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Insurance Litigation 2021

Brazil: Trends & Developments

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Trends and Developments

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Introduction: Reaching Adulthood

A little over a decade has passed since the most relevant revolution in the Brazilian insurance market: the breaking of the monopoly of *Instituto de Resseguros do Brasil* (IRB), the Brazilian state-owned reinsurance company, that happened on 15 January 2007.

Since then, the market has grown more and more dynamic, a constant evolution that has stemmed from new players blowing fresh air into the system. There has been progressive development of new products and increased capacity for risk taking, which surely – albeit timidly – brought Brazil closer to international market standards.

Now, a new revolution is ongoing following the publication in March 2021 of Resolution No 407 (the "Resolution") by *Conselho Nacional de Seguros Privados* (CNSP), the superior normative body of the Brazilian insurance regulatory system, aimed at fostering economic freedom.

The Resolution is the keystone of Brazilian insurance deregulation, as it gives the parties of "large risks non-life insurance" free rein over the terms and conditions of the contract. The new guiding principle is "broad contractual freedom" for large risk policies, with "minimal and subsidiary state intervention" (Article 4 of the Resolution).

"Large risks" status was attributed by the Resolution to a range of contracts elected according to two criteria: complexity and size (of the parties or policy), in both cases combined with the voluntary decision of the policyholder to adhere to the Resolution framework instead of the general, consumer-driven rules.

Complex – thus, large risk – insurance contracts are those belonging to branches of oil, named or operational perils (fire, liability, etc; or RNO), banks, aeronautical, maritime, nuclear, business loans and/or export credit for legal entities.

Additionally, from an economic perspective, large risks insurances are those bought by policyholders that, in the previous corporate year, had:

- total assets over BRL27 million; and/or
- gross revenue over BRL57 million.

Likewise, any insurance policy with over a BRL15 million guarantee is elective to become large risk, which contributes to significantly broadening the reach of the Resolution.

The new regulation reinforces the constitutional principle of free enterprise (Section 170, caput, of the Brazilian Federal Constitution) that was ratified by Federal Act No 13.874 of 20 September 2019 – the Economic Freedom Act. For the insurance market, it means the first true step away from the model of government-directed contracts that prevailed for over half a century.

Due to the paradigm shifting, at least in the market of large risks, the predominant objective of protecting an idealised consumer that, by definition, was considered lacking in comprehension and skill cedes the spotlight to focus on the necessities of the insured.

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The development of tailor-made contracts for particular risks is finally replacing the standardised products created over the years by *Superintendência de Seguros Privados* (SUSEP), the Brazilian insurance agency (that had a penchant for contract drafting). Indeed, a policyholder will no longer have to bow before a policy that has little to no resemblance to its activity or, sometimes worse, butcher it through innumerable particular clauses that turn the contract into an incomprehensible mishmash, a veritable "Frankenstein".

Notwithstanding these changes, the consumer protection remains unscathed. To the core distinction of insurance contracts between life and non-life, another one of stark practical effect is added: the distinction of large and mass risks insurances.

This new dichotomy highlights the consumer as deserving of state protection, precisely because it differentiates it from the large risks policyholders. Only the latter ones will, with legal entitlement, negotiate directly with the insurers, in equal conditions, thus incurring the pros and cons inherent to a parity contract.

But the Resolution was not the only change in the Brazilian regulatory framework; far from it! New norms include Circular No 621, published on 17 February 2021, which sets the ground rules for mass risks (that is, all not within the scope of the Resolution), and Circular No 637, published on 28 July 2021, which consolidated rules of liability insurance branches.

Also in the pipeline, the draft of a circular to regulate surety bonds proposes deep, structural changes in this so far conservative branch. Once published – if the text remains mostly unchanged from the public consultation procedure held last July – the Brazilian surety market will be much closer to the international one and far more insured-friendly, as the insurer will be back-to-back bound to the terms of the underlying contract that it agreed to guarantee.

Unforeseen to many, the Brazilian judiciary is at the eye of this hurricane of changes promoted by SUSEP and the Brazilian legislators. It will play a fundamental role in safeguarding freedom of contract by interpreting insurance policies in accordance with the parties' will, guided mainly by Sections 421 and 421-A of the Brazilian Civil Code.

It is the twilight of a system marked by inappropriate predetermined insurance products and the dawn of creativity and innovation, leading to renewed interest in Brazil as a developing market. Finally, adulthood!

Immediate Consequences: Focus on Contract Design

There is no dispute that the changes in regulation highlighted above will send ripples across the Brazilian insurance market and act as a catalyst for a shift in business perspective.

The first (and foremost) target of insurers is contract design. Products that were created over the past couple of decades, mostly reflecting mandatory state guidelines or standardised policies, will be reviewed; preferably rebuilt from scratch, lest old habits undermine the purpose.

Strategic litigation planning is an indispensable part of this process.

For too long the judge was a mere afterthought in the insurer's mind, paling against the looming threat of the Brazilian Consumer Protection Code and the overwhelming regulation, themselves enough to repel any innovative ideas. However, they have now become a key variable in the bottom-line equation.

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A legitimate solution is to avoid meeting the judge altogether or, at the very least, postpone the unpleasant meeting as much as possible. Alternative dispute resolution (ADR) methods are a noteworthy tool in that respect.

Arbitration naturally comes to mind: the thought of placing the case in the hands of a neutral third party with expert knowledge of insurance is a soothing one.

Once the contracts reveal more closely the parties' interests under the new paradigm, technical insurance solutions arising from expert arbitrators seem to be much more adequate.

Costs aside – and one has to remember that large risk policyholders are often large entities themselves – there are undeniable advantages to this well-known method of ADR that make it a staple in the biggest venues.

Mediation and conciliation, however, should not be overlooked. There is a strong synergy between these consensus-focused ADR methods and the bilateral, parity nature of large risk policies. Taking a step back and looking at the problem from a different angle might be – hopefully – all the parties need to untie the knot.

That said, there are unavoidable circumstances in which a judge (and their peers in the courts) will be called upon to decide in binding fashion, and the parties must be ready for it.

A step in the right direction is understanding that a policy, as much as it is proof of an agreement between an insurer and the insured, is also a letter of intent directed at the judge, who will interpret that contract in the event of a dispute between the parties. Thus, it must be written in clear, unambiguous terms, to assist in the difficult task of "teaching" Brazilian courts the new lay of the land, still unfamiliar to them.

For this reason, large risk insurance contracts tend to become more direct: overdue is the abolition of book-length policies; tiresome exclusion lists, completed by indecipherable carve backs; and the confusing layered structure of general, special and particular clauses. Removing these issues that plagued insureds for years will contribute immensely to more effective litigation and assertive case law.

The strategic drafting of contractual instruments, in any case, will allow parties to make efficient decisions to avoid the transaction costs of negotiating policy provisions for all foreseeable contingencies. The trade-off between ex ante costs of negotiation with the ex post costs of litigation, which is the hallmark of rational contracting, is likely to give rise to new contractual language to be shared in the Brazilian insurance market, including both principle-based standards and clear-cut rules; to the extent that, under a newly gained freedom of contract, each of those clauses could meet the concrete interests and economic expectations of insurers and policyholders alike.

Another tool that can help guiding a lawsuit to a fair result is the "procedural contract" that is set forth in Sections 190 and 191 of the Civil Procedure Code of 2015 and that has, so far, seen very few uses, particularly in insurance litigation.

Through a "procedural contract", the insurer and insured may establish a reasonable framework of procedural rules that better match their strengths and weaknesses, somewhat preventing or mitigating the volatile nature of the Brazilian judiciary.

Conclusion: Trends and Developments

Brazil is in the midst of a tearing down of its insurance regulatory framework, which is being rebuilt oriented towards freedom of contract and minimal state intervention. Though still largely

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unmapped, the impact of these changes in insurance litigation will be huge.

Insurers will undoubtedly review the terms and conditions of their products considering the many differences between the rules applying to mass risks (protective of the consumer) and large risks (grounded in parity of the parties).

An integral part of said review will be finding ways to ensure the insurance contract is interpreted in accordance with the parties' will. Among the tools available are ADR methods, which are aimed at evading the Brazilian judiciary, and contract structure and language, which are aimed at taming it. However, none is as relevant or as powerful as the paradigm shift introduced by the Economic Freedom Act.

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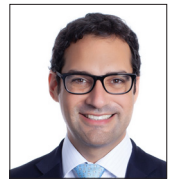

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