Regulator's muddled ruling over sanctions causes crisis for Brazilian insurers

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In July 2019, the Brazilian insurance regulator, SUSEP, issued an update on the embargoes and sanctions clauses of Brazilian insurance contracts which has caused a major stir among Brazilian insurers.

The initial trigger and background to this story was a specific case involving the Cuban beneficiary of a travel insurance policy. Anyway, as a result of the ruling, that is applicable to all the insurance policies to be issued in Brazil, Brazilian insurers may be held widely responsible for sanctions violations.

Notwithstanding market efforts to get the regulator to truly understand the issue, the Circular Letter revealed a real lack of knowledge of the consequences of the non-adoption of and/or disrespect for the embargoes and sanctions clause. Instead SUSEP made a grave error in choosing to understand that sanctions imposed by countries on other countries are contrary to Brazilian law and the consequences for insurers are serious.

In the Circular Letter, SUSEP also confirms that it is the responsibility of the insurer to undertake research and to determine, at the time of underwriting the risk, if there are sanctions-related limitations on the coverage to be granted. Should the insurer find that there are limitations, they must refuse to underwrite the risk.

However, it is not always possible for the insurer to determine when underwriting the risk if there are likely to be sanctions violations. Clearly, some limitations may emerge during the time period of the policy or may be identified only if a loss occurs.

Added to this, SUSEP confirmed that the later loss of rights, or exclusions from coverage arising from embargoes or economic or commercial sanctions can only occur in a case of intentional fraud committed by the insured. However, for sanctions to be applied, it should be the case that the application of embargoes or economic or commercial sanctions can be based on objective external criteria, not only on the intentional acts or omissions of any specific person and/or the insured.

A further issue with SUSEP's stance is that the embargoes and sanctions clause is not a new contractual rule that is changed or revealed during the life of the insurance contract. Rather, it is a contractual rule that refers to a set of embargoes and sanctions that is regularly updated.

The stance taken by SUSEP means that it becomes impossible for a Brazilian insurer to update their position regarding current insurance and reinsurance contracts should a new international sanction be issued by the UN.

The actions of the regulator have set Brazil's insurers legally apart from the rest of the world, requiring that insurers operating in Brazil should follow costly and unusual practices that have no legal basis and are divorced from the logic and practices that govern the global markets. In fact, it is the case that the entire ruling by SUSEP appears to be based on an erroneous misconception of how sanctions are applied internationally. This, in

addition to the evident mismatch between the insurance and reinsurance coverages, may make some Brazilian insurance and reinsurance contracts unviable.

Meanwhile, the contradictions are beginning to pile up. For example, insurers also need to consider Brazilian Law no. 13810, published on March 8, 2019, which, among several other issues, provides for compliance with sanctions imposed by resolutions passed by the United Nations Security Council.

When this law comes into force, SUSEP, among other financial services supervisory bodies in Brazil, will be responsible for setting rules for compliance with the new law and will be required to supervise measures taken to freeze the assets of sanctioned individuals and legal entities*.

According to the new law, assets must immediately be frozen in compliance with either the resolutions of the United States Security Council or its sanctions committees; or at the request of any foreign central authority (provided that their request is in accordance with the applicable legal principles and is based on objective grounds that meet the criteria set by the UN Resolutions.)

This is a rule which has a dynamic similar to embargoes and sanctions, in that the rule itself does not change, however, the list of bodies affected by it can be updated. In this case the Brazilian legal system recognizes that an international decision may cause an immediate impact on contracts without violating the Brazilian constitution and the contracts themselves. In spite of this highly comparable example the Brazilian insurance regulator SUSEP has chosen not to recognize the same likelihood when discussing embargoes and sanctions clauses.

In other words, according to SUSEP Circular Letter, the sanctions law, but not the contractual rules that go alongside it, must be observed; which, given the constitutional nature of the protection of contracts, does not make sense, not to mention the major disturbances that this will cause Brazilian insurers.

SUSEP has made a grave error in choosing to understand that the clauses on sanctions that refer to sanctions imposed by countries on other countries are contrary to Brazilian law and the consequences for insurers are serious.

It now remains for insurers to develop procedures to deal with cases that arise. In an extreme case, it may be necessary not to perform the insurance contract and wait for a court order for its enforcement, which will reduce the risk of the insurer being held liable for noncompliance with embargoes and sanctions. All in all, this is a true Brazilian “jabuticaba”[1].

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*Defined in article 9 of Law no. 9613, of March 3, 1998.

[1] Fruit similar to grape that exists in Brazil only, the reason why it is often compared to our ruling exoticisms.