

Regulating Foreigners

Marcelo Vieira Rechtman and Mariana Cavalcanti Jardim of Levy & Salomão Advogados explain how Brazil's new regulations may limit reinsurance sales by foreigners.

Two regulations issued Friday 10 December by Brazil's insurance regulator, the Brazilian National Council for Private Insurance (CNSP), are expected to strongly impact the sale of reinsurance products by foreign groups in Brazil.

Brazilian insurers may only seek reinsurance from reinsurers that are registered with Brazil's Superintendent of Private Insurance (SUSEP), the executive authority charged with policing the industry pursuant to CNSP guidelines, and that are licensed as either 'local', 'admitted' or 'occasional' reinsurers. Local reinsurers must be incorporated in Brazil and have local reserves of no less than 60 million Brazilian Reais (roughly US\$35 million). Admitted and occasional reinsurers may operate from abroad, but as a consequence are subject to a number of restrictions.

Since the opening of the Brazilian reinsurance market in 2008, almost 100 new reinsurers have been registered, most of them as admitted or occasional reinsurers. Only six have registered as local reinsurers.

The first regulatory change, which is scheduled to enter into force on 31 March 2011, mandates that at least 40 per cent of all reinsurance in Brazil be obtained from local reinsurers. The current regulatory regime provides that insurers must initially seek to reinsure with local reinsurers at least 40 per cent of their risks, but may transfer abroad 100 per cent of their risks if the local reinsurers cannot offer terms similar to those offered by foreign reinsurers. In contrast, the new rule caps the market share of foreign reinsurers to a maximum of 60 per cent, thus creating a market reserve for locals and in particular, for statecontrolled reinsurer IRB Brasil Re, which is by far Brazil's largest reinsurer.

The second change, which is scheduled to enter into force on 1 January, prevents all Brazilian insurers and local reinsurers from transferring risks to foreign reinsurers that are part of their respective groups. Pursuant to the existing rule, intra-group transactions were permitted, provided they were reported to SUSEP. In practice, the existing rule permitted insurers to maintain a small presence in Brazil and acquire large risks based solely upon the financial capacity of their foreign parents, to which they would transfer most of the risks they underwrote.

The main purpose of the changes is to compel foreign reinsurers that seek to have an important share of the Brazilian market to establish a presence within Brazil, thereby allowing SUSEP to regulate the use of their reserves and to reduce the risk of insolvency. However, CNSP was expected to issue regulations in accordance with the law that opened the local reinsurance market (complementary law 126 of 2007) and there are strong arguments to be made that the pending changes violate certain aspects of such law.

SUSEP's concern with regard to controlling the reserves of foreign reinsurers is clear. A third portion of the new regulation issued last Monday, 13 December, requires local insurers and reinsurers to increase their capitalisation in accordance with their exposure to 'credit risks'. The calculation of the exposure level takes into account a large number of variables, one of which is whether the company is reinsuring risks with domestic or foreign-based reinsurers. Where an insurer chooses to reinsure with foreign reinsurers under this formula, the company is deemed to have an increase in its credit risk exposure and is therefore required to increase its capitalisation.

São Paulo

Av. Brig. Faria Lima, 2601
12º andar - 01452-924
São Paulo, SP - Brasil
Tel: (11) 3555 5000

Brasília

SCN - Quadra 4 - Bloco B
6º andar - 70714-900
Brasília, DF - Brasil
Tel: (61) 2109 6070

Rio de Janeiro

Praia de Botafogo, 440
15º andar - 22250-908
Rio de Janeiro, RJ - Brasil
Tel: (21) 3503 2000

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Very importantly, Brazil's insurers union (CNSeg), to which most of Brazil's domestic insurers belong, has already expressed its disapproval of the pending changes and is discussing with representatives of CNSP and SUSEP potential alternatives to the restrictions. No formal proposals for change have been issued as of this writing, but it is expected that the government and CNSeg will agree to some middle ground with respect to the new rules.

Marcelo Vieira Rechtman
mrechtman@levysalomao.com.br

Mariana Cavalcanti Jardim
mjardim@levysalomao.com.br

São Paulo

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12º andar - 01452-924
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