Market Developments - Industry presentation on Reinsurance Trade Barriers and Market Access Issues Worldwide

IAIS ReTF Meeting

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Outline of Presentation

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Freedom of Reinsurance

- Vital for reinsurance markets to operate efficiently and allow for **global diversification of risk**.
- Barriers to trade lead to **higher reinsurance costs** and **less capacity** in the long run.
- It is in a countries' own economic interest to refrain from protectionist measures. These are likely to **impede growth and recovery of global and national economies**.
- *Case study: Recovery of New Zealand after the Christchurch earthquake vs. the recovery of Haiti.*
- Importance is further reinforced by:
  - **the increasing frequency of extreme weather events** and increasing severity over the last decades;
  - the **growing protection gap** (only c. 30% of economic losses are insured).
- Despite the economic and financial stability arguments in favour of open reinsurance markets, the number of these measures in place or being contemplated is increasing.

Main market access issues

- Most of the mandatory cessions and other requirements have been imposed by other government officials at the national level other than the insurance regulator and their rational has often been economic or political and not prudential. This conflicts with the independence of the insurance regulator who should be in charge of all aspects of market regulation.
- The requirement to establish locally or post large amounts of capital locally takes capital away from capacity for smaller more emerging markets or business lines. Thus while some larger countries may be able to force localization on global reinsurers, this harms small and medium markets in terms of capacity and cost.

Main market access issues (continued)

- The GRF's trade barriers table, which was first published in August 2015, identifies 26 major territories which have either implemented, or are in the process of implementing, barriers such as:
  - compulsory cessions, right of first refusal rules, or other trade barriers affecting foreign reinsurers;
  - discriminatory requirements on cross-border foreign reinsurers for collateralization or localization of assets;
  - discriminatory barriers affecting the establishment of branches or subsidiaries.
- The GRF updates the table every 6 months.

Main market access issues (continued)

- **Mandatory cessions to local reinsurers:** most common barrier, restrictions impose a limit on the risk that can be transferred to foreign reinsurers.
- *Examples:*
  - ***Brazil** requirement to place at least 40% with 'local' reinsurers. This will be gradually reduced to 15%, but this will take 5 years and even after that date still impose a material restriction on foreign reinsurance. Local reinsurers are also given the right of first refusal before cedants can go to the open market.*

Main market access issues (continued)

- **Right of first refusal:** national reinsurers in high growth markets are often state sponsored and therefore rights of first refusal hinder competitive reinsurance markets.
- *Examples:*
  - ***India** has recently introduced new requirements which would give the local Indian reinsurance General Insurance Corporation (GIC) a right of first refusal.*

Main market access issues (continued)

- **Limits on intra-group reinsurance:** reinsurance depends on the ability to diversify the risks by type and geography to avoid concentration.
- *Examples:*
    - ***Argentina*** *requirement for reinsurers not to transfer more than 40% of premium corresponding to each transaction to subsidiaries or companies belonging to the same financial conglomerate abroad.*

Main market access issues (continued)

- **Requirements for risk retention:** disincentivize sound risk management and compromises financial stability.
- *Examples:*
  - ***Ecuador** in March 2015 a compulsory retention of 95% for individual life, group life, personal accidents, health and motor was introduced.*

Main market access issues (continued)

- **Limits for reinsurers operating cross-border or through a branch:** the option to establish a branch gives cedants access to the entire capital strength of the reinsurer. However, some jurisdictions refuse to allow foreign reinsurers to operate via branches or limit foreign ownership.
- *Examples:*
  - ***Brazil*** *foreign reinsurers must set up and capitalize an insurance company in Brazil, with a required minimum 50% risk retention on a calendar year basis. A 2% withholding tax applies to overseas premium remittances.*

Main market access issues (continued)

- **Credit for Reinsurance (including collateral requirements):** some solvency frameworks limit the recognition of foreign reinsurance in the solvency calculation or make this conditional on the posting of collateral. Such requirements are not risk based and do not take into account the robust solvency regimes EU reinsurers are subject to.
- *Examples:*
  - ***United States*** *the most obvious example of collateral requirements are those imposed by the US, although in many states the 100% collateral requirements have been reduced the collateral requirements relating to in force business remain significant.*
  - ***Israel*** *foreign reinsurers must deposit collateral for proportional treaty reinsurance transactions based on their rating.*

Main market access issues (continued)

- There is a growing trend amongst policymakers to require localization of reinsurance risks in some form and we believe this poses risks both to policyholder protection and financial stability both mandates of the IAIS:
- ***Promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and to***
- ***Contribute to global financial stability***

Remit of the IAIS ReTF

- We acknowledge that the remit of the IAIS ReTF includes a review of ICP 13 "Reinsurance and Other Forms of Risk Transfer" and proposed amendments;
- With the overarching objectives to ***promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and to contribute to global financial stability***

ICP 13.5.3 External triggers ‘collateral’

- IAIS already have recognized that with respect to liquidity that issues related to collateral “*may cause liquidity issues among reinsurers and tend to be pro-cyclical*” 13.5.3
- IAIS remedying language to address recognition of those issues is as follows: “*Therefore, supervisors have to be aware of the consequences of such triggers for overall efficiency in the market*” [13.5.3]

ICP 13.1 Reinsurance and Risk Transfer Strategies

- ***The supervisor requires that cedants have reinsurance and risk transfer strategies appropriate to the nature, scale and complexity of their business, and which are part of their wider underwriting and risk and capital management strategies. The supervisor also requires that cedants have systems and procedures for ensuring that such strategies are implemented and complied with, and that cedants have in place appropriate systems and controls over their risk transfer transactions.***
- Measures which restrict or limit reinsurance and risk transfer strategies pose a risk to policyholder protection
- These measures create risk concentration concerns and create capacity constraints which are prudential matters.
- Additionally, they pose problems for local reinsurers in the same way.

Recommendation for consideration

- ICP 13.1.1.
- A cedant's reinsurance strategy should be part of its wider risk and capital management strategy, which should take into account the cedants overall risk appetite, comparative costs of capital, liquidity positions, the cedant's views on future market and economic trends, and underwriting forecasts. The strategy should be appropriate to the nature, scale and complexity of the cedant. ***Supervisors should be aware that measures that limit or restrict cedants' ability to optimize risk spreading pose a risk to the ability to serve policyholders appropriately.***

Questions?

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