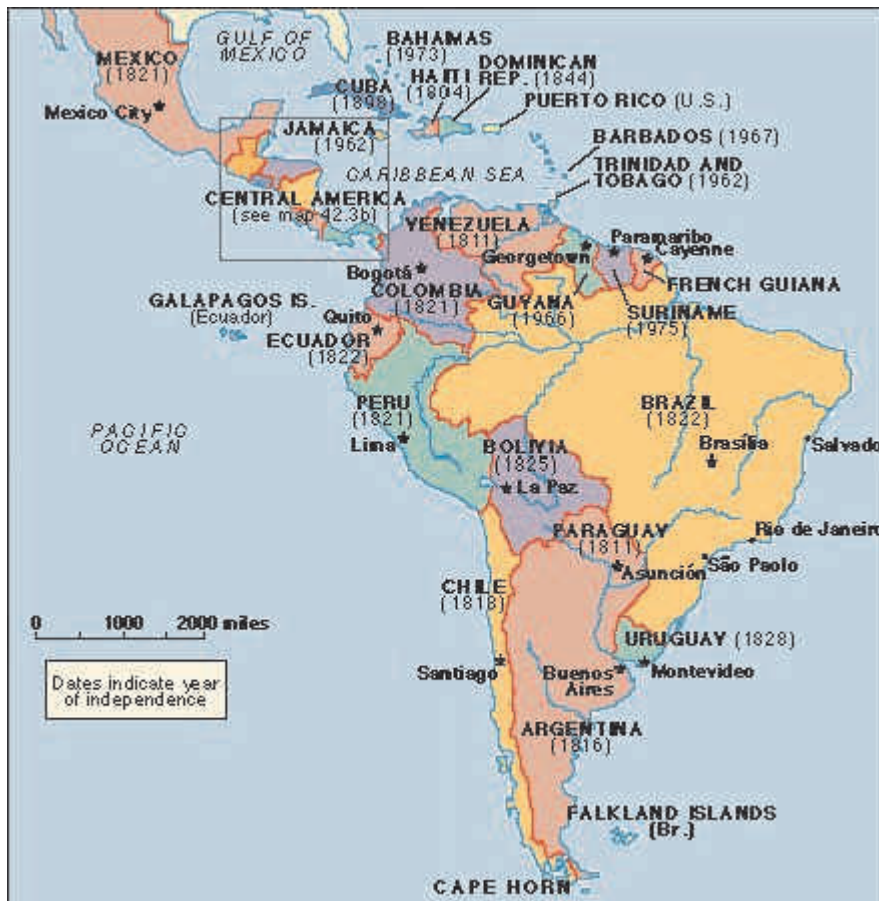


(Re)emerging Mercados: Significant Recent Developments in the Latin American Insurance and Reinsurance Markets

© Edwards Angell Palmer & Dodge LLP, January 2009

John P. Dearie and M. Machua Millett*



*John P. Dearie and M. Machua Millett are attorneys in the Insurance and Reinsurance Department at Edwards Angell Palmer & Dodge LLP. They can be reached at jdearie@eapdlaw.com or mmillett@eapdlaw.com.

TABLE OF CONTENTS

- I. Introduction: Rediscovering Latin America**
 - A. Insurance and Reinsurance as a Political, Social and Economic Stabilizer**
 - B. Consistent Market Growth and Liberalization**
 - C. Interest Spurred by Global Economic Crisis**
 - D. A Word of Caution**

- II. Major Insurance and Reinsurance Developments in 2008**
 - A. Brazil: Reinsurance Explosion**
 - 1. Background: The Monopoly Comes to an End**
 - a. Local Reinsurers**
 - b. Admitted Reinsurers**
 - c. Occasional Reinsurers**
 - 2. Market Reaction: The Rush to Register**
 - 3. Remaining Issues: Regulatory and Market Limitations**
 - a. Restrictions on Liberalization**
 - 1. “Right of First Refusal”**
 - 2. Cession Limits**
 - 3. “Tax Haven” Restriction on Occasional Reinsures**
 - b. Growing Pains and Market Uncertainties**
 - B. Chile: A Mature Market Flirts with Further Modernization, Taxation**
 - 1. Modernizing Legislation**
 - 2. Capital Gains Tax Hikes for Foreign Insurers**
 - C. Argentina: Uncertainty Despite Promise**
 - D. Mexico: Steady Growth and Development**

E. Costa Rica: Opportunity and Risk in a “New” Market

1. A New Opportunity

2. New Risks

3. Market Reaction: The INS Prepares and The Market Waits

III. Conclusion: Cautious Optimism

(Re)emerging Mercados: Significant Recent Developments in the Latin American Insurance and Reinsurance Markets

I. Introduction: Rediscovering Latin America

A. Insurance and Reinsurance as a Political, Social and Economic Stabilizer

At 1:21 p.m. local time on January 8, 2008, an earthquake measuring 6.2 on the Richter scale occurred in the Central American country of Costa Rica. It left 18 people dead, 40 missing and hundreds injured. The earthquake also caused landslides that blocked a number of roads, displaced approximately 1,200 residents and damaged several hotels and major businesses. In the news reports about the earthquake in the following days, three things are particularly noteworthy: (1) how human tragedy can bring together even the most bitter of rivals, as evidenced by the Nicaraguan government's offering of assistance to Costa Rica despite the nations' ongoing disputes over immigration and ownership of the Rio Coco; (2) the immediate response of the Costa Rican insurance industry to mobilize engineering and lost adjustment efforts to allow the funding of rebuilding efforts (*BN Americas* reports that Costa Rica's Instituto Nacional de Seguros began receiving claims the day after the earthquake and expects to report initial insurance loss estimates by the end of the month, much of which is likely reinsured by international companies); and (3) the number 6.2 -- it sounded hauntingly familiar.

At 12:29 a.m. local time on December 23, 1972, an earthquake measuring 6.2 on the Richter scale occurred in the Central American country of Nicaragua. The similarities end there.

The earthquake in Nicaragua killed 20,000 people, injured another 20,000, left 250,000 people homeless (between 60% and 80% of the capital city's population), and essentially displaced the entire population of Managua, as only 10% of the city had running water or electricity more than a week after the quake. The earthquake destroyed 13 square kilometers at the heart of Managua's business district, left 53,000 homes uninhabitable, destroyed all fire fighting equipment in the city and left all 4 main hospitals unserviceable. 90% of the city of Managua was destroyed. In the aftermath of the earthquake of 1972, foreign aid poured into Nicaragua in the form of money and materials from some 27 countries, as well as private organizations. As a result of mishandling and corruption, little of this aid ever reached the Nicaraguan people. Insurance for the damage to public and private buildings and infrastructure was basically nonexistent.

Thirty-six years later, the city center of Managua has still not been rebuilt, with the city instead characterized by business and office parks scattered around an epicenter of rubble and slums where the proud business center formerly stood. In the 1960s and 1970s, despite political instability, Nicaragua was one of the most developed countries in Central America. Amid the political, social and economic turmoil that followed the earthquake and that has persisted to this day, Nicaragua has consistently remained the second poorest country in the Western Hemisphere, trailed only by Haiti.

In sharp contrast, although Costa Rica will certainly mourn those killed in the recent earthquake, it will rebuild its damaged roads and other infrastructure, and many impacted home and business

owners will turn to insurance to fund the rebuilding of their properties and lives. There is little doubt that Costa Rica will remain the most vibrant economy in Central America in the coming years, and there is no reason to fear that mishandling of reconstruction and relief efforts will lead to revolution, much less 36 years of social and economic strife.

Although we certainly do not mean to claim that the availability of insurance is the only reason for the disparate impacts of the two earthquakes, neither can the salutary effects of proper risk management and the assistance of insurance proceeds be entirely discounted. There is no question that insurance is a stabilizing force for a country's economic and political condition, and that differences in the availability and liberalization of insurance and reinsurance markets are closely tied to the vastly different economic, political and social climates that exist within the countries of Latin America.

We have recently witnessed a recent resurgence in international interest in Latin America as an alternative insurance market. Although this type of interest seems to come periodically, caused by developments in the local Latin American insurance markets and the global economy, and can be fleeting, it can have a long-lasting impact both on local economies and on the international companies that decide to invest in or pass on developing or expanding their role in the region.

The latest upsurge in international interest now being directed toward Latin America can be traced to some key local developments, such as the opening of the Brazilian reinsurance market, the potential for liberalizing legislation in Chile and the opening of Costa Rica to insurance and reinsurance competition. It can also be attributed to global economic conditions, as many commentators predict that the Latin American nations and insurance industries will be better able to weather the global economic crisis than many of the major and other emerging markets.

B. Consistent Market Growth and Liberalization

The Latin American insurance market remains very small in comparison to those in developed countries, generally representing only about 2% of global insurance premiums, or about one-fifth the size of that of the United Kingdom. The relative size of the market, however, must be considered in the context of the low insurance penetration rates and the developing consumer economies in the region. Insurance penetration rates generally run between 2% (Brazil) and 6% (Chile), with the majority of Latin American nations at or below 4% (including Argentina and Mexico). At the same time, steady economic growth in the region, coupled with greater exposure to consumerism and the concept of insurance, indicates tremendous potential for growth in many of the Latin American insurance markets.

This trend became evident in recent years, as gross written premiums experienced annual growth rates exceeding 15% in many Latin American countries, including Brazil, Argentina, Costa Rica, Chile, Venezuela, Colombia, the Dominican Republic and Uruguay. Industry observers now predict double digit annual premium growth in many of the jurisdictions in the region well into the next decade. For example, Brazil's Superintendency of Private Insurance (SUSEP) recently reported annual premium growth of 17.6% for 2008 and predicted growth of 16.2% for 2009 and 11.4% for 2010, while Fitch reported that Costa Rica's insurance market grew by 28% in the past year with similar growth expected in the coming year.

Further, as a result of internal demands and international trade commitments, the region as a whole has been steadily moving forward toward insurance liberalization. This trend continued in 2008, with Brazil opening its reinsurance market to local and foreign competition, Costa Rica ending its longstanding government monopoly on insurance and reinsurance and Chile introducing legislation to significantly liberalize and modernize its regulation of insurance and reinsurance. These initiatives not only bode well for companies doing or considering doing business in these particular countries, but also for the prospects for continuing liberalization throughout the region.

C. Interest Spurred by Global Economic Crisis

As the economic crisis has deepened in many of the major and other emerging markets around the world, interest in Latin America as an alternative market has increased not only among insurance and reinsurance companies, but also among the international businesses that drive much of the insurance demand in these emerging economies. In particular, many industry observers predict that Latin American nations, both in the insurance realm and more broadly, are better positioned to weather the economic crisis than other, more established markets.

The tighter economic conditions in many of the major and other emerging economies caused international players in significant industries to reevaluate their interest in Latin America. For example, a survey of 326 senior executives recently commissioned by credit insurer Atradius and conducted by *The Economist* found that more than 50% of companies had recently considered expansion in Latin America, with 83% of respondents citing market growth as a reason for entry or expansion. Furthermore, approximately 60% of respondents expected their annual revenue and profit to increase by more than 6% in the coming three years, and reported that they had seen no significant impact on their Latin American operations from the economic slowdown in the United States. Brazil and Mexico were of particular interest, as 69% and 48% of respondents identified these countries as important targets for expansion.

The potential growth in the Latin American economies, both in terms of domestic development and foreign investment, is of course a positive sign for insurers and reinsurers. First, foreign companies entering or expanding in Latin America are more likely to seek insurance coverage both for their own operations and for the local companies in which they invest. Second, as the size and sophistication of local companies grows, such entities are more likely to appreciate the role of and seek out insurance coverage. Finally, as the local population becomes more professionalized and connected to consumer culture, such individuals are more likely to seek out personal lines coverage such as life, health, auto and property insurance.

In addition, local and international observers have noted that Latin America's insurance and reinsurance markets are themselves well-insulated from the economic crisis in Europe and the United States:

- In Brazil, the Superintendencia de Seguros Privados (SUSEP) recently stated that it does not believe the Brazilian market is at risk to the factors at play in the U.S. crisis. In support of its position, SUSEP noted that the investment of reserves of Brazilian insurance companies is rigidly and strictly controlled by SUSEP and such reserves may

not be invested in “high risk” products. SUSEP also noted that the strong growth in the Brazilian insurance market since the beginning of the year continued in August, with non-health premiums in the first 8 months of 2008 totaling 17.3% more than the same period the prior year.

- In El Salvador, the Executive Director of the Asociacion Salvadorena de Empresas de Seguros (ASES), Raul Betancourt, recently noted that technical reserves had increased 11% in the first half of 2008 and further commented that he did not believe the financial crisis would have a significant effect on the insurance market in El Salvador. Mr. Betancourt explained that the Salvadorian insurance market makes up only a small part of the national economy and engages a disproportionately wealthy client base in the country that is largely isolated economically from the majority of the population. As a result, he believes, existing insureds are able to withstand economic pressures and are unlikely to cancel policies even when money becomes tight for much of the population. Therefore, ASES expects the insurance market in El Salvador will continue to grow this year at a rate of 5-6%.
- In Paraguay, the Director of the Superintendencia de Seguros, Diego Martinez, recently stated that he believes the global financial crisis will have little impact on the Paraguayan insurance market because Paraguayan insurers hold very limited amounts of foreign assets. Pedro Flecha, the President of the Asociacion de Administradores de Fondos de Pensiones in Paraguay, similarly stated that the crisis should have little effect on the country’s private pension system.
- In Argentina, Fitch Ratings recently reported that, despite difficulties due to inflation and a decrease in investment returns, the insurance market has grown by an average of 12.8% annually over the last four years. The Fitch report also stated that prospects for Argentina’s insurance market in general look bright in large part due to insurers’ increasingly transparent policies and procedures, the unveiling of new and varied insurance products, and a geographic spreading of risks.
- Regulators and commentators in Bolivia, Colombia and Ecuador have also predicted that the global economic crisis will not take a major toll on their domestic insurance markets, citing strict regulation of insurance companies’ reserves and investments and continuing strong growth trends.

Taken together, these factors indicate that Latin America may be one of the few areas in the world where insurance and reinsurance companies can seek increased revenues and profits while the economic crisis continues to play out elsewhere.

C. A Word of Caution

Not to be lost in this enthusiasm, however, is the fact that many of the limitations and risks that have previously discouraged some insurers and reinsurers from making significant investments in Latin America still remain. Political and economic turmoil remains an issue in many countries in the region, including Venezuela, Ecuador, Bolivia, Nicaragua and even Brazil and Argentina.

Significant protectionist regulations (both formal and informal) also still exist in many Latin American countries, as evidenced by the limitations placed on this year's market liberalizations in Costa Rica and Brazil (as discussed in detail below). Finally, given the fluid economic and political situations in many of the region's jurisdictions, any steps forward in terms of liberalization can be quickly reversed upon a change in power or significant political, economic or natural event.

In short, as insurers and reinsurers reevaluate their operations in Latin America, local and global developments offer both tremendous opportunities and significant risks for companies that choose to expand their presence. While the Latin American insurance markets remain characterized by consistent growth and ever-developing potential, they are likewise notorious for their often idiosyncratic local restrictions, requirements and traditions. On the other hand, companies that opt to effectively pass on the region could be conceding large potential profits to their competitors. International companies would be well-advised, therefore, to carefully evaluate their existing and potential operations in Latin America and consider how recent local and global developments should positively impact future plans in the region generally and in particular jurisdictions.

II. Major Insurance and Reinsurance Developments in 2008

Although all of the Latin American jurisdictions had notable regulatory and market developments in 2008, five nations in particular stand out as most significant given the size of the markets involved and/or the fundamental nature of the developments. These developments happened in the largest markets in the region and in one of the smallest, but each deserves significant attention from insurers and reinsurers interested in Latin America.

A. Brazil: Reinsurance Explosion

Brazil is by far the largest insurance market in Latin America, representing approximately 44% of the gross written premiums in the region. Despite this impressive market share, with by far the largest population in South America, the 10th largest economy in the world by GDP, low insurance penetration rates and more than 81% of current insurance premiums concentrated in life, auto and fire insurance, the Brazilian insurance market still has tremendous growth potential (estimated by some to be the third best growth potential in the world, behind only China and India). Indeed, Fitch Ratings recently released a report finding that the Brazilian insurance market grew by 15% in 2007 and predicting that, given the country's low insurance penetration and favorable economic environment, the market will experience "consistent growth in the short and medium term"

Therefore, it came as little surprise that the opening of the Brazilian reinsurance market to competition in early 2008 brought a flood of attention and interested foreign reinsurers to the country.

1. Background: The Monopoly Comes to an End

After many years of debate and an “impending” opening that had lasted some ten years, on January 15, 2007, Complimentary Law No. 126 established a framework for ending the long-standing government monopoly on the reinsurance business in Brazil and opened the Brazilian reinsurance market to private foreign insurers. On December 17, 2007, SUSEP and the National Council on Private Insurance (“CNSP”) issued Resolution No. 168, which implemented Complimentary Law No. 126 and established the requirements for foreign reinsurers wishing to underwrite reinsurance in Brazil. Resolution No. 168 became effective on April 19, 2008, effectively opening the doors to private reinsurers to obtain authorization to do business in Brazil.

Complimentary Law No. 126 and Resolution No. 168 established three categories of private reinsurers: (1) local reinsurers (*resseguradores locais*); (2) admitted reinsurers (*resseguradores admitidos*); and (3) occasional reinsurers (*resseguradores eventuais*). Local reinsurers are defined as reinsurers organized under Brazilian law as Brazilian corporations (*sociedades anonimas*). Admitted reinsurers are defined as reinsurance companies incorporated under the law of foreign jurisdictions that maintain a representative office in Brazil and are registered as such with SUSEP. Finally, occasional reinsurers are defined as reinsurance companies incorporated in foreign jurisdictions that do not have a representative office in Brazil, but are registered with SUSEP.

a. Local Reinsurers

A foreign reinsurer wishing to establish a subsidiary in Brazil to act as a local reinsurer must establish a Brazilian corporation under Brazilian law with the performance of reinsurance and retrocession activities as its sole business. Such a local reinsurer is subject to all local laws and regulations generally applicable to Brazilian insurers, except as otherwise excepted under Brazilian law. A local insurer must hold minimum capital of R\$ 60 million (approximately US\$ 28 million), plus appropriate risk-based capital as provided by law.

b. Admitted Reinsurers

A foreign reinsurer wishing to establish a representative office in Brazil must meet the following requirements:

- Authorization in its country of incorporation to underwrite local and international reinsurance in the same lines as it seeks to underwrite in Brazil;
- Solvency, and operation in its country of incorporation for greater than 5 years;
- A minimum net worth/surplus of greater than US\$100 million or the equivalent;
- A permanent agent domiciled in Brazil, with broad powers of administrative and judicial representation.

- A minimum rating as follows from one of the major rating agencies: Standard & Poor's (BBB-), Fitch (BBB-), Moody's (Baa3), AM Best (B+);
- A bank account in foreign currency "linked" to SUSEP with a minimum of US\$ 1 million for life reinsurers, or US\$ 5 million for general reinsurers;
- A local representative office in Brazil that acts as an independent entity or branch of the company, with a head of the representative office that meets the various requirements to be an office of a local insurance company; and
- Compliance with annual and continuing reporting requirements to SUSEP concerning, among other things, status, internal controls and supervisory fees.

c. Occasional Reinsurers

A foreign reinsurer not wishing to establish a representative office in Brazil, is permitted to register with SUSEP as an occasional reinsurer if it satisfies the following requirements:

- Authorization in its country of incorporation to underwrite local and international reinsurance in the same lines as it seeks to underwrite in Brazil;
- Solvency, and operation in its country of incorporation for greater than 5 years;
- A minimum net worth/surplus of greater than US\$150 million or the equivalent;
- A minimum rating as follows from one of the major rating agencies: Standard & Poor's (BBB), Fitch (BBB), Moody's (Baa2), AM Best (B++); and
- A permanent agent domiciled in Brazil, with broad powers of administrative and judicial representation.

2. Market Reaction: The Rush to Register

In the months following the opening in April 2008, the reinsurance authorization applications poured into SUSEP, often overwhelming the personnel that had been dedicated to processing these requests. Nonetheless, despite some delays and other minor issues, SUSEP was able to process the flood of requests with relative efficiency. By the end of the year, a total of 41 private reinsurers and some 30 reinsurance brokers had received authorization, with a significant number of applications still being processed. Of the 41 reinsurance companies, 5 received authorization as local reinsurers, 16 as admitted reinsurers and 20 as occasional reinsurers.

Given the spike in market growth and development expected to be spurred in part by the newly admitted reinsurers, SUSEP recently stated that it expects the nation's insurance and reinsurance market to top R\$ 100 billion (approximately US\$ 62 billion) this year and to grow another 12-15% in the coming year. As discussed below, however, the question has been raised whether the market can support such a high number of foreign reinsurers.

3. Remaining Issues: Regulatory and Market Limitations

Some industry spokesmen lobbied for a further postponement of the opening of the Brazilian reinsurance market on the basis that the country lacked the regulatory and market resources to supervise and support an open reinsurance market. Although these players certainly had their vested interests in delaying the market's opening, certain questions do remain as to how and whether the Brazilian economy and authorities will be able to sustain and regulate a liberalized reinsurance. Furthermore, although SUSEP placed certain restrictions on the market liberalization in response to the expressed concerns, many of these restrictions have caused more controversy and confusion than comfort among industry players.

a. Restrictions on Liberalization

Although significantly liberalized by the new reinsurance statute and regulations, Brazil is not yet an entirely free market, instead having opted for an "orderly opening of the market" reflected in several significant limitations on the role of foreign reinsurers.

1. "Right of First Refusal"

Ceding companies must offer local reinsurers the right of first refusal on at least 60% of the premiums ceded until January 16, 2010 (and 40% for at least three years thereafter). This vetting requirement permits a ceding company to first obtain quotes from foreign reinsurers and then present a quote to local reinsurers, who will have either 5 days (facultative reinsurance) or 10 days (treaty reinsurance) to match such quote. The vetting requirement will be fulfilled when local reinsurers either accept 60% of the risk or when all local reinsurers have refused or partially refused to match the foreign reinsurer's quote.

It is the sole responsibility of the local insurer, not the reinsurer, to comply with this vetting requirement. How this requirement can and will be enforced has been the source of considerable debate among commentators and market participants.

2. Cession Limits

Cessions to occasional reinsurers by a Brazilian insurer may not exceed 10% of the insurer's total annual premiums ceded to reinsurers. Furthermore, no Brazilian insurer or local reinsurer may cede more than 50% of the risk it underwrites annually to admitted or occasional reinsurers. Compliance with this requirement is also the sole responsibility of the local insurer or reinsurer and has likewise caused significant debate as to its manageability and enforceability.

3. "Tax Haven" Restriction for Occasional Reinsurers

No foreign reinsurer may register as an occasional reinsurer if it is incorporated in a "tax haven," a term defined to mean any jurisdiction in which income tax is levied at less than 20% and/or where reinsurance companies are subject to excessively strict rules of confidentiality regarding their constitution and composition. This limitation clearly applies to companies domiciled in

Bermuda and poses some concern for companies located in other jurisdictions that might be found to satisfy the definition of “tax haven,” such as Delaware. Nevertheless, international companies may use companies organized in acceptable jurisdictions, so long as they meet the other requirements for registration as an occasional reinsurer, and then retrocede to companies based in Bermuda or other “tax havens.”

b. Growing Pains and Market Uncertainties

Although business prospects for foreign reinsurers willing to negotiate these regulatory hurdles appear bright, a number of significant market issues also remain:

- Is the Brazilian reinsurance market, even if it grows as predicted, of a size sufficient to support the recent influx of foreign reinsurer?
- Will these restrictions discussed above be progressively relaxed, remain the same or be further tightened as foreign participation in the Brazilian reinsurance market grows?
- How, if at all, will admitted and occasional reinsurers be taxed by Brazilian authorities?
- Will admitted and occasional reinsurers be permitted to resolve disputes with ceding insurers in foreign arbitration or be required to litigate or arbitrate disputes within Brazil?
- What role will the IRB now play in the Brazilian reinsurance market? Should the further extension of the IRB’s right to retrocede to non-registered foreign insurers be seen as a method of smoothing the transition to an open market or a warning sign that the IRB will likely continue to receive favorable governmental treatment?
- Can enough qualified personnel be found in Brazil and/or brought in from abroad to properly staff branch and representative offices of foreign reinsurers?

Chile: A Mature Market Flirts with Further Modernization, Taxation

By most measures, Chile is considered the third largest insurance market in Latin America. It is widely considered to have the most favorable economic and political environment in the region, but these advantages are significantly counterbalanced by the advanced development of the country’s insurance market, as reflected by the region’s highest insurance penetration rate. As one of the most open insurance markets in Latin America, Chile’s most significant developments this year were in areas reminiscent of many of the major markets: modernization and taxation.

1. Modernizing Legislation

In July 2008, the Chilean legislature was presented with a draft law designed to modernize the insurance and reinsurance provisions contained within Chile's Code of Commerce. If enacted, the legislation would have replaced Chile's current laws concerning private insurance and reinsurance in their entirety. Several aspects of the proposed law are of particular note:

- Article 513 (Definitions): The existing provisions' set of outdated and limited definitions are replaced with 22 new definitions that recognize certain modern realities and developments in the global insurance business. New definitions are provided for the terms "beneficiary," "deductible," "insurable interest," and "collective insurance."
- Article 518 (Contents of a Policy): An insurance policy should contain, among other things, the following items: (1) the identity of the insurer, insured, counterparty and beneficiary (if any); (2) specification of the insured material; (3) the insurable interest; (4) the risks transferred to the insurer; (5) the inception and termination date of the policy; (6) the amount or quantity insured or the means of determining same; (7) the premium and time, place and form of payment; (8) the signature of the insurer and date of execution; and (9) the signature of the insured when required by law. The authenticity and authority of the insurer's signatory is presumed.
- Article 519 (Delivery of the Policy): The insurer should deliver the policy or certificate of insurance within five days of the perfection of the insurance contract. Failure to complete this delivery obligation shall entitle the insured to recover damages from the insurer or broker. If the contents of the delivered policy differ from the agreed contents, the insured shall have one month to object, which right must be clearly stated in the policy.
- Article 524 (Insured's Obligations): The insured is obligated to properly disclose to the insurer all circumstances necessary to identify and evaluate the risk both before the insurance agreement is reached and afterward as circumstances arise, and is further obligated to inform the insurer of any other insurance in place concerning the risk. In addition, the insured is obligated to use caution in seeking to: (1) avoid an insured loss; (2) not aggravate any risk; and (3) make all efforts to preserve the insured asset in the event of loss; (4) notify the insurer within five days of any occurrence or circumstance; and (5) fully disclose all circumstances and consequences of any loss.
- Article 525 (Errors, Omissions and Inaccuracies in Risk Information): If the insured makes errors or omissions or provides inaccuracies in its disclosure to the insurer of information concerning the insured risk, the insurer's rights against the insured depend upon the nature of the error, risk or inaccuracy: (1) if the information not properly disclosed would have caused the insurer not to issue the policy, the insurer may rescind the policy; (2) if the information not properly

disclosed would only have caused the insurer to charge a higher premium or impose stricter conditions, the policy shall remain valid but indemnification in the event of a loss shall be reduced pro rata by the difference between the premium charged and the premium that would have been charged had the insurer known of the issue (unless such non-disclosure was “inexcusable”, in which case the insurer is entitled to rescind the policy); (3) if the insured was required to complete an application provided by the insurer and disclosure of the issue was not required by the insurer’s form, indemnification shall not be reduced (unless such non-disclosure was “inexcusable”, in which case the insurer is entitled to rescind the policy). These sanctions do not apply if the insurer was aware of the inaccuracies before entering into the insurance contract or if it became aware of the issue after issuance of the policy and accepted the risk either expressly or implicitly.

- Article 529 (Indemnification Obligation/Bad Faith): The insurer’s principal obligation is to indemnify the insured for covered loss. The indemnification obligation of the insurer shall never exceed the policy limit. However, where the insurer fails to indemnify, the insured may be entitled to interest. Furthermore, if the failure to indemnify is due to the insurer’s bad faith, the insured may recover additional damages in addition to indemnification.
- Article 534 (Subrogation): By indemnifying the insured, the insurer becomes subrogated to all rights that the insured has against any third parties as a result of the loss.
- Article 543 (Arbitration): Arbitration is mandatory for coverage disputes exceeding a certain amount (approximately \$200,000), while coverage disputes for less than that amount can be submitted to arbitration or the ordinary courts of Chile.
- Article 572 (Third Party Rights Under Liability Insurance): Third parties may pursue a direct action against the liability insurer for damages allegedly caused by the insured and covered by the policy. In such situations, the insurer shall have the right to appoint defense counsel and control the defense of the insured.
- Articles 585-589 (Reinsurance): Like the existing code, the proposed legislation provides little regulation as to reinsurance. However, the reinsurance sections of the proposed law do establish certain guiding principles: (1) the terms of the reinsurance contract shall prevail over legal norms, except to the extent such norms concern public order; (2) international customs and usages concerning reinsurance shall assist in the interpretation of reinsurance contracts; (3) reinsurance shall have no effect upon the scope of the insurer’s obligations pursuant to the underlying insurance contract; (4) reinsurance contracts may call for the insurer’s indemnification payments to be made directly by the reinsurer; and (5) any disputes regarding the reinsurance contract shall be submitted to an arbitrator in Chile who shall apply national law to the dispute unless the parties

agree that the arbitrator is to resolve the dispute in accordance with international business arbitration norms recognized in the laws of Chile.

Although the legislation was originally expected to obtain quick approval from the legislature, it was not passed during the 2008 legislative session. Nonetheless, most observers still view the passage of the legislation as a question of when, not if.

2. Capital Gains Tax Hikes for Foreign Insurers

In October 2008, in a joint release by the Ministerios de Hacienda y Economía, the Chilean government announced a plan to raise the capital gains tax rate applicable to foreign insurers, foundations and sovereign funds that operate in the country. The move is part of a series of steps being taken by the Chilean government through various ministries in an effort to raise \$850 million to be used to maintain the liquidity of the Chilean credit markets and facilitate access to financing for exporting and local companies.

While increasing taxation of foreign insurance entities may appear a fairly cost-free means of improving the nation's credit market liquidity, any further targeting of foreign companies might negatively impact the prevailing view concerning the favorable nature of the Chilean economy, particularly in light of the relatively limited prospects for growth in comparison to other less-developed markets.

B. Argentina: Consolidation and Uncertainty Despite Promise

By most measures, Argentina is considered Latin America's fourth largest insurance market. The market has continued on a path of steady growth and consolidation in 2007 and 2008. The total number of insurers operating in the jurisdiction declined to 184 in 2007, from 189 the previous year and 266 in 1998. Meanwhile, average insurance market growth has topped 12.8% over the last four years and insurance penetration remains relatively low. That being said, however, Argentina's high sovereign risk and the government's recent nationalization of the nation's private pension funds has caused many Moody's to express concern about the coming year for the Argentinean economy generally and the insurance market specifically.

On October 21, 2008, Argentina's President, Cristina Fernandez de Kirchner, announced a plan to nationalize the country's 30 billion dollars in private pension funds (a number of which were managed by affiliates of international banks and insurance companies), ostensibly in an effort to protect retirees' savings during the current global economic turmoil. The announcement, however, rather than stabilizing Argentina's economy, resulted in greater uncertainty and tremendous economic and social turmoil. Argentina's stock market subsequently lost more than half of its value, the bond market plummeted and the value of the Argentine peso dropped dramatically. The Argentinean government publicly blamed the markets' performance on the ten companies in charge of the pension funds, although much of the losses were attributable to declines in the value of government bonds. After the announcement, the Buenos Aires police raided the pension system's offices and a judge prohibited the companies from trading on the Buenos Aires exchange for a week. The private pension funds then proposed a series of reforms as an alternative to nationalization.

Despite significant domestic and international concerns, the Argentine government moved forward with its elimination of the country's private pension system later in the year. A nationalization bill was passed by Argentina's lower house of Congress on November 7th and by the Senate on November 20th, and President Kirchner signed the law on December 4, 2008, establishing an Argentine Integrated Pension System (SIPA) to replace the current capitalization regime as of January 1, 2009.

The new system calls for the creation of two commissions that will function within the existing national social security system (ANSES): a bicameral one containing members of the majority and opposition parties, and another with representatives from the country's labor unions, businesses, private banks, and retiree groups. Under the new law, the System will be financed through distributions to affiliates and beneficiaries, and it guarantees terms equal to or better than those previously existing under the private system.

Annuity payments will continue being paid through participants' existing retirement insurance companies. Affiliates' voluntary contributions to individual capital accounts may be transferred to ANSES accounts if it is determined that such a move would be beneficial. The new law, however, prohibits compensation corresponding to retirement and pension administrators from exceeding certain levels. Steps will be taken to ensure employment for certain medical, technical, and administrative workers affected by the change. The law also provides for a SIPA Sustainability Guarantee Fund to create structures for sustainable economic expansion of the national economy, the growth of remedial funds set aside for SIPA, and the preservation of the Fund's assets.

Proponents of the plan maintain that nationalization will protect the pension funds' assets from risky investments and pump enough cash into the State Treasury to finance infrastructure projects and pay off considerable amounts of national debt, although the government has publicly denied that the funds will be used to pay off or refinance debt. Opponents of the plan, however, both within Argentina and in the national community, have expressed little faith in the Argentinean government's intentions or in its ability to maintain appropriate fiscal oversight of the funds. A United States court has also frozen American assets owned by Argentinean pension funds, a major roadblock to the effectiveness of the fund nationalization.

Commentators have also cautioned that the pension fund nationalization may have broader ramifications for the Argentinean economy. Standard & Poor's lowered Argentina's debt ratings due to the nationalization and Fitch released a report calling the outlook for Argentinean companies "dismal" for 2009, due in part to the pension fund nationalization:

"Local liquidity is scarce, the banks are working to preserve capital and the international capital markets are closed to Argentine corporates. This situation has led blue chip companies to seek financing in the local bond market, which has become increasingly dormant during 2008. The [nationalization] threatens to eliminate the local bond market as a source of liquidity. While the asset allocation of corporate debt in the Argentine pension system is small, the pension

funds' participation in the local debt market is essential. Without them, there are not enough investors to absorb the huge financing needs.”

Nonetheless, the legislation was widely supported by both the Peronist party and the opposition, and many local commentators disagree with these gloomy predictions.

C. Mexico: Steady Growth and Development

Mexico remains the second-largest insurance market in Latin America, with approximately 25% of the region's gross premiums. As of the end of the first quarter of 2008, the Mexican insurance market was made up of 95 companies, with 47 of those companies majority-capitalized from abroad. 52 of the companies include life insurance operations, while 61 companies maintain non-life operations. Life insurance premiums rose 16.4% over the previous year, while liability insurance premiums grew by 5.2 (11.6% when excluding auto insurance).

Perhaps the most notable aspect of the Mexican insurance market in 2008 was the absence, outside of one particular high profile claims dispute, of any particularly significant developments in the market, which was instead characterized by steady growth and development. However, the Comision Nacional de Seguros y Fianzas (“CNSF”) did issue several circulars of interest to foreign-based insurers and reinsurers, including updated regulations governing minimum ratings for registration as a foreign reinsurer and adjusting the reporting requirements of reinsurers operating in the market.

First, on April 3, 2008, CNSF announced new requirements for periodic reporting by reinsurers of financial information. Under the regulation, reinsurers are required to file a separate annual business plan for each line of reinsurance offered, and are further required to file reports three times a year regarding their operations (again, with a separate report for each line of business). The business plan must include a strategic plan and statistical information concerning risks and amounts assumed and premiums received, while the reports must include certain information regarding reinsurance contracts realized during the relevant period. The stated purpose of these new requirements is to permit the CNSF to better monitor and ensure the financial stability of the reinsurance industry.

Second, on July 14, 2008, CNSF issued new minimum rating requirements for foreign reinsurers seeking registration to operate in Mexico. The new minimum ratings are B+ (A.M. Best); BBB- (Fitch); Baa3 (Moody's); and BBB- (Standard & Poor's). Not surprisingly, if the applying reinsurer cannot meet the minimum ratings requirements, it will not be registered on the General Registry of Foreign Reinsurers and will not be permitted to conduct reinsurance business in the country.

Finally, as to the unfortunate claims dispute issue, it serves as a reminder that, while the Mexican insurance market may appear modernized and stable, it is not without its risks and local flavor. On April 25, 2008, Norberto Luis Ferrara Perini, the head of AIG's Mexican subsidiary, and Nestor Diaz Barriga, an outside counsel for the company, were arrested based upon a criminal fraud complaint filed by TV Azteca arising from a commercial policy coverage dispute. Although TV Azteca subsequently withdrew the criminal complaint, it did so only after the

gentlemen had spent a number of days in prison and the insurer had agreed to settle the coverage dispute. Prior to the arrest, the insurer had maintained that the insured's coverage claim was without merit.

D. Costa Rica: Opportunity and Risk in a "New" Market

While relatively small in comparison to the major Latin American insurance markets, Costa Rica is the largest insurance market in Central America (excluding Panama). The country also has a uniquely diversified economy for the region, has experienced rapid annual growth in the insurance market (between 15% and 46% annual growth in recent years) and still has a relatively low insurance penetration rate (2.6%). Prior to 2008, however, the country had maintained a government monopoly over the insurance market through the Instituto Nacional de Seguros ("INS").

In August 2008, however, new legislation was passed in Costa Rica and signed into law by President Dr. Oscar Arias Sanchez that ended the more than eighty-year-old state-sponsored monopoly over the Costa Rican insurance business. While the new Ley Reguladora del Mercado de Seguros opens the insurance market to private competition from domestic companies and foreign companies with local branches, it also contains prohibitions and increased penalties that may come as a surprise to any foreign insurers that do not carefully review their activities in connection with any Costa Rican risks.

1. A New Opportunity

Under the new law, the Consejo Nacional de Supervision del Sistema Financiero (CONASSIF) was charged with establishing an insurance regulatory authority and implementing the other mandates of the new law. While CONASSIF initially indicated that the market should be open to competition and the regulator should be prepared to accept applications for insurance business by the end of September 2008 at the latest, certain regulations governing the market have still not been finalized as of the time of this writing.

The basic tenets of the regulatory structure, however, are already in place in the form of the statute itself and two sets of regulations issued recently governing authorization and solvency requirements. Companies seeking to sell personal lines insurance will be required to have minimum operating capital of \$3 million, while companies wishing to operate as reinsurers will be required to have minimum capital of \$10 million. While the minimum capital requirements contained in the new law are far lower than those contemplated in earlier drafts, which ranged from \$10 million to \$40 million, they remain fairly high in comparison to many other developing and established insurance markets.

The new law also grants certain new freedoms to the INS, including the ability to expand its operations into foreign markets.

2. New Risks

In addition to opening the Costa Rican insurance market to private competition, however, the new statute and regulations also established new prohibitions against “insurance activities” in the jurisdiction by non-registered foreign insurers and reinsurers and created a new framework of far more serious penalties for violations of these prohibitions. Given these new provisions, and the newly created incentives for the INS to report and the regulators to investigate any violations, the risk of adverse enforcement actions has risen significantly with the new legislation.

For example, in November 2008, the new Superintendencia General de Seguros (Sugese) announced that it was investigating 15 persons concerning allegations by the INS of illegal sales of foreign insurance policies. Potential fines for illegal sales of foreign insurance (the definition of which includes marketing of foreign policies by phone, email or facsimile) appear to range as high as \$360,000 under the new insurance laws. As to its role in the investigation, an INS representative reportedly stated that the INS became aware of the illegal activity based upon reports from consumers and further stated that the INS intends to file complaints against additional persons. The INS representative also reportedly commented that, although the INS has always been aware of illegal insurance sales activity, difficulties in making complaints and minor penalties provided no incentive to report such activities under the prior laws.

In this regard, it should be noted that, while the old law was essentially a non-solicitation statute, the new law’s definition of “insurance activities” that non-registered insurers and reinsurers are prohibited from undertaking in the jurisdiction is not limited to sales solicitation. To the contrary, the definition appears broad enough to implicate any sort of claim investigation or adjusting activities, whether conducted directly or through a local agent. Therefore, while the statute does not prohibit Costa Rican entities from seeking insurance outside of the jurisdiction, an insurer holding such a policy would be left with little ability to investigate or adjust any potential loss.

Therefore, even for companies opting to take a “wait and see” approach as to the development of the Costa Rican insurance market, it is imperative to reevaluate underwriting activities regarding risks related to Costa Rica.

3. Market Reaction: The INS Prepares and The Market Waits

While a number of insurance companies based in Central America and Mexico have indicated interest in entering the Costa Rican market, no company has to date officially sought authorization.

In the meantime, the INS has moved forward with plans to strengthen its position domestically and to expand into the other Central American markets in an effort to restructure, retain customers and grow its business in the face of new competition. First, the INS reorganized its operations by creating four new insurance entities: INS Internacional, INS Servicios, INS Vida and INS Comercializadora. INS Internacional will manage the company’s overseas operations, while INS Servicios will serve an auxiliary function, enabling INS to restructure areas such as auto/motor insurance. Efficiency savings achieved through INS Servicios will be fed back to

customers through reduced policy premiums, according to local press reports. INS Vida will focus on the life insurance sector, which had been largely neglected during INS' time as the monopoly provider. Finally, INS Comercializadora will be the sales arm of INS, offering its range of products to the market. INS has also stated that it may enter the catastrophe risk market, offering insurance on state-owned assets at first.

The INS subsequently announced the launching of 17 new insurance products that it anticipated would be offered in the future by its competitors. The new products, to be marketed and sold through public and private banks, include various personal lines policies, such as a family protection policy and a cancer coverage policy. The family protection policy offers coverage for food, housing, education and transport for surviving family members, while the cancer policy provides coverage for diagnostics, funeral expenses and hospitalization. HSBC Bank, which has 38 branches and 200,000 accounts nationwide, reportedly began selling the policies on January 2, 2009.

III. Conclusion: Cautious Optimism

Trends in the Latin American economies generally and insurance markets specifically indicate that insurance and reinsurance companies with a dedicated strategy and experienced advisors can take advantage of tremendous opportunities in the region. However, the undertaking of activities in the region without a coherent plan or full understanding of the local regulations and markets can lead to unprofitable operations and significant potential enforcement issues with local regulators.

For example, with stock market turbulence and industry consolidation in 2008 have come financial strength rating downgrades for more than 100 insurers and reinsurers. While such downgrades often have a negative impact on insurance companies, one potentially unrecognized consequence is non-compliance with regulatory reporting guidelines in numerous jurisdictions in Latin America.

In order to obtain regulatory authorization to conduct insurance and reinsurance business in many countries in Latin America and elsewhere, companies must file, among other things, a certified copy of their financial strength rating. In addition, to remain in compliance with registration requirements, many countries require companies to periodically or continuously update such filings to reflect any change in financial strength rating. For those countries requiring continuous updates, such as Honduras, the company is often required to provide an update within three months of the downgrade or face penalties, including potential deregistration. It is critical, therefore, for companies facing downgrades to review the regulatory requirements of their jurisdictions of registration to ensure that any necessary updates have been properly filed.

Given these sorts of local idiosyncrasies in many of the Latin American markets, and the frequent fundamental changes such as those seen in the past year in regulatory requirements, failure to understand and closely monitor market and regulatory developments can impact both a company's profitability and its continuing right to conduct business in the region's jurisdictions.

It is imperative, therefore, that insurance and reinsurance companies operating or considering expansion into the region obtain the assistance of experienced and knowledgeable advisors.

John P. Dearie, Jr.

Jack has over twenty-five years experience in the insurance and reinsurance industry, including service as U.S. regulatory counsel and tax advisor for numerous overseas insurers in Bermuda, England, Finland, France, Germany and Switzerland. He is a member of various advisory committees to the National Association of Insurance Commissioners and state insurance departments and has testified at hearings on National Association of Insurance Commissioners Model Acts and proposed state insurance regulations. Jack also represents U.S., UK and EU insurers, reinsurers and (re)insurance intermediaries in connection with authorization and compliance regulations throughout Latin America. He has been awarded an “AV” Rating in the Martindale-Hubbell Law Directory. The “AV” is the highest rating honored by Martindale-Hubbell and identifies a lawyer with very high to preeminent legal ability. The rating is a reflection of Jack’s expertise, experience, integrity and overall professional excellence.

M. Machua Millett

Machua is an attorney in the Insurance and Reinsurance Department, where he advises liability insurers, reinsurers and (re)insurance intermediaries concerning complex claims and coverage and foreign and domestic regulatory matters. He represents U.S., EU and U.K. companies concerning regulatory and claims issues throughout Latin America, including Brazil, Mexico, Argentina, Chile, Honduras, Costa Rica, Colombia, Venezuela, Peru, Argentina and Puerto Rico. His recent work includes experience with the new Brazilian reinsurance laws, the new Costa Rican insurance laws, the proposed new insurance laws in Chile and the Puerto Rican International Insurance Center. Machua grew up in Nicaragua and Costa Rica and is fluent in English and Spanish. He is a frequent author on Latin American regulatory issues and coordinates the firm’s coverage of Latin American developments on its (re)insurance blog, InsureReinsure.com. Machua is a graduate of Tufts University and Harvard Law School.