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Ten Years of the Brazilian Reinsurance Market—Lessons and Perspectives

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Ten years ago Supplementary Law no. 126/2007, the landmark of the Brazilian insurance market opening, was published. And despite all the problems that obviously result from such a major change to a paradigm, this is a fact that should be celebrated by all those that need a developed insurance and reinsurance market or that operate in it.

Personally, I had the honor of leading, within the ambit of the Private Insurance Superintendence–SUSEP, the discussions held with the Brazilian Congress about the law. The interesting aspects of such a process and everything that went into creating it deserve to be remembered.

> Before the publication of the law, we were indeed concerned to prepare the insurers, as much as possible, for the insurance market opening.

In the first place[1], SUSEP is to be congratulated on the quality of the regulation that was initially prepared in view of all the limitations of the lack of experience in reinsurance, the shortage of human resources and the urgent need to make the determinations of the law effective.

Before the publication of the law, we were indeed concerned to prepare the insurers, as much as possible, for the insurance market opening. One example is the rules on risk-based supervision risks (internal controls, accounting and actuarial audit, underwriting risk-based capital and others). However, in practice it was impossible to progress a lot more in the preparation before the market's opening.

In this context, also considering that the closed market was for a long time one of the bases for the development and good functioning of the Brazilian insurance market, to promote an ordered opening was a major challenge. And the result reveals the ability of those involved in the bill both to propose a model and to discuss and improve that model jointly with the private sector.

An example of a good measure was the establishment of relatively few rules (considering the Brazilian excessive interventionist standard practice) and an important barrier for the entry of foreign reinsurers by requiring a high rating and five years of experience. We know that there is no good market with bad companies and the opposite is true almost always.

And the adopted strategy, outlined by the law and detailed by SUSEP, was extremely successful to ensure a less troubled transition.

We also took advantage of the size of our economy and our potential insurance market to set up the foundation for the existence of an actual local reinsurance market.

The permanent concern, at this point, should always be keeping in mind that the protection of the local reinsurance market makes sense only to the extent that such protection will not result in difficulties for the development and good functioning of the insurance market. And the insurance market serves the society when it offers adequate protection safely and at the lowest possible cost.

Concerning the debate on market reserve x preferential offer, it is worth remembering a bit of our history.

It was not the legislator's intent to give the insurance regulator the choice between the market reserve and the preferential offer. We even included in the Law detailed rules on preferential offer, which were approved by the Brazilian Congress and sent to the president for sanction.

But it was the discussion held with the Brazilian Congress, combined with our need to progress with the bill, which forced us to detail more and more the rules that were initially proposed. We even inserted in article 11 of the Law six paragraphs, some with several items, explaining how the preferential offer should be made. For such reason, after the approval of the Bill by the Congress, upon recommendation made by SUSEP itself to the president, such rules were vetoed. The task of detailing them fell on the regulatory agency.

The veto message is clear: "As this is a new market, it is not proper nor convenient to have in a supplementary law a level of excessive detailing, as it may be an obstacle to accomplish the expected purposes of this Bill. Ideally all such rules should be detailed at the discretion of the regulatory agency for the adaptation of the regulatory framework to follow the dynamics and the development of the market itself. It should be emphasized that the spirit of the article, which establishes the preferential offer and defines its magnitude and effectiveness, will remain unchanged, and it will be incumbent upon the regulatory agency, according to the authority defined in the head provision, to define the rules on this preferential offer." (emphasis added) *http://www.planalto.gov.br/ccivil_03/Ato2007-2010/2007/Msg/VEP-16-07.htm)*

The text of art. 11, according to which "Subject to the rules of the insurance regulatory agency, the cedent will engage or offer preferably to local reinsurers ..." was not intended to mean that the regulatory agency may choose between the preferential offer and the market reserve.

Differently, the preferential offer was intended to be satisfied (i) by the offer of risk to all local reinsurers or (ii) by the local contracting of 40 percent of the risks.

However, the "personal" intent or the legislator's intent objectively explained is not even the most important element for the law interpretation. And, according to the words used to write the rule above, it was later interpreted that the regulatory agency had the option to choose the preferential offer or the reserve regime.

Thus, given the failures in satisfying the preferential offer system, and this could have been corrected by localized inspection actions designed to inhibit practices in contravention of the spirit of the law and the legislation, in 2010, after almost three years of experience with the open reinsurance market, the National Council of Private Insurance (CNSP) published resolution no. 225/2010, which imposed the market reserve in replacement for the preferential offer. This market reserve, combined with the prohibition of intra-group transactions (provided for in CNSP resolution no. 224/2010, which was later amended by CNSP resolution no. 232/2011 to become

more flexible) represented a structural reduction in the opening level of the Brazilian reinsurance market.

More than their contents, the way said rules were prepared and published, without an open and transparent discussion, was extremely harmful to the trust that was being established, including abroad, in the Brazilian regulatory environment.

On the other side, it should be noted that, due to a political issue of the Workers' Party,[2] the reinsurance market was opened without the privatization of IRB (state-owned company that monopolized the Brazilian reinsurance market) differently from what occurred in almost all privatization/market opening processes previously promoted by the Administration Fernando Henrique Cardoso in the '90s.

Perhaps, even the maintenance of IRB as a state-owned company was an important element for the smooth transition to an open reinsurance market.

Anyway, the "open by privatizing" strategy made the successful privatization of several monopolist companies viable to the extent that the company that controlled the market on the day before the market opening was being sold. At the same time, the monopolist company was prevented from suffering, in the condition of a state-owned company, the inevitable losses arising from the competition to which it had never been exposed. In other words, the market opening associated with the privatization of the monopolist company prevented the inevitable losses of the ex-monopolist company from being a problem for the government, the ex-shareholder, which became a regulatory state. But

that was not the case of the Brazilian reinsurance market and the IRB.

For this reason, it was not possible to prevent the fact that the negative impacts of the market opening on IRB's transactions would lead the Government to change the regulation imposed on the insurance and reinsurance market to protect IRB. And, among such impacts is the replacement of the preferential offer for the combination of market reserve and restriction on intra-group transactions.

More recently, upon the publication of CNSP Resolution no. 325/2015, there was an attempt to correct in part that move by the increase along the next years of the authorized portion of intra-group transactions and the reduction in the market reserve percentage, all associated with the preferential offer. However, the result was not good.

The evident difficulties arising from the coexistence of the reserve and the preference, as well as the maintenance of the reduction in the intra-group restrictions signal the need for new future adjustments to make the legislation comprehensive and enforceable, without excessive operating costs and without many controversial points. All this in spite of the attempt to clarify the meaning of the rule via the legislation.

Anyway, irrespective of the identification of the mistakes and successes and the comings and goings, it is undeniable that today we actually have a functional reinsurance market.

Moreover, the Brazilian reinsurance market became the driving force for the development not only of the insurance market but also of the Brazilian supervision and regulation practices.

In the past 10 years, the new business environment challenged SUSEP to develop its practices and did it wonderfully. And everything signals that this process, subject to the economic and political turbulences in Brazil, is only beginning.

Today, we entertain the possibility of Brazil being consolidated as a hub for Latin America for insurance and reinsurance transactions of global and local groups.

We are also discussing with the government, on the initiative of the National Federation of Reinsurance Companies—Fenaber—the enactment of new rules to reinforce our capacity to establish in Brazil a regional insurance pole to accept reinsurance risks from abroad.

In brief, we advanced a lot and will advance further with the reinsurance market opening introduced by Supplementary Law no. 126/2007. The perspectives are the best possible. But we must be permanently alert to proactively construct a regulatory and business environment that continually grows.

The private sector, in turn, must prevent demands for SUSEP to intervene and, in addition, must discuss with the agency, whenever necessary, the best alternatives for specific or structural changes to the legislation and the supervision practices. ■

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ENDNOTES

1 I worked at SUSEP until soon after the publication of the law, and the regulation was prepared under the coordination of Director Murilo Chaim, during the ma agement of Superintendent Armando Vergilio.

2 That was the political party of President Lula, and it was during his first term that the law was discussed with the Brazilian Congress.