.

Aiming at protecting the local reinsurance market, rules on market reserve (in replacement of the preference rules) were



created and some strict limits were put to intra-group operations.

On December 10, the National Private Insurance Council - CNSP published Resolutions Nos. 224 and 225, among others. On account of their content and the deadline for their coming into effect, the impact of these new rules could not have been worse for Brazil's image in the local insurance and reinsurance market.

CNSP Resolution No. 224 prohibited the undertaking of any transaction between associate companies when the assignee is domiciled abroad, while CNSP Resolution No. 225 abolished the system of preferential offering to local reinsurers and effectively established a market reserve of 40 percent of all risks ceded in reinsurance.

Far more than a contradiction to a system that had been carefully discussed and de-

signed, the new rules affected the positive image which the Brazilian insurance regulation authorities were then building up and made room to a number of more serious problems. We may mention, but not limited to, the costs with a complex structure of risk placement (known as "triangulations") and the discouragement towards long-term investments based mainly on reliability.

Brazilian regulation underwent troubled times with some positive and negative initiatives and, in all cases, with a very deficient communication that aggravated the feeling of lack of direction accentuated by the enactment of CNSP Resolutions Nos. 225 and 232.

It is important to mention that, at this moment, there are 16 local, 36 admitted and 74 occasional reinsurers operating in Brazil.

III. CNSP RESOLUTION NO. 322/15 AND CNSP RESOLUTION NO. 325/2015

Publication of CNSP Resolution No. 322 (replaced by CNSP Resolution No. 325) may be considered as an attempt to have SUSEP back reaching out for some rationality and safety in its actions.

Firstly, the intragroup risk placements will be progressively increased. Until Dec. 31, 2016, the limit of 20 percent of each cession will be maintained. This limit will be increased to 30 percent from Jan. 1, 2017; 45 percent from Jan. 1, 2018; 60 percent from Jan. 1, 2019 and 75 percent from Jan. 1, 2020.

Further, the market reserve was replaced by a dual system of (i) a preferential offer of 40 percent of the contracts to the local reinsurers and (ii) a pro-

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gressive reduction of the market reserve (40 percent until Dec. 31, 2016, 30 percent until Dec. 31, 2017; 25 percent until Dec. 31, 2018; 20 percent until Dec. 31, 2019; 15 percent until Dec. 31, 2020).

The progressive reduction of the restriction to intra-group operations is worthy of praise. The 20 percent limit of operations between related companies was contrary to the market expectations. In fact, the regulation had been structured on the assumption that local subsidiaries could do business in Brazil supported, also with regard to capital and subscription capacity, by their parent companies.

The criticism to be made to the new rule is that keeping the restriction in the long run—even at a much lower percentage but still applicable to every coverage—forces the ceding companies to keep complex structures of risk placement.

The same can be said as to the reduction of the market reserve. If the regulation authority believes that the market reserve is not positive, notwithstanding the fact that some of the worst effects thereof were mitigated by publication of CNSP Resolution No. 241 (that regulates the lack of capacity or interest of the local market in each risk), then the ideal would be to annul it. Keeping market reserve along with the preference rule sets an additional control, among many others, to be kept by Brazilian ceding companies. The costs associated with such controls are not insignificant, both regarding their imple-

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mentation as well as their maintenance.

The CNSP made a mistake. The Resolution CNSP No. 232 was revoked, but the Resolution CNSP 225 was the one supposed to be revoked. The express revalidation of the preferential offer rules was also necessary. The result is unclear interpretation of the rule and the revocation of the list of insurance lines not subject to the intragroup limitations, with important negative impacts.

In this regard, at least part of this mistake was fixed, with the publication of CNSP Resolution No. 325, which “confirmed the CNSP Resolution No. 322 with amendments,” revoking the CNSP Resolution No. 232 and expressly maintaining the validity of CNSP Resolution No. 232.

It is important to mention that the same CNSP Resolution No. 322 created a Consulting Commission within the scope of CNSP in order to propose measures oriented to adopt the best world practices. Regardless of its practical results, it is clear the regulation authority’s intent to listen to the market and its institutions, particularly the National Federation of Reinsurance Companies.

IV. CONCLUSION

Among some positive and negative aspects and doubts, the enactment of CNSP Resolution No. 322 indicates that SUSEP is willing to adjust the legislation, correcting mistakes and making progress in the implementation of reinsurance market rules compatible with international practice.

Full text of the legal document is set out here <http://www.legisweb.com.br/legislacao/?id=287784> ■



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