Spring 1999

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Cover Page Footnote
International Law; Commercial Law; Law

This article is available in North Carolina Journal of International Law: https://scholarship.law.unc.edu/ncilj/vol24/iss3/3
The Need for Liberalization of Barriers to Trade in Insurance to Promote Consumer Interests: Analysis of the Brazilian Reinsurance System as a Case Study

Christopher R. Rabley†

Insurance is a particularly sensitive area from the point of view of the protection of the consumer.¹

–Court of Justice of the European Communities

I. Introduction

On December 13, 1997, two hours past the midnight deadline, trade negotiators at the World Trade Organization (WTO)²

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The author would like to thank Professor Edgardo Rotman of the University of Miami School of Law for his assistance and comments in the preparation of this article. Special thanks to Jennifer Rabley for her support and encouragement and the staff of the North Carolina Journal of International Law and Commercial Regulation for their hard work and editorial assistance.


² The Uruguay Round of General Agreement on Tariffs and Trade (GATT) established the World Trade Organization. See generally General Agreement on Trade in Services, Dec. 15, 1993, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO], Annex IC, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 31; 33 I.L.M. 44 (1994). The WTO has three basic responsibilities: to demonstrate the rigorous, objective, and expedient enforcement of the world trade obligations; to reinforce support for global trade liberalization; and to administer new Uruguay Round Accords and monitor compliance by WTO signatories. See JEFFREY J. SCHOTT, WTO 2000: SETTING THE COURSE FOR WORLD TRADE 5 (1996). Through its dispute settlement mechanism, the WTO can measure the conformity of country practices with the rights and obligations made through the WTO, but member countries are responsible for compliance. See id. at 4. WTO members have an obligation under international law to comply with WTO rules, but the WTO has no means to force countries to honor such obligations. See id. For recent results of the WTO, see International Institute for Sustainable Development, WTO Ministerial

finalized the first meaningful pact in trade in financial services. The pact succeeded in lowering barriers to foreign suppliers of financial services in 70 countries and locked the commitments of 102 nations into binding WTO rules that are subject to dispute settlement procedures.

The United States and other industrial nations considered the 1997 WTO Financial Services Agreement (FSA or Agreement), which arose out of the 1995 WTO Financial Services Accord (1995 Accord), a major success. The Agreement represented a “decades-long effort” by developed nations to liberalize barriers to trade in financial services in developing nations. The FSA commitments covered an astonishing $17.8 trillion in global securities assets, $2.2 trillion in worldwide insurance premiums, and $38 billion in bank lending. The offers by developing countries in the insurance sector, however, made the Agreement a success.

Insurance and reinsurance companies are no longer defined by geographic region. Major insurers, fueled by competition for

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3 See Frances Williams & Guy de Jonquieres, WTO Pact Will Open Financial Services Sector, FIN. TIMES, Dec. 15, 1997, at 1.
4 See id.
5 See Bhushan Bahree & Helene Cooper, Landmark Deal: WTO Finance Pact Seen as Boon for U.S., Europe, ASIAN WALL ST. J., Dec. 15, 1997, at 1. Commenting on the WT0 agreement in trade in financial services, U.S. Trade Representative Charlene Barshefsky stated: “[T]his is the biggest trade deal the United States will ever do because there’s no sector in the U.S. economy that will ever come close to approaching the financial-services sector.” Id. James A. Leach (R-Iowa), Chairman of the House Banking and Financial Service Committee, commented: “From an American perspective, the agreement could not be better timed. Our private-sector financial houses have never been in better shape to compete in world markets.” Helen R. MacLeod, Insurance Industry Heaps Praise on Global Financial Services Pact, J. COM., Dec. 19, 1997, at 5A [hereinafter Insurance Industry Heaps Praise].
6 Insurance Industry Heaps Praise, supra note 5. See generally Terence G. Berg, Trade in Services: Toward a “Development Round” of GATT Negotiations Benefiting Both Developing and Industrialized States, 28 HARV. INT’L L.J. 1, 1-2 (1987) (discussing attempts to include the subject of trade in services in GATT negotiations).
7 See Bahree & Cooper, supra note 5.
8 See id.
premium growth and risk diversity, have made global expansion a priority.° The most fertile markets for insurers in their quest to expand are the profitable, unsaturated markets found in developing nations.11

Brazil, which has the largest insurance market in Latin America, has been an important target for trade negotiators and insurance companies.12 As a result of the Real Plan economic stabilization program introduced by President Cardoso in June 1995, Brazil has experienced an insurance boom.13 In 1995 Brazil’s insurance market grew to $7.5 billion, an increase of thirty-four percent from the previous year.14 By 1997 the insurance market had grown to a total of $17.1 billion.15 Despite this growth, foreign insurance companies consider the Brazilian insurance market to be a virgin market.16 Should Brazil liberalize its reinsurance market, a similar boom in growth will occur.17 Brazil’s reinsurance market is currently valued at almost $800 million, and within a year following a liberalization of the market, it is predicted to grow to $2 billion.18 The world’s largest reinsurers have longed to access Brazil’s developing insurance

10 See infra notes 53-54 and accompanying text.

11 See infra notes 59-61 and accompanying text.

12 See Bahree & Cooper, supra note 5; infra notes 46-48, 53-54 and accompanying text.


14 See id. The three largest growth areas were automobile (34% of the total), health (17% of the total), and life insurance (13% of the total). See id.


16 See id.

17 Reinsurance is defined as a contract by which an insurer procures a third person to insure him against loss or liability by reason of original insurance. See BLACK’S LAW DICTIONARY 1287 (6th ed. 1990). Reinsurance is an invaluable tool to insurers as it permits them to participate in programs that would normally far exceed their own capacity. See Henry G. Parker, Liberalizing Global Reinsurance, NAT’L UNDERWRITER—PROP. & CASUALTY, Oct. 20, 1997, at 27, available in LEXIS, News Library, Nuprop File. Reinsurance by definition is the most global of all insurance practices. See id.

market in anticipation of capitalizing on this huge opportunity for growth.19

For over thirty years, Brazil's insurance market has been sealed from foreign insurance and reinsurance companies.20 Strict regulations prohibited any new investments by foreign insurers, and a government monopoly over reinsurance kept reinsurers away from Brazil's reinsurance market.21 In the FSA, Brazil finally gave foreign insurers what they had been seeking—a commitment to allow foreign insurers to invest freely in the Brazilian insurance market.22 On the reinsurance side, Brazil indicated it would open its reinsurance sector in the near future by privatizing its reinsurance monopoly (Instituto de Resseguros do Brasil - Reinsurance Institute of Brazil or IRB), thus allowing the "supply of reinsurance services by private institutions."23 Although Brazil's offer was a boost for foreign insurers, its vague commitment to liberalize its reinsurance market damages reinsurance companies and Brazilian consumers.24

A relationship exists between trade barriers and consumer welfare in insurance. Essentially, insurance is a contract for payment in the future.25 The fiduciary character of insurance and

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20 See infra notes 73-76 and accompanying text.

21 See id.

22 See infra note 76 and accompanying text.


24 The structure of Brazil's insurance market can be described as an upside-down funnel. At the wide end exists a multitude of insurance companies that have no choice but to place their reinsurance through the IRB monopoly, situated at the top, narrow end of the funnel. Such a structure indirectly gives Brazilian regulators, via the IRB, constrictive control over the insurance market. In an open market, a multitude of reinsurers would exist, fueling competition to the benefit of insurers and consumers.

its effect on public interest make it a legitimate subject of regulation and control by the state to guarantee performance.\textsuperscript{26} As stated in the official comment to the proposal for the German Insurance Supervision Law in 1900, “the public interest has an especially large stake in a prosperous and solid development of the insurance business, and imposes on the government a duty of special care in this field.”\textsuperscript{27} Among developing nations, however, insurance regulations are often established to protect domestic insurance markets from foreign competition and, thus act as unreasonable trade barriers.\textsuperscript{28} Trade-barrier insurance regulations of this type negatively impact consumers.\textsuperscript{29}

Brazil’s strict reinsurance regulations serve as a substantial barrier to trade and create an isolated marketplace. The regulations suffocate the development of the insurance industry and stifle innovations in products, processes, and market

\textsuperscript{26} See id. at 1010; see also LEE R. RUSS \\& THOMAS F. SEGALL, COUCH ON INSURANCE 2-3 (3d ed. 1996) (discussing public interest in insurance industry). Insurance regulation includes any legislation, rule, or order that affects the insurance industry. See id. at 2-4. Spencer Kimball recommends that objectives of insurance regulation should be based on internal and external goals. See Spencer L. Kimball, The Regulation of Insurance, in INSURANCE, GOVERNMENT AND SOCIAL POLICY 3, 5 (Spencer L. Kimball \\& Herbert S. Denenberg eds., 1968). Internal goals consist of preservation and enhancement of insurer solvency, and objectives to ensure fairness, equity, and reasonableness in the insurance market. See id. Kimball discusses two categories of external goals relating to general public policy of society. See id. at 5-6. The first is political objectives that can further be broken into three subcategories: (1) libertarian objective or freedom of government restraint; (2) avoidance of local protectionism; and (3) federalism or the dispersion of decision making power in the community. See id. at 6-7. The second is socialization of risk, which includes compulsory or quasi-compulsory extension of insurance coverage without involving an equitable distribution of cost on social instead of economic grounds, freedom of entrepreneurs to enter the insurance market, and objectives related to capital accumulation. See id. at 7-8. The principle of insurance regulation is that there should be no interference or intervention in the operation of the economy unless regulators are sure of what it is they are doing. See id. at 8-9.

\textsuperscript{27} Werner Pfenningstorf, Public Law of Insurance, in IX INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, ch. 7, COMMERCIAL TRANSACTIONS AND INSTITUTIONS 16 (Jacob S. Ziegel ed., 1991) (quoting the Insurance Supervision Law of 1900). This encyclopedia is printed in German.


\textsuperscript{29} See id.
efficiency. In such a marketplace, consumers become disempowered and their ability to become risk averse, via insurance, is diminished. Consumers in Brazil have been forced to purchase insurance in an uncompetitive environment where products are excessively priced and inadequate as compared to open market standards. Thus, the Brazilian reinsurance regulations hurt consumers and fail to meet an important part of their existence—to promote consumer welfare.

The higher the barriers to trade in insurance, the greater the harm to consumers. The negative effects of suffocating insurance regulations on consumers is a facet of liberalizing international insurance barriers that is often de-emphasized, if not overlooked. The welfare of insurance consumers in Brazil depends on Brazil’s commitment to remove the barriers to trade in reinsurance entirely and to open its market to foreign competition. The FSA serves as an excellent starting point from which to analyze the Brazilian insurance regulations and its effects on foreign insurance companies and the Brazilian consumer.

II. Background: An Overview of Trade in Financial Services

For the last seventeen years, developing nations have made liberalization to trade in services a priority in multilateral negotiations. In 1982 the United States, a leading advocate for liberalization to trade in insurance, introduced a proposal to the General Agreement on Tariffs and Trade (GATT) for negotiations on trade in services. Although the proposal was rejected, the United States continued to push for multilateral negotiations in the services area. International trade rules finally included trade in services in the 1986 Uruguay Round of GATT. It was out of this round in 1993 that the General Agreement on Trade in Services

30 See generally id. at 63.
31 See id.
32 See Dorothy I. Riddle, Service Led Growth 204-09 (1986).
33 See id. at 204.
34 See id. at 204-05.
(GATS)\textsuperscript{35} was formed, setting global principles and creating a structure for future negotiating rounds to lower barriers to trade in services.\textsuperscript{36}

At the 1986 Uruguay Round, new negotiations to trade in services were planned to begin by January 1, 2000 with the goal of reaching greater liberalization.\textsuperscript{37} In 1995, however, negotiations were reopened because of concerns, mostly raised by the United States, about the shortage of commitments to liberalization by other countries.\textsuperscript{38}

Out of these negotiations arose the 1995 Accord, a provisional agreement whereby WTO members agreed to implement their "best offers" to reduce barriers in financial services.\textsuperscript{39} The 1995 Accord extended original negotiations to resume formally on April 1997, with a positive result anticipated by December 1997.\textsuperscript{40} The United States prematurely reopened negotiations, however, with the intention of arriving at a multilateral agreement for freer trade in financial services—not an agreement to agree in the future.\textsuperscript{41} The last minute decision by the United States to withdraw its 1995 Accord offer of keeping its financial markets open to WTO members effectively destroyed any possibility of reaching a

\textsuperscript{35} See General Agreement on Trade in Services, Apr. 15, 1994, 33 I.L.M. 1168 (1994) [hereinafter GATS].

\textsuperscript{36} See Jeffrey Sismer, \textit{GATS and Financial Service: Redefining Borders}, 3 BUFF. J. INT'L L. 33, 65 (1996). GATS was created as one of several annexes to the agreement creating the WTO. See id. at 47. GATS consists of three tiers: (1) basic commitments and rules of application; (2) annexes, protocols and ministerial decisions; and (3) schedule of reservations. See id.

\textsuperscript{37} See SCHOTT, supra note 2, at 7.

\textsuperscript{38} See id. at 13.

\textsuperscript{39} Second Protocol to the General Agreement on Trade in Services & Related Decisions, S/L/11 (95-2165) (July 24, 1995), \textit{reprinted in} 35 I.L.M. 199, 199-205 (1996). Parties to the agreement include Australia, Brazil, Canada, Chile, the Czech Republic, Egypt, European Union, Hong Kong, Hungary, India, Indonesia, Japan, Korea, Malaysia, Mexico, Morocco, Norway, Pakistan, Philippines, Poland, Singapore, the Slovak Republic, South Africa, Switzerland, Thailand, Turkey, and Venezuela. See id.; NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, INTERNATIONAL INSURANCE RELATIONS TASK FORCE, FALL NATIONAL MEETING 896 (1995).

\textsuperscript{40} See Charles Owen Verrill, Jr., et al., \textit{International Trade}, 32 INT'L LAW. 319, 319 (1998).

\textsuperscript{41} See id.
multilateral agreement in financial services.\textsuperscript{42}

Although the U.S. position to withdraw from the 1995 Accord, and thereby scuttle negotiations, was extreme, the United States did not act alone in pushing for equal agreement terms.\textsuperscript{43} Since the end of the GATT Tokyo Round, other industrial countries have joined the United States in increasing their demands for reciprocity in trade negotiations, particularly to developing nations.\textsuperscript{44} The demands by developed countries for reciprocity have not been without reason. A national study on trade in services shows that the countries most active in erecting barriers to trade in services have been the least developed countries.\textsuperscript{45}

Brazil, considered a “hard liner” and one that was opposed to including services under GATT, was a major target of developed countries seeking reciprocity in trade negotiations.\textsuperscript{46} In the Uruguay Round, Brazil was asked to match trade concessions offered by other WTO parties.\textsuperscript{47} Brazil looked at many of the concessions as “zero-sum games” in which benefits for developed countries would result in losses for Brazil.\textsuperscript{48}

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\textsuperscript{42} See Aviva Freudman & John Zarocostas, \textit{WTO Financial Accord in Sight, Despite Snags}, J. Com., Dec. 11, 1997, at 1A. To avoid a walkout in the 1997 negotiations, representatives of the financial services industries in developed nations established a forum called the Financial Leader Group. \textit{See id.} Since 1995, the Group has met over a one and a half year period to agree on the level of liberalization and to make their views known to national negotiators. \textit{See id.}

\textsuperscript{43} \textit{See generally CARLO ALBERTO PRIMO BRAGA, THE URUGUAY ROUND, SERVICES IN THE WORLD ECONOMY BRAZIL 197 (1990).} The decision by the United States to withdraw from the 1995 negotiations was based on the position that efforts toward liberalization were moving too slowly and that not enough liberalization had occurred to guarantee that it would keep its own market open to other countries on a nondiscriminatory basis. \textit{See} Verrill, \textit{supra} note 40, at 319-20. The United States made its stance clear to the WTO countries that were slowing their liberalization programs without breaking their commitments: either improve offers to liberalize barriers to trade or the United States will close its financial markets. \textit{See id.}

\textsuperscript{44} \textit{See Verrill, supra} note 40, at 319-20.

\textsuperscript{45} \textit{See Berg, supra} note 6, at 9.

\textsuperscript{46} \textit{Id.} According to the U.S. National Study on Trade in Services, in 1984 Brazil had the most impediments to trade in services with 33 listed barriers. \textit{See id.; see also BRAGA, supra} note 43, at 197 (noting Brazil’s resistance to negotiations resulting in multilateral liberalization of trade in services).

\textsuperscript{47} \textit{See BRAGA, supra} note 43, at 197.

\textsuperscript{48} \textit{Id.} During the Uruguay Round, Brazil also argued that “trade liberalization was
Brazil's prior resistance to negotiations in trade in services has both ideological and practical roots. From an ideological angle, Brazil refused to accept the rule of "static comparative advantage" under free trade. Pragmatically, Brazil harbored unwarranted concerns about foreign direct investment in services on the assumption that free trade in services was equivalent to laissez-faire. In the Uruguay Round, Brazil made the point that its economy would be better off using regulatory instruments other than restrictions on foreign capital investment in services. This argument supported the maintenance of Brazil's strict and complicated insurance regulations.

The insurance industry has played an active role in supporting financial service negotiations and has called for trade rules for services since 1973. Insurance companies in developed nations have a strong desire to expand their businesses into new global markets in response to consolidation of the industry and increased competition at home.

In recent years, the insurance markets in the United States and other developed nations have experienced sluggish growth. In 1996 insurance premium income in North America posted a growth rate of only 1.3% from 1995, and Western Europe similarly posted a low 5% annual growth rate in 1996. By comparison, worldwide insurance premiums have grown dramatically in recent years. In 1981 total worldwide insurance


not an end in itself but a possible means of promoting economic development..., the whole negotiating process should be informed by this ultimate goal and that developing countries should be granted special and differential treatment." Id.

49 See id.
50 Id.
51 See id.
52 See id.
54 See infra notes 55-58 and accompanying text.
56 See id.
premiums exceeded $450 billion. By 1996 the total had reached $2.106 trillion with much of the recent growth in developing nations.

Despite annual growth in the world insurance market that far exceeds the pace of global economic development since the 1950s, trade in insurance has increasingly been subject to trade barriers erected mostly by developing nations. The main reason for the developing nations’ resistance to liberalization in trade in insurance is the misunderstanding of the role and importance of insurance in economic development. Insurance regulators in emerging markets fear that investments by foreign insurance companies will take power away from them and put it into the hands of foreign investors. This argument becomes increasingly weak as the developing nations begin to realize that foreign investment by insurance companies is critical to economic growth.

Insurance is essential to economic development because it facilitates trade and commerce and mobilizes savings. Banks readily lend money when they can insure against risk. Also, insurance can act as a substitute for government security programs, thereby freeing precious capital for use in other sectors. Overall, developing economies gain from eliminating barriers to trade in financial services: less expensive capital and financial products spur economic growth.

Negotiators from developed nations that have a distinct

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57 See Bangsberg, supra note 55, at 5A.
58 See Zaracostas, supra note 55, at 1A.
59 See CARTER, supra note 28, at 66.
62 See Follower or Leader, supra note 60 at 1A.
63 See id.
64 See id.
65 See id.
66 See Double Trouble: Trade in Financial Services, ECONOMIST, June 17, 1995, at 79.
comparative advantage in insurance made trade in insurance a priority in the 1997 financial service negotiations. Difficulties in reaching agreements in the insurance area, however, nearly caused the breakdown of services negotiations.

Specifically, Malaysia’s refusal to grant foreign insurance corporations more than a fifty-one percent ownership of its insurance companies required adjustments to the final agreement. India’s failure to propose improvements in insurance weighed negatively on its offer. Japan nearly halted negotiations from the outset by refusing to give multilateral status to the bilateral U.S.-Japan agreement on insurance. Only Japan’s eventual willingness to extend the terms of this agreement to its offer allowed a final deal. It was Brazil’s positive last minute offer in the financial services agreement that kept the negotiations afloat. Brazil’s offer placed considerable pressure on other emerging nations to come up with similar offers or risk derailing the WTO negotiations. Brazil’s crucial role in the financial service negotiations proved to be a major benefit to the global insurance industry.

Prior to the WTO negotiations, Brazil maintained strict barriers to trade in insurance. Since 1966 new foreign insurance

67 See supra notes 5-8 and accompanying text. Trade in services represents a significant portion of the U.S. economy. For example, in 1985 70% of available employment in the United States came from the services sector. See Kenneth A. Votre, Trade in Services: Proposals for the Liberalization of International Trade in Insurance, 13 BRGPT. L. REV. 537, 539 (1993). In addition, this sector accounted for 70% of the U.S. gross domestic product. See id.

68 See Last Minute Push Yields WTO Financial Services Pact, JEI REP., Dec. 19, 1997, available in LEXIS, News Library, Nwltrs File. The insurance lobby claimed that the WTO’s ability to reach a financial services agreement “was in large part thanks to the close cooperation over the last eighteen months between European insurers . . . and those in the U.S.” European Insurers’ Stress Their Role in WTO Financial Services Deal, EUR. REP., Jan. 10, 1998, available at 1998 WL 879936 [hereinafter European Insurers].

69 See European Insurers, supra note 68.

70 See id.

71 See id.

72 See John Zarocostas, Brazil’s Offer Raises Pressure on Asia in Finance Service Talks, J. COM., Dec. 9, 1997, at 3A.

73 See Raymond D. Hill, Brazil: The Insurance Market Consolidation of the
companies were not allowed to transact business in Brazil except for minority partnerships in joint ventures.\(^\text{74}\) Also, foreign insurance companies were not permitted to repatriate more than twelve percent of their profits.\(^\text{75}\) Moreover, companies owned by the Brazilian government were required to place their business with one hundred percent Brazilian owned insurance companies.\(^\text{76}\)

Brazil pleased the WTO trade negotiators and foreign insurance companies by agreeing to allow the establishment of new branches and subsidiaries of foreign insurance companies, along with increases in the percentage of foreign participation in Brazilian insurance institutions.\(^\text{77}\) Brazil suggested that future regulations would “permit the supply of reinsurance services by private institutions,” and that “commitments regarding commercial presence in reinsurance would be undertaken within two years after the adoption of relevant legislation.”\(^\text{78}\)

The motivation behind Brazil’s positive offer to the WTO was to attract foreign investment. In 1990 the Brazilian government initiated a vigorous Privatization Program pursuant to federal law.\(^\text{79}\) The program was implemented out of a desire to attract foreign capital to finance a growing trade deficit and to draw technology to modernize Brazil’s infrastructure.\(^\text{80}\) As a result of


\(^74\) See id.

\(^75\) See id.

\(^76\) See id. Prior to the WTO negotiations, in 1996, the Brazilian federal government attorney’s office (Procuradoria Geral da Uniao) issued a statement to the effect that insurance companies were not considered financial institutions. See Foreign Competition, Deregulation, Shape a New Market in Brazil, \textit{Lagniappe Letter}, Nov. 8, 1996, available at 1996 WL 8394944. Therefore, foreign insurance companies could enter the market without awaiting further legislation. Although foreign insurance companies then began investing in Brazil’s insurance market, they did so with reservations because of the lack of definition of the new rules. See id.

\(^77\) See \textit{Summary of the Main Improvements}, supra note 23.

\(^78\) Id.

\(^79\) See Jose Luis De Salles Freire, Privatization in Brazil, Paper Presented at the SBL 11th & SGB 7th Biennial Conference (Oct. 1993). The privatization program was instituted by Federal Law No. 8,031 of April 12, 1990. See id.

\(^80\) See \textit{Let the Party Begin: Brazil’s Privatization Program Is as Complex as It Is Gigantic but It Promises Huge Rewards to Foreign Investors—and a Chance to Change the Way Everybody Does Business in Latin America’s Biggest Country}, \textit{Economist},
the privatization program, foreign insurers invested over $1 billion in Brazil between 1994 and 1998.\textsuperscript{81} Brazilian insurance companies, not consumers, have been the primary benefactors from this substantial foreign investment.

Brazil’s removal of entry restrictions satisfies insurers. Its vacuous commitment to liberalize its reinsurance regulations, however, allows a substantial barrier to trade in insurance to remain. Thus, to the detriment of the Brazilian consumer, the formation of an open, competitive insurance market is prevented.

III. The Brazilian Reinsurance System—\textit{Instituto de Resseguros do Brasil (IRB)}

\textbf{A. Overview of Brazil’s Insurance System}

In the late 1960s, Brazil made an effort to support its insurance market by increasing profitability and growth.\textsuperscript{82} Brazil hoped to increase the retention by local insurance companies and therefore reduce the need to obtain reinsurance from foreign insurance companies.\textsuperscript{83} It also sought to generate capital for national investment growth.\textsuperscript{84}

In 1966 the Brazilian government began to consolidate the insurance industry and tighten control through the regulatory authorities.\textsuperscript{85} Starting in the late 1960s, the government forced mergers of insurance companies, reducing the number in Brazil from 189 to 93 by 1978.\textsuperscript{86} On November 21, 1966, the government passed Decree Code No. 73, establishing the Private

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\textsuperscript{82} See Hill, \textit{supra} note 73, at 218.

\textsuperscript{83} See \textit{id.}

\textsuperscript{84} See \textit{id.} at 218-19.

\textsuperscript{85} See \textit{id.} at 215.

\textsuperscript{86} See \textit{id.}
Insurance National System (SNSP), comprised of the National Private Insurance Council (CNSP), the IRB, and the Private Insurance Superintendendency (SUSEP). Included in the basic legislation was Act No. 1186 of April 3, 1939, which created the IRB.

The IRB has the greatest effect on the insurance market and consumers in Brazil. The IRB maintains a strict legal monopoly with respect to the underwriting of reinsurance, giving the government effective control over foreign transactions in insurance. In furtherance of its function “to promote the full utilization of the capacity of the national insurance market,” no consumer can purchase direct insurance abroad without the consent of the IRB. Also, all insurance companies must reinsure with the IRB. The IRB retrocedes a proportion of reinsurance cessions around the Brazilian insurance market and acts as the market’s retrocedent abroad. Although it is the responsibility of the CNSP to define insurance policies, in reality, the CNSP must receive the IRB’s consent since it is the IRB that arranges the reinsurance to underwrite the policy. In essence, the IRB’s

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87 See Trade Policy Review, Brazil, at 162, WTO Doc. WT/TPR/S/21 (1996) [hereinafter Trade Policy Review, Brazil]. Decree Code No. 73 is governed by Decree Code No. 60459 of March 13, 1967. See id. at 162. This regulation was issued by agencies with the Brazilian Private Insurance System, and the Brazilian civil and commercial codes. See id.

The CNSP’s responsibilities include “defining policies for private insurance and reinsurance as well as regulating the establishment, organization, operation and supervision of entities undertaking activities within the SNSP.” Id. SUSEP is responsible for implementing CNSP defined policies and “set[ting] guidelines and general principles for private insurance.” Insurance Legislation and Supervision in Developing Countries, U.N. Conference on Trade and Development, at 85, tbl. 1, U.N. Doc. TD/B/393 (1972) [hereinafter Insurance Legislation].

88 See Insurance Legislation, supra note 87, at 68. The Brazilian Constitution established that supplementary law would create an official agency that would regulate the Brazilian financial system. See PINHEIRO NETO-ADVOGADOS, DOING BUSINESS IN BRAZIL 4 (1996).

89 See id.

90 Id.

91 See id.

92 See id.

93 See id.
monopoly control over reinsurance controls the entire Brazilian insurance market.

B. Financial Performance of the IRB

The success of Brazil’s plan to bolster its insurance market and the effects of the IRB on consumer welfare can be analyzed in part by looking at the financial performance of the IRB. For most of its history, the IRB has operated at a profit. Today the IRB, known as IRB Brasil Re, “requires an injection of $250 million in capital.”

Over the years the IRB has made major errors concerning the financial management of its assets, operations overseas, and basic underwriting practices. In 1992 its President, Luis Quattroni, was forced to resign over a financial scandal involving an alleged irregular payment of $500,000 to debt auditors in France. This incident is minor, however, compared to the IRB’s neglect of basic rules of financial management, such as diversification of risk.

On August 1, 1997, the Finance Minister made public a detailed report, conducted over an eight month period on the administration of the IRB during the last few decades. The report concluded that the IRB had “frittered away public money and assets.” The report also concluded that the IRB lost $2.7 billion in equity from 1992 to 1997. The equity of the IRB in 1997 was $299 million, but it could have been $2.9 billion if the IRB had been treated in a “healthy way.”

The report also found that IRB’s financial director, Ivan Lagrotta, was granted unlimited autonomy by the IRB president,
contrary to Article 15 of the IRB statute. As a result, financial decisions were made without the IRB’s consideration and were made poorly. As of August 1995, the IRB had invested a total of $148 million in Banco Econmico’s branches abroad. This represented fifty-two percent of the total in time deposits, an excessive amount to be invested in only one institution.

In addition, the IRB has been criticized for mismanagement of its export credit insurance operations, which resulted in $750 million in underwriting losses to IRB. The majority of these losses, however, was the result of Brazil’s export incentive policy between 1976 and 1982 rather than IRB policy. Nevertheless, as a result of the IRB’s mismanagement of investments in the international market, the IRB posted its first loss of $120 million in 1994.

In the 1970s the IRB decided to expand beyond its closed insurance market and to enter the international reinsurance marketplace. In 1975 the IRB opened an office in London and in 1978 an office in New York. The IRB offices in London and New York turned out to be a significant waste of public money.

After the discontinuation of the underwriting risk operations, the London office continued to employ 180 people, and thirteen

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102 See id.
103 See id.
104 See id.
106 See id.
109 See id. The IRB entered into a real estate deal in New York at a clear loss to the company. See IRB, WORLD CORP. INS. REP. (FIN. TIMES, London), May 20, 1994, at 1. IRB rented the New York office for $36,000 per month, for a 10 year period, with a pre-established annual increase of 20% every six months. See id. IRB also contracted to pay a $3 million penalty in the event that the rental contract was broken, despite the fact that the whole building was valued at only $6 million. See id.
years later recorded office costs of $2.2 million. 110 Most importantly, due to poor underwriting practices, the IRB lost a combined $800 million from the London and New York operations between 1987 and 1997. 111 The IRB’s results in London and New York illustrate that the IRB, in its present structure, can only operate within its own borders protected by a strict environment without competition.

Recently, the IRB has begun to improve its condition. As a result of its restructuring process, which was initiated in June 1997, the IRB became a corporation. 112 The IRB reduced its work force from 1800 to 500, cut costs, and pursued new market niches. 113 Since the August 1, 1997 report by the Brazilian Finance Minister, the IRB’s results have improved. In the first half of 1998 the IRB registered a net profit of $48 million, an increase of sixty-seven percent from the previous year. 114 Additionally, in June 1998, after not paying a dividend for three years, the IRB paid its shareholders approximately $10 million. 115 Although the IRB’s recent results are encouraging, there is no guarantee that a change in government policy or regime will not result in the IRB’s digression, leading it to again become a grossly inefficient and mismanaged government entity. As long as the IRB remains a non-private entity shielded from competitive market forces, the risk remains that the IRB will return to a state of inefficiency and mismanagement.

C. Efforts to Privatize the IRB

On August 1, 1996, the House of Representatives and the Brazilian Senate approved Constitutional Amendment No. 13, bringing an end to the IRB monopoly for reinsurance activities in

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110 See id.


113 See id.

114 See id.; supra note 100.

The amendment, however, which was promulgated by the President of the Senate, Jose Sarney, still requires enabling legislation and regulations that have yet to be drawn and may take a long time to develop. In addition, the anticipated date for privatization has been pushed further into the future. On November 27, 1997, Lidio Duarte, Director of SUSEP, stated that the IRB will be privatized in 1998. Soon after, Paulo Oscar Franca, Vice President of the IRB, claimed that the IRB would be fully privatized before the first half of 1999. Then on December 9, 1997, Marcos Caramuru De Paiva, Brazil’s chief negotiator at the WTO talks, issued a statement that the IRB would be privatized by the year 2000.

The privatization of the IRB is not a recent topic. In 1989 the superintendent of SUSEP issued a proposal under the framework of Article 192 of the 1988 Constitution to end the IRB’s

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118 See Work Group, supra note 117.


121 See John Zaracostas, Brazil's Offer Raises Pressure on Asia in Finance Service Talks, J. Com., Dec. 9, 1997, at 3.

122 Article 192 contains rules for insurance.

123 The Constituição Federal (Federal Constitution or C.F.), the supreme law of Brazil, was amended and published on October 5, 1988. See supra note 116.
monopoly of domestic reinsurance. Under the SUSEP proposal, the IRB would become a non-monopolistic reinsurer, and SUSEP would supervise and control the reinsurance area in the same way it regulates insurance companies. The opposition to SUSEP's plan, however, was strong and came from both the IRB and large domestic insurance companies.

The IRB argued that the end to the monopoly would bring with it the danger of oligopoly and that small insurers would disappear. The IRB president also stated that "the 1988 Constitution admits the central role of an official insurer without mentioning competition with the private sector, and that the central determination of policy by IRB enables the maximum retention of domestic capacity." Brazil's largest private domestic insurance company, Bradesco Seguros SA, supported the IRB's position, and ultimately the SUSEP proposal was withdrawn.

Recently, the Brazilian government has made efforts, which appear to be more concrete than in the past, to privatize the IRB. On June 18, 1997, President Cardoso announced Provisional Measure 1,578. This Provisional Measure determined a new
share holding composition of the IRB, making it a mixed capital company owned fifty percent by private insurance firms and fifty percent by the government with the state holding all voting shares.\(^{131}\) In addition, the IRB’s shares, which belonged to the National Social Security Institute, were transferred to the federal government.\(^{132}\) A new administrative council was formed, resulting in the IRB sharing management responsibilities with the federal government and ultimately being presided over by the executive secretary of the Finance Ministry.\(^{133}\) Initially, the National Privatization Program (PND) excluded the IRB from privatization as an activity considered within the exclusive competence of the state.\(^{134}\) On December 1997, however, a commitment was made to include the IRB into the PND.\(^{135}\) On March 26, 1999, the National Development Bank announced that the IRB will be privatized by the end of the summer.\(^{136}\) Although rules governing the IRB and reinsurance have not been drafted, it is expected that forty percent of the reinsurance market will be reserved for the privatized IRB.\(^{137}\) Therefore reinsurers will still be obliged to cede reinsurance policies before they can obtain their own reinsurance.\(^{138}\) Thus under this plan, even though the IRB will no longer be government-operated, reinsurers will still be forced to participate in a government-arranged reinsurance market and will not have complete free access to the global reinsurance market.\(^{139}\) President Cardoso has a strong interest in privatizing
the IRB, but as in the past, a strong resistance to privatization efforts continues.

A strong local interest remains in at least having a slow privatization of the IRB. During the swearing-in ceremony of the new management of the IRB on November 11, 1997, the Finance Minister, Pedro Malan, said that opening of the market would be gradual and cautious.140 The recent announcement of the sale of the IRB was a condition of the letter of intent by the Brazilian government with the International Monetary Fund that was signed in November 1989 and provided Brazil with a $41 billion emergency credit line.141 However, as of February 1999, fifty-two countries had ratified the 1997 FSA.142 Brazil was one of the eighteen countries that had not ratified the FSA and has been given until June 15, 1999 to do so.143 Brazil has informed the WTO that it could take an additional ten months to arrange its domestic laws so that Brazil can ratify the FSA.144 Moreover, in Brazil’s offer to the FSA, it states that “commitments regarding commercial presence in reinsurance would be untaken within two years after the adoption of relevant [domestic] legislation.”145 In reality, changes in the reinsurance monopoly cannot happen until regulations are drafted which will establish rules for a new reinsurance system. Regulations, which serve to protect both primary insurers and consumers from unstable carriers, are typically complex and will, as a result, be promulgated with caution.146

Furthermore, domestic insurance companies in Brazil have a

140 See id.

141 See Kielmas, supra note 136.

142 See John Zarocostas, WTO Will Lower Barriers March 1, J. COM., Feb. 18, 1999, at 8A.

143 See id.

144 See id.

145 Summary of the Main Improvements, supra note 23.

146 In July 1998 the Brazilian Development Bank announced that Ernst & Young/Maxima Corretora and Associacao IRB Brasil consortiums were chosen to perform the economic-financial evaluations, which include evaluating of the IRB as well as providing suggestions of a package of rules for the opening of the reinsurance market. See Consortia Defined to Evaluate IRB Brasil, GAZETA MERCANTIL ONLINE, July 29, 1998, available in LEXIS, News Library, Gazdly File.
great interest in slowing privatization efforts. Their motivation springs from their need to improve operations in order to become more competitive.¹⁴⁷ Local insurance companies may also be motivated in slowing privatization efforts by their interest in an opportunity to own a portion of the IRB and their desire to continue profiting from the artificially high prices created by the monopoly reinsurance system. The IRB itself suffers a comparative disadvantage in international competition and, as a result, will naturally resist privatization until it is competitive.¹⁴⁸

The recent change in the IRB administrative councils, the Brazilian government’s selection of firms for regulatory proposals and announced sale are encouraging signs. No actual market-opening changes have occurred, however, and it is unlikely that privatization will occur in the near future. Yet, as a result of substantial foreign investments, rapid changes have occurred within the Brazilian primary insurance market and among Brazilian consumers. Consequently, an odd situation has formed, and a tremendous market-friction has been generated. The Brazilian government is making slow progress in reforming the IRB regulations, but demand for improved, sophisticated insurance products by insurance companies and consumers is reaching a peak.

IV. Consumers of Insurance

A. Approaches to Purchasing Insurance

To understand the effects of the IRB on consumers, a survey must be made of the approaches taken by large consumers when purchasing insurance. Large corporations operating in open insurance markets have become extremely sophisticated in arranging insurance to protect their assets and business exposures. The most effective and typical approach taken by large companies to protect their operations in different locations is to purchase insurance on a “program basis” using one lead insurance company. The best suited insurance company for such insurance programs is one that has an extensive network of offices so that insurance

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¹⁴⁸ See CARTER, supra note 28, at 66.
policies and services can be provided directly to each operation. To support multinational corporations, an insurance company must have extensive offices around the world for the same reasons.

The benefits to buying insurance on a program basis, or in bulk, are that companies can negotiate their insurance premium with one lead insurance source and, therefore, achieve significant savings and leverage through economies of scale. This approach also provides for easy management. Companies can negotiate the terms and conditions of their entire insurance scheme from their home office. Furthermore, they can easily affect the design and quality of insurance for each operation.

Also, large companies usually employ the services of insurance brokers.\textsuperscript{149} Insurance brokers represent the interests of buyers and are considered experts in reducing or financing a company’s risks and improving “risk management” practices.\textsuperscript{150} Besides providing additional services such as loss control, brokers have a high degree of knowledge and, if large enough, leverage in the insurance marketplace.\textsuperscript{151} Insurance brokers stimulate market efficiency and promote consumer interests.\textsuperscript{152} Similarly, large companies will place their insurance business by broker or by broker specialty to achieve economies of scale and efficiency.

In recent years, large companies have turned to the alternative insurance market largely as a means of reducing cost.\textsuperscript{153} The alternative market includes captives, private retentions, qualified self insurance, risk retention groups, and self insurance pools and trusts.\textsuperscript{154} Most commonly, large companies retain a large portion of


\textsuperscript{150} See id. Insurance brokers are just as eager to do business overseas as insurance companies and have developed the Model Insurance Broker Law in an attempt to aid foreign countries in establishing or modifying existing law as it pertains to insurance brokers. See id.

\textsuperscript{151} See id.

\textsuperscript{152} See id.


\textsuperscript{154} See id. For an in depth discussion and analysis of the alternative market and its use by insurance buyers, see Ruth Gastel, Captive and Other Risk-Funding Options, Ins. Info. Inst.: Ins. Issues Update, June 1997, at 1.
their insurance exposure and finance this risk by incorporating a captive insurance subsidiary. For tax reasons, most captives are domiciled in Bermuda, the Cayman Islands, Ireland, and more recently Panama. In the United States, the alternative market itself has grown from $66 billion in 1990 to $285 billion in 1999, and the use of captives worldwide has grown from 3,029 in 1994 to 4,000 in 1997. An integral part of the alternative market approach is the ability to move cash from a division receiving protection to its captive subsidiary domiciled in another country. This cash flow process is often hampered, if not completely blocked, in restrictive insurance environments.

B. Brazilian Consumers of Insurance

Demand for modern, competitive insurance products in Brazil has increased in relation to the number of foreign multinationals investing in Brazil and the speed at which the Brazilian government continues to privatize large state companies. Both types of entities, as a result of their size, complexity of operations, and competitiveness, require a sophisticated approach to covering their business risks. In many respects the need for sufficient insurance products and services has outpaced what local insurance companies and the IRB have been able to offer.

In a survey conducted by Price Waterhouse LLP in New York, ninety percent of sampled executives from major U.S. multinational companies announced plans to invest in either Brazil or Argentina within the next three years. The companies based

155 See Gastel, supra note 154.
156 See id. Panama is the first Spanish speaking captive domicile and is eager to attract Latin American companies. See Panama Stakes Claim to Captives; New Law Makes It the First Spanish Speaking Domicile, BUS. INS., Sept. 2, 1996, at 63. Currently, however, sites of most of the 20 Latin American captives remain in Bermuda. See id.
160 See Paula L. Green, South America Eyed by U.S. Execs, J. COM. Apr. 2, 1997, at
their decision to invest in Brazil on the Brazilian government's economic reforms that stabilized chronic inflation, which had peaked at 2148% a year in 1993, as well as political stability and liberalization in the regulatory environment. Brazil's gross domestic product grew an attractive 4.27% in 1995 and 2.91% in 1996.

Net direct foreign investment in Brazil was $10 billion in 1997 and increased steadily to $18 billion in 1998. Between 1996 and 2000 an approximate $10 billion in net direct foreign investment will be made from automobile manufacturers (Fiat, Volkswagen, Ford, and GM) alone. Often, investments by large companies snowball into further investments by smaller companies. For example, forty automobile suppliers followed Ford Motor Company's investment in Rio Grande. Given the current level of growth, Brazil is expected to become the world's fourth largest manufacturer and fifth largest exporter of automobiles by the year 2000.

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3A (surveying 70 multinational executives).

161 In an interview Paolo Carega, Managing Director and Region Head Latin America/Caribbean for J&H Marsh & McLennan, a New York based insurance broker, said that "the percolating Brazilian economy has made it the most viable country in the region (Latin America) for foreign investment." Russ Banham, Trend Toward Open Markets Grows Slowly: Multinationals See Wider Range of Opportunities, J. COM., May 7, 1997, at 6A.

162 See Average GDP Growth Over Last 10 Years at 1.89%, GAZETA MERCANTIL INV. NEWS, Mar. 6, 1997, available in LEXIS, News Library, Gazinv File.


166 See Charles W. Thurston, Private Sector Tackles the Infrastructure Gap; Foreign Capital Flows to Fill Pent-Up Demand, J. COM., Nov. 14, 1997, at 5C. Ford Motor Company predicts that the Brazilian economy could overtake the United Kingdom and Spain by the year 2000. See Charles W. Thurston, Global Auto Makers Augment Brazil's Own Investment Effort: Domestic and Export Opportunities Foreseen as the Nation Grows, J. COM., Aug. 11, 1997, at 4C [hereinafter Global Auto Makers].

167 See Global Auto Makers, supra note 166, at 4C. An automobile manufacturer is a good example of a type of company that requires a number of diverse insurance products. As manufacturers of a complex product, they need to make substantial investment in physical assets such as buildings, machinery and equipment, raw materials, and warehouses, all of which need to be insured against destruction by various
The Brazilian government’s privatization program has also increased the number of large companies operating within its borders. In 1995 President Cardoso accelerated the pace of Brazil’s privatization program with the passage of legislation allowing for the sale of government electrical, gas, oil, and telecommunications assets considered too strategic to previously sell. Between 1991 and 1997, the government sold fifty-five companies for a total of $15 billion, with many receiving foreign capital. Of particular note was the announcement in April 1997 of the sale of Vale do Rio Doce, a Brazilian mining company whose mine in Carajas produces a quarter of the world’s iron ore and was estimated at the time to sell for $3 billion. In April 1998 private investors paid an estimated $7 billion for Brazilian B-bandwidth cellular phone concessions. In September 1998 Brazil’s state phone system, Telebras, was sold for $19 billion and divided into twelve operating companies. Once privatized, the government will operate like a private insurance consumer. Private insurance consumers are conscious of maintaining market share and increasing profits and, in turn, place great emphasis on perils such as fire and lightening. The closing of a plant for even a short period can result in a substantial loss in sales and profit, which is insured as a business interruption. Protection against legal liabilities for such risks as pollution and products liability is also needed, as is protection for workers compensation and benefits not already provided by the state for employees. The manufacturers will look to export their product to other nations, thus, requiring inland transit and ocean marine insurance. Other insurance products that would be considered are political risk, director’s and officer’s liability, construction all risk, and fleet automobile.

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168 See Hill, supra note 73, at 213. In the 1970s two of Brazil’s largest state companies, Petrobas and Vale do Rio Doce, were on the Fortune 500 list of the largest corporations outside the United States. See id. The number of Brazilian companies on the Fortune 500 list increased to five by 1984. See id. In 1996 Companhia Vale do Rio Doce ranked as Brazil’s largest exporter with $1.6 billion and Petrobas ranked fifth with $693 million. See NATIONAL CONFEDERATION OF COMMERCE, SYNTHESIS OF THE BRAZILIAN ECONOMY 64 (1997).


170 See Let the Party Begin, supra note 80, at 1.

171 See Brazil Plans to Move on Sale of Mining Firm, J. COM. Apr. 7, 1997, at 11B.

172 See Thierry Ogier, Brazil About To Make Privatization History, J. COM. Apr. 15, 1998, at 3A.

obtaining suitable, sophisticated insurance schemes to protect their substantial business risks on the most competitive basis possible.

As state owned entities privatize and multinational corporations continue to invest in Brazil, the demand for sophisticated, competitive insurance products will increase. The success of multinational and recently privatized Brazilian companies depends on their ability to secure appropriate coverage for their business risks. Such an escalating and important demand for sufficient insurance products should force the Brazilian government to quickly liberalize its reinsurance market.

V. The Unreasonable Brazilian Reinsurance Regulations and Their Negative Effects on Insurance Consumers

One goal of the Brazilian government in establishing the IRB was to retain a high percentage of the insurance market’s gross writings in Brazil and thereby reduce or eliminate its need for foreign sources for reinsurance.174 A study conducted by Raymond D. Hill concluded that this consolidation did not adversely affect consumers.175 It can be argued, however, that because the Brazilian market was not competitive before monopolization, the negative effects of monopolization did not make an impact.176

The deliberate action by the Brazilian government to reduce or eliminate the need for foreign reinsurance has a particularly severe negative impact on large consumers. When large, sophisticated consumers cannot obtain suitable coverage for their business risks through the primary insurance market, they must be able to rely instead on the participation of international reinsurers to meet their needs.177 The IRB’s monopoly control over reinsurance eliminates this option for large consumers. The monopoly reinsurance system has also created an insurance marketplace where the type of protection available for consumers is limited. Thus, large corporations in Brazil are forced to purchase insufficient insurance through the primary market or self-insure. Such an arrangement

174 See Hill, supra note 73, at 218.
175 See id. at 212-27.
176 See id. at 212, 219.
has a negative effect on consumer productivity as businesses become less willing to take risks and, in turn, reduce efficient utilization of resources and economic growth.\textsuperscript{178}

The negative effects from unreasonable regulations can be categorized as either direct or indirect.\textsuperscript{179} Direct negative effects result from insurance regulations that control the market, such as pricing controls.\textsuperscript{180} Indirect negative effects are the product of regulations that discriminate against foreign insurance/reinsurance companies and therefore limit the quality of insurance products and services available to consumers.\textsuperscript{181}

A. Direct Negative Effects on Consumers

Of key importance to any consumer of insurance is the ability to obtain an insurance program offering the most competitive terms, conditions, and pricing that a market has to offer. In particular, large commercial consumers maintain considerable market leverage through economies of scale. To a significant degree, the IRB takes away the ability of large consumers to negotiate the price and type of insurance.\textsuperscript{182}

In November 1988 Brazil enacted Decree Law No. 930871, or Circular 22, abolishing “tariff” rating or direct government regulation over insurance rates for fire and consequential loss.\textsuperscript{183} The IRB’s sole control over the placement and price of reinsurance, however, has the same effect as if the government rates were still in force. Furthermore, the rates set by the IRB are artificially high and can be as much as two or three times the normal open market rate on basic risks.

The IRB’s inefficiency and lack of competition for reinsurance increases the cost of reinsurance. Insurers also drive the cost of reinsurance upward by the IRB’s policy of mandatory proportional

\textsuperscript{178} See id. at 763.

\textsuperscript{179} See id. at 751-66.

\textsuperscript{180} See id.

\textsuperscript{181} See id. at 763-66.

\textsuperscript{182} See id. at 756.

cessions of all lines of coverage. This forces insurers to cede business that could be retained and for which competitive rates could be calculated.

Over the years the IRB's strategy, with respect to its acceptance and cessions of business, has fluctuated. The IRB's initial policy of ceding more business abroad than it accepted changed in 1970 to matching acceptances and cessions. In the late 1970s, the IRB decided to export insurance services with disastrous results—posting a loss in 1983 of $300 million. A return by the IRB to its two earlier policies will result in an increase in rates for insurers and consumers. The first two policies reduce the volume and spread of proportional reinsurance to foreign reinsurers and require the IRB to purchase, for its own protection, far in excess of its loss coverage. As a result, foreign reinsurers' portfolios have become less balanced and they must "load" their rates to the IRB to compensate.

Although IRB policy prevents a competitive rating system, consumers are still able to obtain some forms of rate competition, albeit on a very small scale. A non-exhaustive list of forms of price competition includes the financing of premiums below market rates of interest, commission of agents and brokers that can be restructured through indirect means of payment, and technical knowledge. Insurance brokers and agents can ensure that a consumer receives a minimum rate for a risk by establishing as many credits as allowed for risks with good protection against loss. The last form is a loose interpretation of underwriting guidelines, allowing a certain risk to be placed in a lower priced

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184 See Hill, supra note 73, at 217. The IRB's required cessions are so excessive they violate sound financial practices. See id.
185 See CARTER, supra note 177, at 763.
186 See Hill, supra note 73, at 224.
187 See id.; see also supra notes 102-25 and accompanying text (discussing the financial performance of the IRB).
188 See CARTER, supra note 177, at 763.
189 Id.
190 See Hill, supra note 73, at 215.
191 See id. at 216.
192 See id.
The monopoly control over the placement of reinsurance also prohibits the use of captives by consumers. Therefore, consumers are unable to offset the high cost of tariff premiums by utilizing their captives as partial reinsurers in their insurance programs.

Besides creating artificially high rates, the IRB effectively controls the type of insurance policies made available to insurers and consumers. Such control over the type of available coverage eliminates the opportunity for consumers to negotiate, personally or through brokers, for specialized, tailored coverage to suit their needs. Instead, only limited "boiler plate" policies issued by the IRB can be obtained.

Against this backdrop of restrictions on pricing and coverage, Brazil has established strict laws against the use of foreign reinsurance. The sanctions under Brazilian law for placing reinsurance outside the IRB are considerable. For any insurance or reinsurance arranged illegally, the insurer can be fined up to the limit of the insurance policy.

Recently, the IRB has allowed some flexibility by permitting consumers with extremely large insurance risks to use private, foreign reinsurance. This is not allowed without IRB participation or approval and is the exception rather than the rule. The IRB’s

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193 See id. Lax interpretation of standards reflects a concept in Brazil known as the jeito. Jeito is defined as a knack, twist, way, or fix and is employed in bending legal rules and regulations to reach an expedient result. See Keith S. Rosen, Brazil’s Legal Culture: The Jeito Revisited, 1 FLA. J. INT’L L. 1, 2 (1984). In Brazil jeito is considered a paralegal institution and is the norm and the formal legal rule the exception. See id. at 3.

194 See Brazil: IRB on Brazil Reinsurance—Still Ours, LLOYD’S INS. INT., Feb. 12, 1996, at 1. In February 1996 the IRB issued a warning to foreign reinsurers that it was still against the present law to arrange reinsurance without going through the IRB. See id.

195 See id.

196 Unlike in the past, should a risk exceed the IRB’s capacity, the IRB will allow the participation of foreign reinsurers to meet demand. See Interview with Jeffrey Wingate, Senior Vice President of Global Services Group at J&H Marsh & McLennan, in New York, New York (Aug. 1998). For example, recently the IRB approved and was involved in the development of the program for Usiminas, a major Brazilian steel manufacturer. See Brazilian Company Using Global Markets, BUS. INS., Nov. 11, 1996, at 55. The IRB was the lead carrier with a 25% share of the risk. See id. In this case the required policy limit was a massive $1 billion dollars, far in excess of the IRB’s
participation on these programs remains mandatory and raises the overall program rate above that which would have been obtained without the IRB's involvement.

Another way for Brazil to ensure that consumers do not freely access the international insurance market is via the nonadmitted insurance law that is regulated by Decree Law No. 73. This law requires all insurance to be purchased by a company within its borders, not via the nonadmitted market, unless it serves a national interest or is refused by the IRB.

The outright ban on the use of the nonadmitted insurance market in Brazil is a way of forcing consumers to purchase the expensive, limited insurance available in Brazil. The solution to the strict, nonadmitted insurance law in Brazil seems simple. In Brazil, one should not purchase insurance through the nonadmitted market but only through local insurance carriers. This solution, however, is not without problems.

Due to prohibitive insurance premiums, consumers in Brazil often purchase limited insurance coverage and go without certain major coverages. Some multinational companies maintain a streamlined policy in Brazil that will meet local law and make up the balance of coverage via a nonadmitted "master" policy purchased in a foreign market. Problems arise, however, when a loss occurs that is covered only under the nonadmitted "master" policy. By purchasing the nonadmitted "master" policy, a

underwriting capacity which is estimated at $240 to $250 million. See *id.* To meet this demand, foreign reinsurers were involved in the program but only with the IRB's permission. See *id.*


198 *See id.* The U.S. National Association of Insurance Commissioners defines nonadmitted insurance as any coverage placed with an insurer not licensed or admitted to transact business in the state where the risk is located. *See NATIONAL ASSOCIATION OF INSURANCE COMMISSIONER, A BACKGROUND STUDY OF THE NON-ADMITTED INSURANCE MARKET* 2 (1980) [hereinafter NAIC].

199 *See NATIONAL ASSOCIATION OF INSURANCE COMMISSIONER, PROCLAMATION NO. 896 (1995). As a comparison, consumers in the United States can access the nonadmitted market but must first make an effort to use insurers licensed in the state. See NAIC, supra* note 199, at 2. The United States has established specific "surplus lines" laws in an attempt to regulate nonadmitted insurance. *See id.* For nonadmitted insurance not covered by surplus lines laws, however, U.S. consumers are made aware that the nonadmitted insurance is exempted from statutory jurisdiction, in whole or in part by law, or is beyond the jurisdiction of insurance law. *See id.*
company violates Brazilian law. Thus, the program carrier will not pay loss funds to the Brazilian entity that suffered the loss but instead will pay to another entity where possible. In this scenario the company faces the difficulty of having to disguise any funds it forwards to its Brazilian division as "recapitalization" instead of insurance proceeds.

The above scenario repeats itself for multinationals, even when they purchase the broadest possible insurance contract available in Brazil. Multinationals negotiate international insurance programs to free market insurance-contract standards, containing terms and conditions not readily available in Brazil. As a result differences in coverage are maintained under the nonadmitted "master" policy that responds to any losses not covered under the restrictive Brazilian policy. Due to the strict nonadmitted law in Brazil, the same problems will be faced in the event of a loss that is only covered under the nonadmitted policy.

Facing a soft international reinsurance market, the IRB recently reduced its rates by twenty to thirty percent—giving consumers some relief.\(^{200}\) Theoretically, a rate decrease in the international reinsurance market would still be curbed by the IRB since it must account for its own inefficient, expensive operations before passing any discounts to insurers or consumers. Consumers would be in a far better position to receive maximum rate discounts if the Brazilian reinsurance market consisted of multiple reinsurance companies that must be efficient to survive.\(^{201}\)

Consumers in Brazil can achieve some rate competition, but it is minimal in comparison to the gains that can be realized in an open, competitive insurance market.\(^{202}\) Also, the IRB’s policy of selecting the substantial consumers who can access the international market is flawed. By accessing the international insurance market, substantial consumers can obtain better policy conditions and pricing and greatly improve efficiency.\(^{203}\) Yet this gives substantial consumers an unfair advantage over smaller

\(^{200}\) See Reinsurance Prices Drop Abroad and in Brazil, GAZETA MERCANTIL INV. NEWS, July 23, 1997, available in LEXIS, News Library, Gazinv File.

\(^{201}\) See id.

\(^{202}\) See id.

\(^{203}\) See id.
consumers who do not have access to an open market.

Ironically, the IRB’s process of selective access has resulted in the IRB poking a hole in its own dam of regulations and could force the IRB to privatize at an even quicker pace. Companies that have partially accessed the worldwide market will look to make their programs even more competitive by eliminating the IRB from the program altogether. Smaller consumers will have an even greater desire to access the open market as they become aware of the benefits enjoyed from the open market and become pressured to be as efficient as larger competitors.

B. Indirect Negative Effects on Consumers

Before Brazil’s commitment in the 1995 Accord, Brazilian regulations disallowed investments by foreign insurance companies. In addition, discriminatory measures were placed on foreign insurance companies already in Brazil.

Since Brazil eliminated its thirty-two year restriction, foreign investment by insurance companies in Brazil has grown at an explosive rate. The influx of insurance companies has eroded some of the indirect negative effects on consumers in Brazil. The exclusion of foreign reinsurers from the Brazilian market, however, severely limits this progress.

Foreign insurance companies faced with intense competition at home have become extremely efficient and innovative in the

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204 See supra notes 73-76 and accompanying text.

205 See U.S. NAT’L STUDY, supra note 25, at 1010-13. According to a U.S. Department of Commerce study on barriers to trade in insurance, discriminatory measures placed on foreign insurance companies consist of abusive licensing procedures, mandatory local incorporation accompanied by national majority ownership requirements, restrictions on remittances, unfair taxation, exclusion from trade associations, and restrictions on employment of non-nationals. See id. For a discussion on barriers to insurance company transactions, see generally John N. Geracimos, Barriers To International Insurance Transactions: The Search for a Liberalization, 6 J.L. & COM. 489 (1986).

206 See supra note 81 and accompanying text. In 1998 three of the ten largest insurance companies in Brazil were foreign owned, an increase from one in 1994. See Mario de Almeida, Competition Will be Tougher in Insurance Sector, GAZETA MERCANTIL INV. NEWS, Oct. 9, 1998, available in LEXIS, News Library, Gazinv File. “Further, the foreign capital growth rate between 1996 and 1997 was 245%, compared to 7% for domestic capital for the same period.” Id.
products they offer consumers. Once allowed to do business in Brazil, foreign insurance companies will import sophisticated insurance services, underwriting practices, and modern management techniques. The benefits of this to Brazilian consumers can be many including improved quality of services and diverse products.\footnote{Examples of the effect of foreign investments increasing the number of products available to Brazilians are many. The insurance company AIG Life, an arm of AIG, announced that by the year 2003 it will have 3000 insurance agents throughout Brazil providing customer service. See AIG Wants to Expand Sales to Other Social Classes, GAZETA MERCANTIL ONLINE, May 25, 1998, available at LEXIS, News Library, Gazdly File. AIG Life is selling its most basic life policy at R$20 a month. See id. American insurance company Cigna, partnered with Banco Excel, has plans to launch three new products to Brazilian consumers. See Excel and Cigna Launch Three Insurance Models, GAZETA MERCANTIL INV. NEWS, Mar. 20, 1997, available at LEXIS, News File, Gazinv File. Cigna also sells unemployment insurance policies through a popular department store, Lojas Arapua, for less than R$10. See Arapua Launches Unemployment Insurance in May, GAZETA MERCANTIL ONLINE, Apr. 27, 1998, available at LEXIS, News Library, Gazdly File.}

An example of an important service for large commercial purchasers of insurance is insurance engineering. Engineering services allow consumers to analyze their risks of loss and implement measures to mitigate their business risks. In this instance insurance companies are more likely to provide a reduction in premiums and broader insurance policies. In addition modern underwriting practices stimulate market creativity and benefit large consumers that have dynamic operations and require insurance products that meet their changing needs. Foreign insurance companies have also made substantial investments in technology, resulting in increased efficiency and accuracy in transactions with clients and brokers. The importation of modern management techniques will reduce the cost of doing business with local insurance companies. Although foreign investment will greatly benefit local insurance companies by forcing them to become more efficient, consumers in Brazil remain at a disadvantage due to the existence of the IRB as a reinsurance monopoly.

Local insurance companies who have partnered with foreign insurance companies must purchase their insurance through the IRB. The IRB's underwriting practices are stale and slow to
respond to client needs. In addition, their high cost of doing business will be passed on to the consumers no matter how efficient the primary insurance company becomes. Hence, consumers will not receive the full benefits associated with foreign investment until reinsurance can be purchased in the open, competitive market.

Recent legislation in Brazil has increased the potential for loss by consumers and increased the need for an open reinsurance market. For example, Brazil has enacted laws in the area of environmental protection that make polluters liable regardless of knowledge, fault, degree of care, or intent.\(^{208}\) This new law has resulted in a substantial number of cases being brought in Brazilian courts.\(^{209}\) With these environmental protection measures, the potential for consumers to suffer financial loss has increased. Until the IRB’s tight hold on the reinsurance market is liberalized, any losses suffered by consumers will most likely be underinsured or uninsured. Unless the regulations controlling the IRB are reformed, the opening of Brazil’s insurance sector to foreign insurers will result in only a redistribution of the income generated by the IRB regulations.\(^{210}\)

VI. Conclusion

Free trade in insurance and reinsurance spurs economic welfare for countries and its consumers. An intimate relationship exists between liberalizing barriers to trade in insurance and consumer welfare. When negotiating for liberalizations in insurance, WTO member states have not always taken into account the welfare of their insurance consumers but instead have often acted only in the interests of insurance producers.

Brazil’s commitments to the FSA illustrates that liberalizations of barriers to trade in the primary insurance sector can satisfy the eagerness of other WTO member states to support their own primary insurance industry’s access to a new market. Gravely overlooked, however, is that without a corresponding removal of

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\(^{209}\) See id.

\(^{210}\) See BRAGA, *supra* note 43, at 197.
barriers to trade in reinsurance, the positive effects upon Brazilian consumers of trade liberalizations achieved in the primary Brazilian insurance sector are significantly diminished.

A fundamental aspect of consumer welfare in insurance is providing consumers unrestricted, safe access to a competitive global insurance market. A successful WTO multilateral agreement will liberalize barriers to trade in insurance and reinsurance and result in countries acting in concert to establish fair global regulations over the global insurance market. Such global regulations would support access to financially sound insurance and reinsurance carriers operating in the global insurance market without hindering the international insurance economy. 211

Presently, Brazilian consumers have no choice but to accept a delusionary governmental policy that perpetuates the existence of severe barriers to trade in reinsurance. Brazil’s reinsurance regulations have not kept pace with the country’s economic development. The regulations ignore the global insurance market and instead deliberately create an isolated and monopolistic market. Until liberalizations to barriers in reinsurance are achieved, Brazilian consumers will operate at a heavy disadvantage stunting the growth of the Brazilian economy.

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211 The WTO is a suitable mechanism for the creation and implementation of such global insurance regulations. This would mean that monitoring of compliance by signatories of their commitments could exist. Although the WTO does not have the force of international law to ensure countries honor their obligations, it would be able to rule on the conformity of national practices and has an effective dispute settlement mechanism.