



## **System Brazilian and American Reinsurance: needed of convergence**

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### **ABSTRACT**

This study presents definitions and characteristics of insurance and reinsurance, emphasizing the representation of these issues in Brazil and the relationship among the Brazilian and American reinsurance scheme. We will present the key moments of the two systems, up to the present, where Brazil started as a monopolistic system with the creation of the Brazilian Institute of Reinsurance - IRB, in the Vargas Era, until the opening of the market, with the sanctioning of the Complementary Law 126, in 2007. This openness enables the integration between Brazil and the international markets, highlighting the American market, and increased competition and search for the best price that indicates need for adjustments of the current system. The American system of reinsurance, open to the markets for a longer period of time, therefore with greater expertise in this service, faces the challenge of the tax evasion, ie, the leakage of money to tax havens and therefore the nonpayment of taxes, and the need to unify the regulation of reinsurance in the country. The two countries, in the current scenario, have a lot to adjust and develop in this market, and the changes to come will generate worldwide consequences in this segment.

**KEYWORDS:** reinsurance; competition; Complementary Law 126; market, international.

## **Sistema de Resseguro Brasileiro e Americano: Necessidade de convergência**

Marcela Semeghini Pereira

### **RESUMO**

Este trabalho objetiva apresentar definições e características de seguro e resseguro, enfatizando a representação destes temas no Brasil e a relação do sistema de resseguro brasileiro

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e o americano. Apresentaremos os principais momentos dos dois sistemas, até o momento atual, onde o Brasil passa de um sistema monopolista iniciado com a criação do Instituto de Resseguro Brasileiro - IRB, na Era Vargas, para a abertura de mercado, com o sancionamento da Lei Complementar 126, no ano de 2007. Esta abertura possibilita integração do Brasil com os mercados internacionais, destacando o mercado americano, além de maior concorrência e busca de melhor preço o que indica necessidade de adequações do sistema atual. O sistema de resseguro americano, aberto para o mercado a mais tempo possuindo, portanto, maior know how neste serviço, tem como desafio a evasão de divisas, ou seja, a fuga de dinheiro para Paraísos Fiscais e, conseqüentemente, o não recolhimento de impostos e a necessidade de unificar a normatização do resseguro no país. Os dois países, no cenário atual, têm muito a ajustar e desenvolver neste mercado, e as modificações que estão por vir gerarão conseqüenciais mundiais neste segmento.

**PALAVRAS-CHAVE:** resseguro; concorrência; Lei Complementar 126; mercado; internacional.

## 1. INTRODUCTION

The promulgation of the Complementary Law 126, in 2007, starts the opening of the reinsurance market in Brazil. In this article, we will deal with the topic of insurance and, in particular, the Brazilian reinsurance system, its history and the path taken to reach the monopoly.

The subject “insurance” is common in the life of all human beings – car insurance is the most common, beyond life insurance and home/property insurance. However, one subject that is gaining attention in the news and in the debates of economists is the reinsurance, in other words, the insurance of the insurance or second level insurance, which is contracted to spread risks with higher value, as the Petrobras Oil Companies case. These debates are occasioned by the modifications in the legislation as well as the necessity of adequacy.

Highlighting, also, the importance of the works of PAC (growth acceleration program) and of the Pre-Salt as boosters of these changes, considering that the country did not have conditions to comply with specific operations to insure and reinsure these investments.

Taking into account the shift of paradigm of the national reinsurance system, we will deal in this work with the major characteristics from this new systematic, including the Preemptive Right, which have caused controversy in many countries, like USA. We note, also, that the downfall of the monopoly that emerged in the Vargas Era, since the creation of IRB (Brazilian



Reinsurance Institute), the practice of the principles of free enterprise and free competition arise to expand and improve the reinsurance hiring.

Some of the advantages that can be achieved with the end of the monopoly: opening to negotiations between national and international insurers; wider offer of goods; downfall of the prices of the insurance premium, because it would have more competition; know-how flow, as the experiences of the foreigner insurers is superior than the national; Brazil would be more attractive to the inflow of foreign capital.

USA is likewise readapting the insurance legislation of the country in other to avoid tax evasion to Tax Heavens and to unify the laws of this segment in the country, taking into account that each State has its own legislation.

This is a valuable opportunity of experience and knowledge interchange, it has also the possibility of gain in market, both North American and worldwide, seeing that, whether American laws were considered too stringent, Brazil would be able to assimilate the market share that would not accept or would not adapt to the new American rules. So, in the following topics we will analyze the two systems at the present, noting the importance of the attendance of the modifications that will come.

With these elucidations, in the development of the article, it is going to be analyzed the historical process of the reinsurance system development in both countries, taking them to the present moment, and, possibly, predicting legislative alterations that will be determinants to decision taking of the enterprises connected to this activity.

## **2. INSURANCE, COINSURANCE, REINSURANCE AND RETROCESSION DEFINITION.**

### **2.1 INSURANCE**

To the understanding of this article, especially the understanding of the reinsurance operations, it is going to be presented the major definitions and information around the subject.

According to the Article 757 of the 2002 Brazilian Civil Code, the insurance contract is the one in which the insurer part assumes, upon the receipt of certain amount, that is called the insurance premium, the obligation to guarantee the legitimate right of the insured, that referees to



require the payment of a possible sinister, if it occurs. The major reason that leads the insured to contract the insurance is the prevention of a possible damage or loss.

In this legal transaction, the amount to be paid by the insured as the insurance premium is calculated based on statistic methods developed by the actuarial mathematics. This determines the occurrence probability of the future, uncertain and harmful events ensured by the insurance contract, so that the collected amount is sufficient to constitute fund able to indemnify those affected by the sinister verification and to cover the operational expenses from the business company.

The role of the insurance activity is, in general terms, the socialization, among persons who are exposed to certain risks, as the theft of a car or a work accident that causes permanent disability. According to Piza (2002, p.22), this activity is configured as “an anti-random operation of collective struggle”<sup>2</sup> which has as its most outstanding characteristic the mutualism of its relations, because “undertake and assume responsibilities requires certain confidence in future, and if the insurance does not avoid the sinister, dilutes its effects between all the insured”<sup>3</sup>.

Paulo Piza<sup>4</sup> informs that “implies a commonality of interests, a mutuality of people who pay contributions to ensure, collectively, the consequences of all sinister that occur within it, through the company diaphragm”<sup>5</sup>. According to the same author, “against the insurance there is not a prefix, but the insurance, before, presupposes the formation of a common fund for the protection of policyholders, through a statistical summary, as far as possible accurate, of the probabilities of sinister due to accurate facts”<sup>6</sup>.

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<sup>2</sup>Freetranslation of “Operação anti-aleatória de luta coletiva”.

<sup>3</sup>Freetranslation of “empreender e assumir responsabilidades exige certa confiança no futuro, e se o seguro não evita os sinistros dilui os seus efeitos entre todos os segurados”.

<sup>4</sup>PIZA, Paulo Luiz de Toledo. O Contrato de Resseguro: Tipologia, Formação e Direito Internacional. São Paulo: IBDS, 2002. p. 33.

<sup>5</sup>Freetranslation of “o seguro implica uma comunhão de interesses, uma mutualidade de pessoas que se cotizam para garantir coletivamente as consequências do conjunto de sinistros que ocorrem em seu seio, por meio do diafragma da empresa”.

<sup>6</sup>Freetranslation of “ao seguro não se antepõe, mas o seguro, antes, pressupõe a formação de um fundo comum de proteção dos segurados, mediante um levantamento estatístico, tanto quanto possível exato, das probabilidades de sinistro, em razão de fatos precisos”.



Calmon de Passos points the legal nature of the insurance activity, emphasizing its correlation with collective and transindividual interests<sup>7</sup>:

The contemporary doctrine has already stated the peculiar nature of the insurance contract. It is a commutative contract, indeed a legal collective transaction, integrated by many individual acts that contribute to the common fund the technical resources required for the safety of all in relation to the uncertainties of the future. The common mass of financial resources does not belong to anyone, in terms of individual property, being something open and permanently available to meet the needs that arise and to whose satisfaction was constituted<sup>8</sup>.

The insurance operation is not free of risks that can compromise the possibility of due performance of all indemnities of claims that can occur, which can affect, in the end, the solvency of the insurers. The risks are subject to befall due to detours between the calculations of the frequency and the historical intensity of claims used in the pricing of premiums and the verification of accidents that actually occurred during the term of the insurance contract.

## 2.2 COINSURANCE

The lack of balance that affects the insurance activity by its risks impossibilities its development in an isolated way, that imposes to the insurers the necessity of, together, measures intended to protect against these risks to ensure their solvency.

In accordance with the definition of the Complementary Law n° 126/07, the coinsurance is a “insurance operation in which two or more insurers societies, with the consent of the insured, share among them, percentually, the risks of an insurance policy, without joint liability among them” (Art. 2º, §1º, II, da LC n° 126/70). By the coinsurance contract, two or more insurers share the insurance risk contracted, each one is responsible for a share risk.

Evaluating some advantages and disadvantages of coinsurance relative to reinsurance, Pedro Alvim concludes that this “could create difficulties for the insured which would have to deal with diverse insurers and it would be commercially counterproductive to own insurer in the moment he reveals its business limitations exposing it to the competition of peers”, while the

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<sup>7</sup>PASSOS, J. J. Calmon de. A Atividade Securitária e sua Fronteira com os Interesses Transindividuais: Responsabilidade da Susep e Competência da Justiça Federal. Revista dos Tribunais. São Paulo: RT, ano 88, v. 763, mai 1999. p. 95-102. p. 91.

<sup>8</sup>Freetranslationof: “A doutrina contemporânea já precisou a natureza peculiar do contrato de seguro. É ele um contrato comutativo, em verdade um negócio jurídico coletivo, integrado pelos muitos atos individuais que aportam para o fundo comum os recursos tecnicamente exigidos para segurança de todos em relação às incertezas do futuro. A massa comum dos recursos financeiros a ninguém pertence, em termos de propriedade individual, sendo algo em aberto e permanentemente disponível para atender às necessidades que surjam e para cuja satisfação foi constituída”.



reinsurance, as it does not depend on the direct action of the insured, it “offers conditions to operate efficiently and quickly, without prejudice to the insurer's business”. Also in a critical tone to the coinsurance, Paulo Piza says that “as good as it can be performed, far it will be to promote an integral and generalized accommodation, that can avoid even the most trivial gaps from the portfolio of insurance business”<sup>9</sup>.

### 2.3 REINSURANCE

The Complementary Law n° 126/07 defines reinsurance as the “transference operation of risks from a transferor to a reinsurer” (Art. 2º, §1º, III, da LC n° 126/07). By the reinsurance contract, the reinsurer, by paying the premium, undertakes to guarantee legitimate rights of the insurer against the risk of their own activity, resulting from the conclusion of one or more insurance contract. To Ariel Dirube<sup>10</sup>:

“(…) reinsurance is a second level insurance form, in which, through various modalities, the insurance companies looking for homogenize and limit their responsibilities to normalize the behavior of the portfolio of risks assumed, by the coverage of the inadequacies or imbalances that may affect the frequency, intensity, and temporal distribution of the individual value of claims that affect it.”

The reinsurance spread the risk, sharing it with the insurers, highlighting its importance in the international market, considering the values they involve.

### 2.4 RETROCESSION

Retrocession is the insurance of the insurance, diluting the risk even more, according to Paulo Piza<sup>11</sup>:

“It is a contract that may be concluded with another reinsurer, to individual risks or by treaties, noting to allude that to the retrocessionaires can share the obligations assumed by concluding treaties of a second or a third retransfer, for example”.

As an example of reinsurers, we can mention: Lloyd's<sup>12</sup>, JMalucelli, Swiss.RE, Munich.RE, Hannover.RE, Mapfre.RE, IRB Brasil.RE.

<sup>9</sup>PIZA, Paulo Luiz de Toledo. *O Contrato de Resseguro: Tipologia, Formação e Direito Internacional*. São Paulo: IBDS, 2002. p. 87.

<sup>10</sup>DIRUBE, Ariel Fernandez. *Manual de Reaseguros*. Buenos Aires: General Cologne Re, 1990. p. 7.

<sup>11</sup>PIZA, Paulo Luiz de Toledo. *O Contrato de Resseguro: Tipologia, Formação e Direito Internacional*. São Paulo: IBDS, 2002. p. 294.



### 3. FRAMEWORK OF THE REINSURANCE ACTIVITY IN BRAZIL

#### 3.1 REINSURANCE HISTORIC

Reinsurance activity in Brazil has begun in 1808 with the ports opening to the international trade. The first insurance society that operated in the country was “*Companhia de Seguros Boa-fé*”, which aimed to operate in the maritime insurance. Only in 1850, with the promulgation of the Brazilian Commercial Code, through the Law No. 556 of June 25, 1850 is that marine insurance was first studied and regulated in all its aspects<sup>13</sup>. With the expansion of the sector, the foreign insurance companies began to become interested in the Brazilian market, turning up in 1862 the first insurers’ branches located abroad.

In 1901, the Decree nº 4270, and its annex regulation, known as “*Murtinho*” regulation, presented regulations regarding the operation of life, maritime and terrestrial, insurance companies, domestic and foreign, already existing or to come to organize itself in the national territory. Also extending the inspection standards to all insurers operating in the country this regulation created the Insurance General Superintendence directly linked to the Ministry of Finance.

With the creation of this Superintendency, in a single specialized office, all matters relating to the insurance supervision were concentrated, before distributed among different organs. This jurisdiction reached the national territory, and its competence contained the preventive inspections, exercised when examining the documentation of the society, that required authorization to operate, under the formation of direct and periodic inspection of societies. In 1906, Decree No. 5072 was promulgated, which replaced the Insurance General

<sup>12</sup>O Lloyd's é o principal mercado especializado em seguros do mundo. Possui 44 agentes e 62 sindicatos, que oferecem uma incomparável concentração de subscrição especializada. Lloyd's é a marca de seguro mais conhecida do mundo, mas provavelmente a menos compreendida. Isto porque o Lloyd's não é uma companhia de seguros, mas uma sociedade de pessoas, tanto físicas quanto jurídicas, que subscreve em sindicatos, cujos profissionais de seguros aceitam ou não riscos. O capital de lastro é fornecido por instituições de investimento, investidores especializados, companhias de seguro internacionais e por indivíduos. Os corretores do Lloyd's levam os negócios ao mercado. Os riscos colocados nos *underwriters* originam-se de clientes, de outros corretores e intermediários, de todas as partes do mundo. Juntos, os sindicatos tornam o Lloyd's um dos maiores Seguradores / Resseguradores do mundo. A estrutura do mercado incentiva inovação, rapidez e valorização, sendo assim, atrativa para os segurados. O acesso imediato aos responsáveis pelas decisões significa que as “respostas sobre a aceitação dos riscos são rápidas, permitindo ao corretor fornecer soluções rápidas e de qualidade”. Informações disponíveis em <<http://www.ascunhabueno.com.br/htmls/resseguro/quemsomos/lloyds.htm>>. Acessado em 05/10/2012. **LINK NÃO FUNCIONA**

<sup>13</sup>Informações disponíveis em: <http://www.susep.gov.br/menu/a-susep/historia-do-seguro>. Acessado em: 02/10/2012,



Superintendence for a Inspectorate of Insurance also connected directly to the Ministry of Finance.

During the first three decades of the twentieth century, regulation of the activity of reinsurance was treated in an unequal way. As stipulated in art. 8 of Decree No. 5,072, companies preexisting to this regulation would only be required to comply with the legislation in force at the time of its establishment. The imbalance in favor of foreign insurance companies was strongly contested whereas was in force, being responsible for the increase of the demands for the nationalization of the insurance activity<sup>14</sup>.

The years in which foreign companies operated under unequal conditions to the national companies have provided hegemony of those on the national insurance market. Beyond the simple transfer performed by foreign insurance companies to their headquarters, usually in other countries, stands out the reinsurance contract as a mechanism also used to perpetrate the evasion of amounts received as the insurance premium to foreign countries.

Through, especially of this mechanism, which remained free from regulation and supervision during the Old Republic, foreign reinsurance and insurance companies exercised important influence on the Brazilian insurance market, controlling even its development, explains Pedro Alvim.

To Pedro Alvim, it is important to the developing countries, that need to defend from the dominance of other more developed countries, the State interference in the economic domain to make it insurance national markets stronger and to restrain the acting of the foreign entrepreneur, because, as the author states, only through this intervention is possible to: (a) maintain a balanced foreign exchange balance of payments, (b) foster the security against the risks that threaten the success of enterprises, life and property of the people, and (c) guide the implementation of the funds raised for the benefit of the country's economic development.

### **3.2 THE IRB (BRAZILIAN INSURANCE INSTITUTE) ORIGIN**

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<sup>14</sup> ALVIM, Pedro. *Política Brasileira de Seguros*. São Paulo: Manuais Técnicos de Seguros, 1980.



The Federal Constitution of 1934, pursuant the interventionist and nationalist tendency carried by President Getulio Vargas, delegated to the Union the possibility, motivated in the public interest to constitute a public monopoly on any industry or economic activity.

Persisting in the effort to reduce foreign influence over the Brazilian insurance market and to create conditions for the strengthening of national insurers President Getúlio Vargas, based on Article 135 of CF/37 determined the absorption by the Brazilian state of the reinsurance sector in April 1939 through Decree-Law No. 1.186/39, giving the newly created Brazil Reinsurance Institute (IRB)<sup>15</sup> monopoly on the exploitation of the reinsurance activity in the country.

Marly Silva da Motta<sup>16</sup> explains that, in accordance with the assessment of Frederick Rangel, the necessity that guided the Vargas government's decision to create an official reinsurer agency was configured not only in the ascertained evasion of profits abroad, but mainly on the risks and trade restrictions brought by international war climate at the time. Thus, "the possibility that the effects of an impending global conflict disassembled the insurer's circuit strengthened the positions of those who defended nationalization proposals and monopoly, especially in the reinsurance sector", in order to provide adequate shelter to the Brazilian insurance market.

In 1988, the Federal Constitution in Art. 192, item II, approved the monopoly of the reinsurance market in Brazil providing the figure of "the official reinsurer" and the enactment of Amendment No 13/96 opened the way for changes, excluding the above text. Anyway, Brazil was adapting the global changes.

### 3.3 COMPLEMENTARY LAW 126 – OPENING OF THE REINSURANCE MARKET

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<sup>15</sup>Discurso de Vargas, no início das operações do IRB: "Vejo com grande satisfação hoje, aqui realizado, um dos propósitos mais antigos e persistentes do meu governo. Meus esforços foram sempre ludibriados, ora pelo conluio de interesses estranhos aos do país, ora pela resistência de espíritos de boa fé iludidos nos seus intuitos ou julgando talvez temerário um empreendimento como este. Não estava nos meus objetivos prejudicar interesses de capitais estrangeiros aqui empregados e que foram, nesta organização, devidamente respeitados. Pretendia apenas organizar, sob a égide de uma fiscalização eficiente, as legítimas atividades industriais que se desenvolvem no país, procurando, porém, evitar que fossem drenadas para o exterior as nossas economias que constituem o sangue e a vida da nacionalidade."

<sup>16</sup> MOTTA, Marly Silva da. A Criação e a Estruturação de uma Instituição-Modelo da era Vargas: o Instituto de Resseguros do Brasil. In. ALBERTI, Verena (coord). *Entre a Solidariedade e o Risco: História do Seguro Privado no Brasil*. 2. ed. Rio de Janeiro: Editora FGV, 2001. p. 103.



Only in 2007 with the promulgation of Complementary Law 126, the State has chosen to open the market, ending the IRB monopoly.

The end of the monopoly enables greater offer of reinsurance and the chances for the smaller insurers to compete with large insurers will be higher considering that with the expansion of its underwriting risk capacity, as a consequence of the reinsurance contract, may offer better guarantees to national business. The consequence resulting from innovations to the domestic reinsurance market is getting competitive advantages by new reinsurers.

With the edition of Complementary Law 126, two principles are highlighted: free competition and free enterprise.

The principles of free competition and free enterprise are present in Article 170 of the Federal Constitution. Concerning the organization of our economic order it seems undeniable a predominance of the two principles.

Free enterprise guarantees everyone the right to launch on the market, in the operation of a particular activity on its own account and risk, not ensuring the prevalence of market laws.

Free competition ensures the economic agent the possibility to enjoy the exploration of a sector subject to rules that allow competition in conditions of equality, isonomy in relation to other competitors.

Free competition involves competitiveness, the dispute for more than one company around the conquest of the market, which generates greater productivity, price improvements and product quality.

With the breakdown of the Brazilian reinsurance monopoly, these two principles are ratified and valued, indicating opportunity to develop this segment and consequently the country.

With the opening of the reinsurance to free competition many innovations will arise, both in terms of coverage distinct than the present, in terms of more specific services related to the regulation of claims (sinister), which possibly will result in a reduction of both the insurance premiums paid by consumers, as the reinsurance premiums paid by insurers, who have seen more quotations options.

Also, in relation to globalization, it will favor the opening of the way greater integration of reinsurers markets within MERCOSUR. It may emerge partnerships with countries such as Argentina and Chile.



Ilan Goldberg<sup>17</sup> highlights other benefits resulting from the end of the monopoly. In this scenario, there will be (i) openness to negotiation between national insurers and foreign reinsurers, (ii) the positive impact of reinsurance primary insurance market, certainly, on the whole economy, (iii) wider offer of goods; (iv) a decrease in the price of premiums charged, due to increased competition, (v) the flow of *know-how* (knowledge), whereas the expertise of foreign reinsurers is considerably higher than the expertise amassed by technical body of the IRB-Brazil Re, either by greater maturity of foreign reinsurers, or even by the time they are already performing their duties, (vi) with the opening of the reinsurance market, it is believed that Brazil as a whole, will become more attractive to the input of foreign capital, which, in the same direction, would contribute to improve the risk classification of the country, because the expansion will result in the share of the risk.

One of the reasons that led the government to enact the Complementary Law 126 was the concern in the insurance policies of the PAC works and especially the investments in the Pre-Salt.

The government and the market await the creation of a new state company, to be called Empresa Brasileira de Seguros S.A. (Brazilian Insurance Company), that aims to conduct insurance operations in any modalities. The government's justification for this creation is the supposed inability of the insurance private sector to guarantee large government projects, such as the works arising from the Growth Acceleration Program (PAC) and the Pre-Salt. Depending on the form and attributions of the new company, the reinsurance market can turn out to be even more attractive for the entry of new players, or in the consolidation of the current.

The expected total investment of Petrobras for 2011-2015 is \$ 224.7 billion, and only for the execution pre-salt investment, the company will allocate \$ 53.4 billion by 2015. Given this optimistic scenario, the reinsurance industry will have great opportunities in the coming years, since the work of the oil industry involves a series of protections, which range from insurance risk engineering to health insurance for employees.

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<sup>17</sup> GOLDBERG, Ilan. Dissertação de Mestrado. *Do Monopólio a livre concorrência: A Criação do Mercado Ressegurador Brasileiro*. Rio de Janeiro: Universidade Cândido Mendes, 2006, p.95-96. Disponível em: [http://www.pmd-ucam.org/index.php?option=com\\_docman&task=doc\\_view&gid=23](http://www.pmd-ucam.org/index.php?option=com_docman&task=doc_view&gid=23). Acesso em 24/09/2012.



The development of the existing relation in the country between the State and the market, in general, has shown that the Brazilian constitutional economic order does not save more space for a regime in which prevails monopoly in any segment. Segments focused on distribution of piped gas at the end of the market reserve in coastal shipping, telecommunications, electricity distribution as well as to oil and natural gas, were important steps towards the rise of the flexibility of the erstwhile existing monopolies, given that the Complementary Law. 126, from January 15, 2007, recently sanctioned, represented the mark that was aimed to be achieved for the Brazilian insurance and reinsurance markets.

### **3.4. RESTRICTIONS IMPOSED BY THE COMPLEMENTARY LAW 126**

By imposing some restrictions, the legislator weighed the economic evaluation and sought to provide a stable environment favorable to the development of the national reinsurance market over a given period of time. Such incentive, in the view of the legislator at the time, would be determining not only at initial business capture, but also in the stabilization period of its business activity, as it would allow a better long-term planning. The main constraint is the one practiced by the Preemptive Right, which is going to be discussed in the following section.

#### **3.4.1. THE PREEMPTIVE RIGHT.**

Inside the regulatory framework pointed out in the Complementary Law 126, it was decided, in a first moment, to grant a preemptive right to local reinsurers<sup>18</sup>.

It is important to highlight that, in March 2011, there were in the country, 7 local reinsurers, 27 admitted reinsurers, 53 admitted and 33 insurance brokers. According to the Article 11 of the Complementary Law No. 126/07, during the three (3) first years that the complementary law has entered into effect (ended on January 2010), local reinsurers had the preemptive right of 60% (sixty percent) of the insurance ceded; after this period this right was reduced to 40% pursuant to the terms of section II from the aforementioned legal provision. The preemptive right, pointed out by the legislator, has generated unwillingness with the U.S. government, which has great interest in the Brazilian market.

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<sup>18</sup>The text of the Complementary Law presents the definition of local companies as: The company that opens an office in the country, with its own CNPJ with minimum capital of U.S. \$ 60 million, the eventual companies as: those that operate in the country of origin for more than 5 (five) years, have Net Equity greater than \$ 100 million, minimum risk classification and have \$ 5 million to ensure its internal operations and the companies admitted: are the eventual that receive authorization to operate according to the its business needs in Brazil, operating in the country of origin for more than five (5) years, have Net Equity greater than \$ 150 million and minimum risk level.



In accordance with “*Isto É*”<sup>19</sup> magazine, the commercial trading office of the United States, the USTR, quoted the Insurance and Reinsurance industry as one that has barriers to the presence of foreign companies, and argues that American companies who want to enter the Brazilian insurance and reinsurance market shall establish the subsidiary, enter into a partnership or acquire a local company, hampering the insertion in the country.

The U.S. government claimed to the Ministry of Finance changes in the regulation rules in the reinsurance sector in Brazil, after the privatization of Brazil Reinsurance S.A (IRB, the former Brazilian Reinsurance Institute).

The U.S. wants the government to end the deposit of \$ 5 million that will be required of international insurers that will be able to operate in Brazil without opening a company in the country. The U.S. government also requested that it should be increased from 10% to 20% the maximum limit of market share that will be permitted to the eventual insurers - companies that will make reinsurance operations in Brazil without maintaining a representation in the country.

Thus, claim greater freedom of negotiation and participation in the Brazilian reinsurance market. For Brazil, the U.S. interest is a great opportunity to leverage the business, so for business leaders and legislators it is highly relevance the knowledge of the American reinsurance system, and it is possible to highlight strategic points in the development of this market.

### **3.5. PERCEPTIONS OF THE REINSURANCE MARKET IN BRAZIL AFTER THE COMPLEMENTARY LAW**

In 2007, Complementary Law 126 was promulgated and along with it was the opening of the Brazilian reinsurance market, according to a survey conducted by KPMG<sup>20</sup> in 2011, completed three (3) years of the enter into effect of the law, found that the balance was positive, even with the difficulties presented.

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<sup>19</sup>REVISTA *ISTO É*. Disponível em [http://www.istoedinheiro.com.br/noticias/93120\\_VIDA+MILIONARIA](http://www.istoedinheiro.com.br/noticias/93120_VIDA+MILIONARIA). Acesso em 25 set 2012.

<sup>20</sup>KPMG Auditores *Independentes*. *Abertura do Mercado de Resseguro no Brasil: Percepções do mercado*, 2001. Disponível em: [http://www.kpmg.com/BR/PT/Estudos\\_Analises/artigosepublicacoes/Documents/Financial-Services/Abertura\\_do\\_Mercado\\_de\\_Resseguro\\_no\\_Brasil.pdf](http://www.kpmg.com/BR/PT/Estudos_Analises/artigosepublicacoes/Documents/Financial-Services/Abertura_do_Mercado_de_Resseguro_no_Brasil.pdf). Acesso em 03/10/2012.



Sporting events (World Cup and Olympics), the pre-salt and government investment programs in infrastructure demonstrate strong growth of domestic industry insurance, for which it is needed to have the support of the international reinsurance market.

The benefits that have been collected demonstrate the correctness of the change implemented and the discussions are part of the consolidation process. In a survey conducted by KPMG, in numerical terms, it was found that 100% of respondents agree that the risk management of insurers improved and 83% report that insurers are more profitable. Another finding was that the economic crisis that has hit many rich countries, little affected the Brazilian insurance companies and stresses the opinion of 70% of respondents. As for the prospects of the segment, 83% think that in the years 2012 and 2013 insurers will grow at least 10% per year and reinsurers will grow 50%.

In 2011, the turnover of the reinsurance market in the country is \$ 2.5 billion, with the possibility to triple in the next 10 or 20 years. In 2010, the IRB-Brazil was leading with 54% of revenues.

Issues highlighted in the opening of the reinsurance market:

- Perception from 100% of respondents that insurance companies were more profitable and have better management of risks;
- As a weak point, the creation of new products as a result of the opening, both on persons and from elementary areas, has small offer;
- The replies have indicated that agents think that reinsurance costs are lower;
- Urgent need of increased skilled labor, and
- Develop culture of knowledge dissemination with the participation of policyholders and insurance brokers, exchange of know-how between insurers and reinsurers.

Hence, although the improvement after the market opening is visible, it is believed that adjustments and improvements are crucial for the consolidation of this segment in Brazil, therefore, a comprehensive study on the regulation of the U.S. markets is of great value, since this market is also undergoing through a moment of adjustments and adaptations to the current world scenario.

#### **4. REINSURANCE MARKET IN THE UNITED STATES OF AMERICA.**

##### **4.1. LANDMARK MOMENTS IN THE HISTORY OF AMERICAN REINSURANCE.**



As IlanGoldber<sup>21</sup> states, the U.S. market has gone through three important moments in time, regarding reinsurance.

The first occurred in the nineteenth century, because barely were, at that time, concerns about the economic and financial stringency.

The offer of insurance coverage at low prices, combined with the acceptance of bad risks, namely susceptible to claims of large proportions, had put the market in a very delicate situation, which led to a state concern to initiate regulation.

According to Goldber, the second moment was marked by a trial conducted by the U.S. Supreme Court in 1914, driven by a demand from the German Alliance Insurance Company against Lewis in which, differently to the standards of the time, the Court concluded that the regulation of insurance activity was related to the public interest.

The third moment occurred in the 80s, the high yields paid by the financial market, especially due to the high interest rates prevailing in the 70s, seduced the insurers, who had decided to direct their capital reserves for applications in the financial market. So they could capture more resources and consequently, invest more, according with risks of any nature, including bad risks, leaving in a second plane the securitarian operation.

In the '80s, interest rates started decreasing so precipitous, that is, the return arising from applications also began to decline which motivated the need that concerns should return specifically for insurance operations as such, and not for the financial operations. At this time, the acceptance of any risks had made the insurers feel difficulties in managing their technical reserves against losses incurred. The option for financial transactions over securitarian operations became known as cash flow underwriting and put the market into crisis.

So, analyzing the three moments identified above, we note that the experiences in the U.S. have made very clear the necessity that the insurance and reinsurance markets would have to be regulated, as they were intrinsically related to the public interest.

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<sup>21</sup> GOLDBERG, Ilan. *Do Monopólio a livre concorrência: A Criação do Mercado Ressegurador Brasileiro*. 2006. Dissertação (Mestrado em Direito) - Universidade Cândido Mendes. p. 190-91 Disponível em: [http://www.pmd-ucam.org/index.php?option=com\\_docman&task=doc\\_view&gid=23](http://www.pmd-ucam.org/index.php?option=com_docman&task=doc_view&gid=23). Acesso em 24/09/2012.



Stands out the importance allocated by the competent authorities to the restrictions imposed on insurers, in order that they do not subscribe to risks that exceeded their retention capacities, avoiding, in this way, potential problems at its origin.

Since 1945, each state member of the United States had specific regulations related to insurance and reinsurance, in other words, the insurers and reinsurers to conduct their activities should follow different standards, in accordance with the state in which they were acting.

The interest in the standardization of rules inherent to the regulation has provoked, in 1871, the creation of the National Association of Insurance Commissioners - NAIC<sup>22</sup>.

Even lacking the authority to regulate directly reinsurers established in various states of the country, NAIC has succeeded in its task of making their standards started to be observed<sup>23</sup>.

The main areas in which reinsurance regulation in the U.S. focuses are the following<sup>24</sup>:

(i) Conducting business upon reinsurance authorization: the first step to be taken to make a reinsurer be able to act freely in U.S. consists in obtaining authorization in their home state. After obtaining it, usually it will be free to provide reinsurance coverage both in their home state and in other states.

(ii) Restrictions on the retention of risks: it is common to restrict the ability of risk retention on the part of ceding insurers, in order to avoid excessive exposure of its capacity in the event of asset loss occurrence of major proportions.

(iii) The reinsurance contracts concluded by ceding insurers: reinsurance regulation in the U.S. is primarily focused on the reinsurance covers obtained by insurers. Hiring a coverage, derived from the reinsurance is only considered as an asset or as a reduction of technical reserve when the reinsurance is offered by one who is authorized to act in the state in which the business was conducted; the hypothesis of the coverage being offered by a reinsurer that has subsidiaries in USA, there will be need to submit its accounting documentation to the conference of the competent authorities; the reinsurer must maintain solid investments in a renowned North American financial institution.

<sup>22</sup> Available at <<http://www.naic.org/>>, accessed in 10/04/2012.

<sup>23</sup> WANG, Wallace Hsin-Chun. *Reinsurance Regulation: a Contemporary and Comparative Study*. London: Kluwer Law International, 2003, p.35

<sup>24</sup> WANG, Wallace Hsin-Chun. Ob. cit., p. 36.



(iv) Regulation of the content of reinsurance contracts: unlike what happens with insurance contracts, in which there is intense regulation on the part of the authorities, established in many U.S. states, in the reinsurance contract incisive regulation does not exist on the content of contracts.

#### **4.2. MANDATORY CLAUSES IN AMERICAN REINSURANCE CONTRACTS.**

Whether because of the specificity, both because of the complexity and, moreover, considering that ressecuritarian coverage should ultimately bring benefits to reinsurance policyholders themselves, regulatory authorities in the U.S. usually require the insertion of three clauses in contracts, which are: (1st) insolvency clause, which imports the impossibility that the reinsurer evades its responsibilities if the primary insurers become insolvent, (2nd) Service of process clause, which means that it will be up to the reinsurer to have a representative in the U.S., acting on behalf of it; (3rd) intermediary, stipulating that the intermediary is an agent of the reinsurer with the purpose of receive and pay amounts<sup>25</sup>.

It is remarkable the concern to harmonize the regulation of reinsurance, to facilitate the performance of its reinsurers at the international level and, if there is the possibility, not only on the European continent and in the American continent, but worldwide. As for the U.S. reinsurance market, it should be clarified that, notwithstanding the achievement of regulation with different nuances from state to state, the role of the NAIC - National Association of Insurance Commissioners - consists precisely to seek to standardize the aspects regulated, ensuring by:

(i) protection of the public interest, (ii) promotion of competition in the market, (iii) fair and equitable treatment to consumers, (iv) the solvency of insurers and (v) support and development of regulation<sup>26</sup>.

The mandatory inclusion of the aforementioned clause insolvency lends itself to precisely prevent that the insolvency of the insurer causes the sacrifice of the primary insured, by having, in a situation like, the initiative to be directly taken against the reinsurer.

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<sup>25</sup>WANG, Wallace Hsin-Chun. Ob. cit., p. 37.

<sup>26</sup>Trata-se da missão da National Association of Insurance Commissioners, disponível em [http://www.naic.org/index\\_about.htm](http://www.naic.org/index_about.htm). Acessado em 02/10/2012.



## 5. TAX HAVENS AND TRENDS OF REGULATION OF AMERICAN REINSURANCE.

Over the last two decades, there has been a notable increase in the use of tax havens to allow multinational corporations to reduce or avoid U.S. taxes. These offshore tax havens deplete public coffers of income.

Responsible and sustainable businesses are at a competitive disadvantage when other companies hide their assets in tax havens and avoid paying taxes.

Evasion deprives American nation of needed revenue to maintain and modernize the infrastructure that underpinne a strong economy. The American economic progress is hampered when companies are rewarded for financial manipulation instead of creating innovation, investment and productive work. Furthermore, the use of havens allows systemic risk to be hidden. As an example, in 2008 the U.S. had amount of U.S. \$ 33 billion of reinsurance contracts, these, \$ 21 billion went to Bermuda. To become competitive, domestic insurance companies form offshore companies in tax havens for the main purpose of avoiding tax, keeping only superficial presence in these countries.

In an article published in the newspaper "*Valor Econômico*<sup>27</sup>" is said that besides the problems faced in tax evasion, since the reduction in payments of taxes: the U.S. faces a fiscal calamity, stressing that are focused on the "tax gap" that threatens to materialize in 2013 when all tax rates will rise by subtracting the equivalent of more than 3% of GDP for households and businesses. The automatic cuts in government spending on defense programs and not defense will subtract another 1% of GDP.

For example of the concern of the country to minimize and even end up with the challenges elsewhere, there is an increase of tax regulation, in 2010 they have created the FATCA, a law of tax compliance for foreign accounts. They are also more stringent in the supervision of insurance and reinsurance operations, emphasizing that this supervision and restriction may indicate business opportunity for Brazil.

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<sup>27</sup>FELDSTEIN, Martin. *Para corrigir problema fiscal dos EUA*. Valor Econômico, São Paulo, 02/10/2012, Caderno A15.



The recent U.S. legislation indicates a tendency of the Congress in that country to bring under federal the regulation of insurance market, which is likely to substantially change the rules applicable to large insurers and reinsurers.

With regard to reinsurance market itself, the wording encourages more uniform regulatory environment for this sector, which may indicate, even now, the concern of the Federal Government of that country to establish clearer and more precise rules for the financial system.

Thus, depending on legislative developments in the United States, which might lead to barriers or to lay down to requirements hard to comply with, it is possible that Brazil will become even more competitive as another option in the reinsurance market for new investments. Brazil and the United States, in dealing with two markets fairly young in regard to Federal regulation it is necessary and enriching an accompaniment of regulatory innovations of the latter country, which may prove to be appropriate and helpful, to the extent that it may, somehow, influence the legislative development and behavior of the Brazilian reinsurance market.

## **6. FINAL CONSIDERATIONS.**

1. The Complementary Law. 126, of January 15, 2007 was the milestone essential and necessary for the Brazilian insurance and reinsurance markets. Hardly a country is developed through monopolizing a segment.

2. The opening of the reinsurance market enables the emergence of innovations like different coverages, more specific services inherent in regulation of claims (sinister), which may result in the reduction of insurance premiums paid by consumers as the reinsurance premiums paid by insurers since it will have greater options quotes, enforcing the principles of free enterprise and free competition.

3. The regulation of reinsurance in the country should be under the responsibility of an independent regulatory agency, and to whose directors are assured fixed mandates in order to specialize the labor in more depthand, moreover, to make possible to the Federal Government to be able to transfer the regulatory responsibilities that are, ordinarily, features of it, ensuring thereby the impartiality and necessary freedom for the regulation reinsurance to be free from the public and / or private capture.



4. After the promulgation and the sanction of Complementary Law 126, it is necessary for Brazil to study and perform some experiments from countries like the United States, which have not exercised a monopoly and have experience in this market.

5. The main areas in which focuses the regulation of reinsurance contracts in the U.S. are well defined and could be the basis for the Brazilian market.

6. The U.S. is willing to unify the rules of reinsurance regulation in order to facilitate the performance of these companies in the international level, if there is the possibility, not only on the European continent and in the American continent, but worldwide, which greatly influence the Brazilian market. In this respect, it is important to observe the implementations and modifications to come, to the development of our own system and to gain market.

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