



FINANCIAL REGULATOR
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Requirements for Life Reinsurance Undertakings

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1 Introduction

1.1 Scope

On the 15th of July 2006, Statutory Instrument 380 of 2006 (“S.I. 380”) transposed into Irish law Council Directive 2005/68/EC (“Reinsurance Directive”). The Irish Financial Services Regulatory Authority (“Financial Regulator”) is issuing this paper further to its statutory powers under S.I. 380. The requirements in this paper apply to reinsurance undertakings established in the State carrying on life reinsurance business, hereinafter referred to as “life reinsurance undertakings”.

The International Association of Insurance Supervisors (IAIS) has developed a set of standards relevant to both the supervision of insurance and reinsurance undertakings. The IAIS standard on reinsurance “Supervision of Reinsurers”, issued in October 2003 (available at www.iaisweb.org), elaborates on their earlier publication on the principles of supervision “Minimum requirements for supervision of reinsurers”, which focuses particularly on where reinsurers differ from primary insurers, hence requiring the supervisory framework to be adapted. The Financial Regulator has had regard to the IAIS standards in drafting this paper.

1.2 Legal Basis

Chapter 2 contains prudential rules of the Financial Regulator pursuant to Regulation 23(2) of S.I. 380 with respect to the technical reserves that are to be established and maintained by a life reinsurance undertaking established in the State. For consistency, this paper uses the phrase 'technical provisions' to refer to items described in S.I. 380 as 'technical reserves' and 'technical provisions'.

Chapter 3 contains prudential rules of the Financial Regulator pursuant to Regulation 26(5) of S.I. 380 as to how life reinsurance undertakings must comply with Regulation 26 of S.I. 380.

Chapter 4 provides guidance, pursuant to Paragraph 9 of Schedule 1 of S.I. 380, on the determination of the solvency margin for life reinsurance undertakings, and contains prudential rules of the Financial Regulator pursuant to Regulation 25(1) of S.I. 380.

Chapter 5 requires authorised life reinsurance undertakings established in the State to lodge certain returns with the Financial Regulator, pursuant to Regulation 21 of S.I. 380.

This paper may be amended or supplemented by the Financial Regulator from time to time. Failure by a life reinsurance undertaking to comply with the provisions of S.I. 380, or rules or other requirements laid down in this paper, may be the subject of an administrative sanction under Part IIIC of the Central Bank Act 1942 and shall, except where there is a reasonable excuse, constitute an offence, in accordance with S.I. 380.

2 Technical Provisions

2.1 Introduction

Regulation 23 (1) of S.I. 380 requires that technical provisions be determined in accordance with Directive 91/674/EEC (“the Insurance Accounts Directive”) and any rules of the Financial Regulator in force under Regulation 23(2). Statutory Instrument No. 23 of 1996 (“the Insurance Accounts Regulations”) transposed the relevant provisions of the Insurance Accounts Directive into Irish law.

Life reinsurance undertakings must have technical provisions determined on the basis of recognised actuarial methods annually by a Fellow Member of the Society of Actuaries in Ireland¹ with due regard to the principles of Article 20 of the Life Assurance Business Directive and in accordance with any rules of the Financial Regulator made under Regulation 23(2) of S.I. 380, including such rules in sections 2.2 and 2.3 of this Chapter. This is equivalent to their existing obligation under S.I. 23 of 1996.

For the avoidance of doubt, on the basis of their compliance with the above, the Financial Regulator does not require life reinsurance undertakings to calculate their technical provisions for life reinsurance business in accordance with the more detailed requirements outlined in the European Communities (Life Assurance) Framework Regulations, 1994 (S.I. No 360 of 1994).

For the avoidance of doubt, technical provisions as referred to throughout this paper shall include provisions against any reinsurance contracts, as defined in S.I. 380, irrespective of how such contracts are accounted for in the audited financial statements of a life reinsurance undertaking.

¹ As required in Paragraph 26(4) of Part II of the Schedule to the Insurance Accounts Regulations.

2.2 Gross and Net Technical Provisions

As a prudential rule hereby made pursuant to Regulation 23(2) of S.I. 380, a life reinsurance undertaking must calculate both gross and net technical provisions.

The above rule has been made in order to establish the extent of a life reinsurance undertaking's exposure to its retrocessionaires. Life reinsurance undertakings must maintain a retrocession strategy approved by the Board of Directors, and notify the Financial Regulator of any material changes to their retrocession strategy in a timely manner.

To assist life reinsurance undertakings, the Financial Regulator refers life reinsurance undertakings to the paper "Guidelines on the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers", which was published in January 2004 (hereinafter referred to as the "January 2004 paper") and a copy of which can be found in [Appendix 1](#). Life reinsurance undertakings must also be cognisant of Regulation 26 of S.I. 380 when developing their retrocession strategy.

In the event the Financial Regulator determines that the retrocession programme of a life reinsurance undertaking is not consistent with the guidelines contained in the January 2004 paper (or any amended or updated paper), some or all of the retrocessionaires' share of technical provisions may not be considered admissible as assets covering the technical provisions or used in the solvency margin calculations.

Please note that the Financial Regulator is currently reviewing the January 2004 paper with a view to updating the paper to ensure it is appropriate with reference to, inter alia, S.I. 380 and in particular Regulation 66 of S.I. 380².

² The Financial Regulator's position in this regard will take into account any new, amended or proposed European provisions on the equivalence assessment of regulatory and supervisory regimes in third countries.

2.3 Guaranteed Surrender Values

As a prudential rule hereby made pursuant to Regulation 23(2) of S.I. 380 in relation to life reinsurance business, a life reinsurance undertaking must hold technical provisions that are equal to the minimum guaranteed surrender values calculated at the level of the reinsurance contract.

A life reinsurance undertaking must value any and all liabilities that may arise from the termination, at the option of the cession undertaking, of a life reinsurance contract. Where a termination at the option of the cession undertaking of a life reinsurance contract results in an increase in total net liabilities of a life reinsurance undertaking (such as an elimination of negative reserves, or the payment of break-up penalties or fees), provisions in respect of the higher amount must be held.

3 Assets Covering Technical Provisions

Reinsurance undertakings must adopt a prudent person approach when determining the assets covering technical provisions. In particular, life reinsurance undertakings must ensure that Paragraphs (2) to (4) of Regulation 26 of S.I. 380 have been applied as part of their prudent person approach. The Board of Directors of the life reinsurance undertaking must ensure that the reinsurance undertaking can demonstrate, upon request by the Financial Regulator, that it is adopting a prudent person approach in accordance with Regulation 26 of S.I. 380 and the rules in this Chapter.

Life reinsurance undertakings must consider their entire business from acceptance through to retrocession when deciding the asset mix (and investment) strategy best suited to match all of the liabilities of their business. As part of this approach, consideration must be given to the claims payout patterns of their technical provisions and the potential volatility of these patterns with a view to projecting liquidity requirements and ensuring that the assets selected provide the degree of liquidity required by this analysis. The asset mix (and investment) strategy of a life reinsurance undertaking should consider, *inter alia*, the testing of the resilience of the asset portfolio to a range of market scenarios and investment conditions.

In formulating their approach in compliance with Regulation 26 of S.I. 380 and the rules in this Chapter, life reinsurance undertakings shall also have regard to the following:

- the Insurance Accounts Regulations' rules on valuation of assets (mainly in Chapter 2 of Part II of the Schedule);

- the Guidelines for Insurance Companies on Asset Management, issued by the Department of Enterprise, Trade and Employment to the insurance industry in July 2001 (attached in **Appendix 2** of this paper) or any such updated paper; and
- Guidance Paper No.9, 'Guidance Paper on Investment Risk Management', issued in October 2004 by the International Association of Insurance Supervisors (available at www.iaisweb.org).

Life reinsurance undertakings must ensure that assets covering technical provisions comply at all times with the prudent person approach of the reinsurance undertaking and with the requirements of 3.1 to 3.4 herein. In accordance with Regulation 27 of S.I. 380, life reinsurance undertakings must maintain a register of assets covering technical provisions.

Any asset³ that does not comply with the prudent person approach of the life reinsurance undertaking or the prudential rules herein must be classified as a non-admitted asset for the purposes of this paper (hereinafter referred to as a "non-admitted asset").

With respect to the specific asset classes of Debtors, Funds Withheld, Deferred Acquisition Costs and Inter-Company Transactions, the Financial Regulator hereby prescribes as prudential rules pursuant to Regulation 26(5) of S.I. 380 the requirements in 3.1 to 3.4 herein to assets covering technical provisions (and for assets used to calculate the available solvency margin as per Chapter 4 herein⁴).

³ As per 4.1 in Chapter 4 herein, this classification must also be applied to all assets when determining the available solvency margin, as per 4.1 in Chapter 4 herein.

⁴ Please note that free assets are defined as assets in excess of technical provisions and the applicable solvency margin requirements in Chapter 4 herein and as such may be non-admitted assets.

3.1 Debtors

The Financial Regulator hereby prescribes as a prudential rule pursuant to Regulation 26(5) of S.I. 380 the requirements herein for an asset recoverable from a debtor.

Life reinsurance undertakings must hold an aged debtor analysis on all its debtors. Any debt (not only those relating to reinsurance activities) that has been contractually due and payable for more than 90 days may not be admitted as an asset covering technical provisions. Such an asset must be classified as a non-admitted asset for the purposes of this paper.

Form r10a of the annual forms⁵ requires life reinsurance undertakings to provide a detailed aged debtor analysis.

Where a life reinsurance undertaking has a significant proportion of its assets recoverable from debtors, the life reinsurance undertaking must establish procedures and processes to ensure the asset is fully recoverable through regular reviews and/or continual monitoring of the credit risk of its debtors.

3.2 Funds Withheld

The Financial Regulator hereby prescribes as a prudential rule pursuant to Regulation 26(5) of S.I. 380 the requirements herein for an asset classified as Funds Withheld.

A funds withheld asset is an asset that is withheld by a cession undertaking for the benefit of the life reinsurance undertaking ("Funds Withheld") and may be admitted as an asset for life reinsurance undertakings provided that such an asset is calculated on a prudent person basis and in accordance with the prudential rules herein and with Regulation 26 of S.I. 380. Any Funds Withheld asset that does not comply

⁵ These forms are available in the reinsurance section of the Financial Regulator's website (www.financialregulator.ie) under CONSUMER PROTECTION AND OTHER REQUIREMENTS.

with the prudent person approach of the life reinsurance undertaking or the prudential rules herein must be classified as a non-admitted asset for the purposes of this paper.

When making such a consideration, the life reinsurance undertaking may first look through to the underlying asset or assets, where identifiable, or, where such underlying asset or assets are not identifiable, value the Funds Withheld asset in a manner consistent with the contractual agreements in place with the cession undertaking and the prudent person approach of the life reinsurance undertaking.

3.2.1 Cession Undertaking Credit Risk

Following the consideration above, the life reinsurance undertaking must then specifically consider the credit risk of each cession undertaking as a result of the Funds Withheld arrangement and must write down the value of the Funds Withheld asset to reflect any concerns.

The life reinsurance undertaking may conclude that no write down of the value of the Funds Withheld asset is required where:

- 1) The credit risk of the cession undertaking is eliminated by the Funds Withheld asset being held in a separate trust whereby, under such trust, the underlying asset or assets are legally available to the life reinsurance undertaking to satisfy its obligations in the event of the insolvency of the cession undertaking.
- 2) The credit risk of the cession undertaking is mitigated by way of a legally enforceable contractual provision such as offset or mitigated by other means⁶. The enforceability of any contractual provision must be supported by a written legal opinion from competent legal

⁶ "other means" may cover the situation of collateral support through a guarantee or a letter of credit. In such a case, a guarantee or letter of credit must be direct, explicit, unconditional and irrevocable containing an evergreen clause whereby expiry is only allowed with a minimum of a 90 day prior notice by the issuer and the issuer is an undertaking without any close links to the reinsurance undertaking and is an EEA or equivalent supervised credit institution with a long-term debt rating by a recognized rating agency of at least a Grade 3, as per [Appendix 7](#).

advisers⁷ on the recoverability of the asset (or the extinguishing of a corresponding liability) in the event of insolvency of the cession undertaking having regard to the applicable laws and regulations⁸. The Financial Regulator may request a copy of the written legal opinion.

Where neither 1) nor 2) above applies, the asset of the life reinsurance undertaking is exposed to the credit risk of the cession undertaking and the value of the Funds Withheld asset may need to be written down to comply with the requirements of this Chapter. In making the determination about the level of the write down required, the life reinsurance undertaking must reconsider its asset mix whereby such a Funds Withheld asset is viewed as a single asset with a credit rating akin to that of an unsecured creditor of the cession undertaking. The write down must consider the requirements of Regulation 26 (2) of S.I. 380 with particular regard to Regulation 26 (2) (e).

Where neither 1) nor 2) above applies and the cession undertaking has a close link (as defined in Regulation 3(1) of S.I. 380) with the life reinsurance undertaking, the life reinsurance undertaking may only include the Funds Withheld asset (as written down above) as an admissible asset where the Financial Regulator has issued a letter of no objection to such inclusion. The Financial Regulator will only consider issuing a letter of no objection in this regard where details are provided on the level of write down proposed by the life reinsurance undertaking with an explanation as to the analysis undertaken and the consideration given to the requirements herein. The life reinsurance undertaking must also provide an explanation as to why the protections against the credit risk of

7 The legal opinion must be provided by an advisor (whether an employee of the reinsurance undertaking or otherwise) who is competent to opine on the issue in question. For example, if the issue is one of offset in a particular US State, the legal resource must have a sufficient knowledge of the relevant laws and regulations in that State to be able to opine on what may happen in the event of an insolvency given existing law and precedent in that State.

8 A recent legal opinion on the enforceability of any provision in one jurisdiction (e.g. by State in the US or by country in the EU) may be used to support a number of reinsurance contracts containing a similar provision with cession undertakings from that jurisdiction. Such legal opinions must be confirmed or updated at intervals determined by the reinsurance undertaking to be prudent but at least every 5 years (in the absence of a legal precedent or a change in law applicable to the provision becoming known to the directors or senior management of the reinsurance undertaking).

the cession undertaking outlined in 1) or 2) above have not been applied. Failure to provide this information will result in the Financial Regulator declining any such request as incomplete.

3.3 Deferred Acquisition Costs

The Financial Regulator hereby prescribes as a prudential rule pursuant to Regulation 26(5) of S.I. 380 the requirements herein for an asset classified as Deferred Acquisition Costs.

Deferred Acquisition Costs (“DAC”) may be admitted as an asset for life reinsurance undertakings provided that such an asset is calculated consistent with the prudent person approach and in accordance with the principles below and with Regulation 26 of S.I. 380. Any DAC asset that does not comply with the prudent person approach of the life reinsurance undertaking or the prudential rules herein must be classified as a non-admitted asset for the purposes of this paper.

When making such calculations, the following principles must be applied:

- 1) A DAC asset may only be used where it is expected that deferred acquisition costs will be recovered from future margins in the portfolio. In particular:
 - a) Only those acquisition costs which have been incurred and which have not already been recovered may be used to determine the DAC asset.
 - b) The net present value of future margins on the contracts in question must be sufficient to cover the deferred acquisition costs.
 - c) The life reinsurance undertaking must be sufficiently certain that these future margins will be realised.
- 2) The spreading of acquisition costs must take into account the nature and timing of the margins arising over the related contracts. In spreading the acquisition costs to determine the DAC asset, consideration must be given to the nature and timing of the margins arising on the reinsurance contracts to which the acquisition costs

relate. It is not necessary to spread the acquisition costs over all future margins if the reinsurance contract design is such that margins specifically earmarked for initial costs can be separately identified and can cover the acquisition costs deferred.

- 3) The basis and methodology used to calculate the DAC asset must be prudent and consistent with that used to calculate the mathematical reserves on the policies to which the DAC asset relates.
Inconsistencies may arise if the DAC asset is not calculated on a prudent basis or if the basis or methodology used to calculate the DAC asset is not consistent with those used to calculate the liabilities.
- 4) The DAC asset must be regularly reviewed. A life reinsurance undertaking holding a DAC asset must regularly check that it is still prudent to assume that incurred acquisition costs will be recovered out of future margins. At a minimum:
 - a) The recoverability of the costs must be confirmed at least annually.
 - b) If circumstances have changed and there is uncertainty over whether future margins will be sufficient to cover the deferred costs, the asset must be reduced appropriately or written off.
 - c) In conducting the review, life reinsurance undertakings must follow the principles herein, in determining the recoverability of the DAC asset.
- 5) A life reinsurance undertaking using a DAC asset for purposes other than to cover liabilities on the portfolio to which it relates must ensure that the DAC asset is recoverable in all reasonably foreseeable circumstances. Life reinsurance undertakings holding a DAC asset face the risk that such an asset will be eroded by discontinuance of either the reinsurance contract or the discontinuance of the policies underlying such reinsurance contracts. The life reinsurance undertaking must have regard to these risks, particularly when considering the requirements in section 2.3 in Chapter 2 and to principles 3 and 4 above (for the avoidance of doubt, the level of prudence required herein is equivalent to that of principle 3 above).

3.4 Inter-company Transactions

The Financial Regulator hereby prescribes as a prudential rule pursuant to Regulation 26(5) of S.I. 380 the requirements herein for an asset classified as an inter-company transaction.

A loan, deposit or receivable is “inter-company” (hereinafter referred to as “inter-company transaction”) where it occurs (in substance or in form) between a life reinsurance undertaking and a person with whom the undertaking has a ‘close link’ within the meaning of Regulation 3(1) of S.I. 380, or who is required to be included in consolidated accounts of the undertaking prepared in accordance with Directive 83/349/EEC (“the Group Consolidated Accounts Directive”).

An inter-company transaction may be admitted as an asset for life reinsurance undertakings provided that such an asset is calculated on a prudent person basis and in accordance with the prudential rules herein and with Regulation 26 of S.I. 380. Any inter-company asset that does not comply with the prudent person approach of the life reinsurance undertaking or the prudential rules herein must be classified as a non-admitted asset for the purposes of this paper.

3.4.1 Inter-company Loans and Deposits

An inter-company loan or deposit asset is exposed to the credit risk of the borrower under the loan or to the credit risk of the holder for a deposit. This credit risk must be eliminated or mitigated by way of ‘ring-fencing’ for an inter-company loan or deposit to be admitted as an asset for the purposes of this paper.

For an inter-company loan, ring-fencing is whereby, under the terms of the contractual arrangement (including any related security document), cash or another liquid asset of at least the value of the sum repayable to the life reinsurance undertaking is segregated from, and does not constitute, the assets of the borrower and is available to the life

reinsurance undertaking in order to satisfy the repayment of the loan in the event of insolvency of the borrower.

Similarly, for an inter-company deposit, ring-fencing is whereby cash or another liquid asset of at least the value of the deposit is segregated from, and does not constitute, the assets of the holder of the deposit and is available to the life reinsurance undertaking in the event of insolvency of the holder of the deposit.

For the remainder of this paper, requirements applicable to an inter-company loan for the purposes of an asset to be admitted shall also apply to an inter-company deposit and any reference to an inter-company loan hereinafter shall include an inter-company deposit.

One example of ring-fencing of an inter-company loan occurs where the assets are placed in a separate trust whereby, under such trust, the underlying asset or assets are legally available to the life reinsurance undertaking to satisfy its obligations in the event of the insolvency of the borrower. Other examples of ring-fencing arrangements are outlined in [Appendix 3](#).

Other than for a trust arrangement as outlined above or the arrangements outlined in [Appendix 3](#), the life reinsurance undertaking must ensure that the validity and enforceability of any ring-fencing arrangement is supported by a written legal opinion from competent legal advisers⁹ on the recoverability of the asset (or the extinguishing of a corresponding liability) in the event of insolvency of the borrower having regard to the applicable laws and regulations. The Financial Regulator may request a copy of any such written legal opinion.

⁹ The legal opinion must be provided by an advisor (whether an employee of the reinsurance undertaking or otherwise) who is competent to opine on the issue in question, considering the laws and regulations applicable to the parties of any contractual arrangements.

3.4.2 Inter-company Receivables

Inter-company receivables can only be admitted as an asset where:

- a) the requirements in 3.1 herein have been fulfilled, and
- b) the asset is administered under written contractual terms between the parties, including settlement intervals, that are equivalent to those commonly in use in the commercial market.

4 Solvency Margin

4.1 Available Solvency Margin

Paragraphs 1 to 4 of Schedule 1 of S.I. 380 state the requirements for determining the available solvency margin of a life reinsurance undertaking.

Life reinsurance undertakings must complete items 1.1 to 1.7 of form LR30 (Life Reinsurance – Solvency I Calculation and Total Solvency Margin Required) of the annual forms¹⁰ in accordance with Paragraphs 1 to 4 of Schedule 1 of S.I. 380.

Intangible items must be included in 1.8 of form LR30 (Life Reinsurance – Solvency I Calculation and Total Solvency Margin Required) of the annual forms in accordance with Paragraph 1(2) of Schedule 1 of S.I. 380.

The Financial Regulator hereby directs pursuant to Regulation 25(1) of S.I. 380 that, when determining the available solvency margin under Paragraph 1(2) of Schedule 1 of S.I. 380, a life reinsurance undertaking must apply the rules in Chapter 3 of this paper, where applicable, with respect to the admissibility of assets to that determination. This means that assets used to calculate the available solvency margin must also comply with the requirements for assets covering technical provisions as per Chapter 3 of this paper.

Therefore when making such a determination, any assets¹¹ of the life reinsurance undertaking classified as non-admitted assets, as per Chapter 3 herein, must be deducted from the available solvency margin on the following basis:

¹⁰ These forms are published in the reinsurance section of the Financial Regulator's website (www.financialregulator.ie) under CONSUMER PROTECTION AND OTHER REQUIREMENTS.

¹¹ For the purposes of 4.1, this classification must be considered in relation to the total assets of the life reinsurance undertaking.

- 1) Any non-admitted asset, net of any related liabilities other than technical provisions (as below), as classified per 3.2: Funds Withheld in Chapter 3 herein. This deduction must be included in 1.8.1 of form LR30 (Life Reinsurance – Solvency I Calculation and Total Solvency Margin Required) of the annual forms.
- 2) Any non-admitted asset, net of any related liabilities other than technical provisions (as below), as classified under 3.4.1: Inter-company Loans in Chapter 3 herein. This deduction must be included in 1.8.2 of form LR30 (Life Reinsurance – Solvency I Calculation and Total Solvency Margin Required) of the annual forms.
- 3) Any non-admitted assets other than those in 1) and 2) above, net of any related liabilities other than technical provisions (as below), as classified under this paper. This deduction must be included in 1.8.3 of form LR30 (Life Reinsurance – Solvency I Calculation and Total Solvency Margin Required) of the annual forms.

For the purposes of the deductions¹² above, the non-life reinsurance undertakings may decide, based upon their prudent person approach, that it is appropriate for them to net non-admitted assets against related¹³ liabilities other than technical provisions. A brief explanation as to the reasoning and the assumptions used in netting any such liabilities against the non-admitted asset must be provided with the annual forms. The Financial Regulator may request the annual forms to be re-submitted without all or a part of the netting above if the explanation provided is not sufficient. For reference, [Appendix 4](#) contains examples of the determination above.

For the avoidance of doubt, free assets defined as assets in excess of technical provisions and the applicable solvency margin requirements in this Chapter may be non-admitted assets as defined in this paper.

12 These deductions are subject to a maximum of zero (i.e. the resulting non-admitted asset net of related liabilities other than technical provisions cannot be negative).

13 Related in this context means between parties that have a close link (as defined in S.I. 380), or where there is a strong association between the asset and the liability class.

4.2 Required Solvency Margin

Paragraph 9 of Schedule 1 of S.I. 380 states the requirements for determining the required solvency margin for life reinsurance business.

4.2.1 Applicable Life Rules

Paragraph 9 of Schedule 1 of S.I. 380 gives the Financial Regulator the option to apply the rules as detailed in Article 28 of the Life Assurance Business Directive for certain classes of business (hereinafter referred to as the “applicable life rules”). The Financial Regulator hereby exercises this option in the case of all business and operations coming within Paragraph 9(2) of Schedule 1. This includes, therefore:

- life assurance linked to investment funds or participating contracts,
- annuities,
- capital redemption,
- management of group pension funds,
- management of group pension funds accompanied by insurance,
- operations carried out by assurance undertakings such as those referred to in Chapter 1, Title 4 of Book IV of the French "Code des assurances".

The Financial Regulator recognises that some of the life reinsurance business being written in the Irish market may not naturally fall into the EU classes of business as defined in the Life Assurance Business Directive. In order to assist life reinsurance undertakings to determine the appropriate solvency margin for their business, the Financial Regulator recommends the methodology process as outlined in [Appendix 5](#).

Form LR30 (Life Reinsurance – Article 28 calculation) of the annual forms¹⁰ requires life reinsurance undertakings to provide a breakdown of the required solvency margin calculation for life reinsurance business that is subject to the applicable life rules.

4.2.2 Applicable Non-Life Rules

For life reinsurance business that does not fall into the categories listed in Paragraph 9(2) of Schedule 1 of S.I. 380, life reinsurance undertakings are required to use the rules outlined in Paragraphs 5 to 8 of Schedule 1 of S.I. 380 in order to determine solvency requirements (hereinafter referred to as the “applicable non-life rules”).

Form LR30 (Solvency Margin Calculation - Life Reinsurance – Solvency I Calculation and Total Solvency Margin Required) of the annual forms¹⁰ requires life reinsurance undertakings to provide a breakdown of the required solvency margin calculation for life reinsurance business that is subject to the applicable non-life rules.

4.2.3 Mixed Reinsurance Business

For reinsurance business that contains elements of both non-life and life reinsurance business, the life reinsurance undertaking may separate such business for the purposes of determining the required solvency margin. Premiums, claims and technical provisions under such contracts may be separated into a component in respect of business to which life rules apply (“the investment component”) and a component to which non-life rules apply (“the protection component”), provided that:

- a) the Board of Directors of the life reinsurance undertaking shall be responsible for approving the methodology used in the separation of these elements and for ensuring the separation is calculated in accordance with such a methodology;
- b) the Board of Directors ensures that whatever actuarial and other professional advice it deems appropriate has been taken by the life reinsurance undertaking; and
- c) the principles in sections 4.2.3.1 to 4.2.3.3 herein are satisfied (or an alternate approach may be used provided such an approach is more conservative than the principles herein and a letter of no objection is sought and received from the Financial Regulator).

4.2.3.1 Separation of Premiums

The method of separation used by a life reinsurance undertaking must be based on recognised actuarial methods. In particular, the life reinsurance undertaking must calculate the premium in respect of the protection component on a basis consistent with the pricing basis that would apply if that component had been accepted on a stand-alone basis. The pricing basis used for this purpose must be set prior to the first regulatory returns in which a given reinsurance contract is included, and must then be applied unchanged for as long as the contract remains on the life reinsurance undertaking's books.

The disclosure of the pricing basis must include as a minimum:

- the mortality, morbidity and other biometric risk assumptions;
- expense assumptions in relation to the protection component (including commission);
- lapse assumptions, if any; and
- allowance for required profit margins.

The pricing basis used for this purpose must be disclosed in full to the Financial Regulator as other information in the Annual Returns required (see 5.1.4 herein) in this paper¹⁴.

The life reinsurance undertaking may take either of two approaches in calculating the premium in respect of the protection component:

- (a) calculate a level annual premium applicable throughout the full term of the reinsurance contract, or
- (b) calculate a premium that varies throughout the term of the reinsurance contract in a direct relationship with the pattern of the underlying biometric assumptions.

¹⁴ Any disclosure to the Financial Regulator will be treated as confidential information in accordance with the Financial Regulator's statutory professional secrecy obligations.

This choice may be made on a contract-by-contract basis. However, once one of the approaches has been chosen for a given contract and included in a regulatory return, the life reinsurance undertaking may not switch thereafter to the other approach.

The premium in respect of the investment component will then be the balance of premium payable under the mixed contract.

4.2.3.2 Separation of Claims

Each life reinsurance undertaking writing mixed business must identify separately claims in respect of the payment of protection benefits and claims in respect of the payment of other benefits under each mixed contract. Life reinsurance undertakings must have in place with each relevant cession undertaking the administrative arrangements necessary for the Board of Directors to be able to satisfy itself that claims in respect of the protection component are accurately recorded. Claims thus identified must then be used as an input to calculating the solvency requirements to which the non-life rules apply.

4.2.3.3 Separation of Technical Provisions

A life reinsurance undertaking may identify the whole of the technical provisions as relating to the investment component.

Where a life reinsurance undertaking separates technical provisions into an investment and protection component, the reinsurance undertaking must calculate the technical provisions in respect of the protection components of mixed contracts on a basis consistent with that which would apply if that component had been accepted on a stand-alone basis. This reserving basis must be fully disclosed to the Financial Regulator as other information in the Annual Returns required (see 5.1.4 herein) in this paper, be consistent with the overall reserving basis for the mixed contract and must include as a minimum:

- the mortality, morbidity and other biometric risk assumptions;
- expense assumptions in relation to the protection component;

- lapse assumptions; and
- allowance for required profit margins.

The technical provisions in respect of the investment component will then be the balance of the total technical provisions held in respect of the mixed contract. This must be consistent with the value of the assets underlying the investment component of the contractual liabilities.

4.3 Minimum Guarantee Fund

Under Paragraph 2 of Schedule 2 of S.I. 380, life reinsurance undertakings are required to maintain a minimum guarantee fund (“MGF”) equal to €3 million, except for captive reinsurance undertakings where a minimum guarantee fund equal to €1 million applies. A distinct MGF is applicable to those life reinsurance undertakings that carry on finite reinsurance¹⁵, as defined in S.I. 380.

The MGF may be subject to indexation in the future according to the review of the EU Commission.

4.4 Miscellaneous Items

The following items may be applicable to the business of a life reinsurance undertaking when determining solvency:

4.4.1 Transfer of Reserves

For reinsurance contracts that result in a direct transfer of existing insurance or reinsurance reserves from a cession undertaking to a reinsurance undertaking, a life reinsurance undertaking may, at its option, separate¹⁶ the contract into a risk component and a reserve transfer component and only use the risk component for the purpose of determining solvency requirements in paragraph 6 of Schedule 1 of S.I. 380, subject to the following conditions:

¹⁵ Separate requirements for life reinsurance undertakings that carry on finite reinsurance business are available in the reinsurance section of the Financial Regulator’s website (www.financialregulator.ie) under CONSUMER PROTECTION AND OTHER REQUIREMENTS.

¹⁶ Irrespective of the accounting treatment that is applied to the reinsurance contract(s).

- a) It can be clearly demonstrated, based upon recognised actuarial methods, by the life reinsurance undertaking that the reserve transfer component is consistent with the existing reserves of the cession undertaking; and
- b) The risk component equals any transfer or payment in excess of the existing reserves of the cession undertaking.

Pursuant to Regulation 22 of S.I. 380, a life reinsurance undertaking must seek a certificate by way of a letter of no objection from the Financial Regulator when acquiring a portfolio of reinsurance contracts held by another reinsurance undertaking (whether or not established in the State). No such requirement applies to a transfer of a portfolio of reinsurance contracts from the life reinsurance undertaking to another undertaking.

4.4.2 Yearly Solvency Changes

It should be noted that for business to which the non-life rules apply, Paragraph 5 (3) of Schedule 1 of S.I. 380 states that there is a requirement that the percentage reduction in solvency margin from one year to the next can be no greater than the percentage reduction in technical provisions, calculated net of retrocession, over the same period.

4.4.3 Administrative Expenses

A life reinsurance undertaking may make payments to a cession undertaking in respect of services performed by the cession undertaking on behalf of the reinsurance undertaking with such payments characterised as ceding allowances or otherwise. The life reinsurance undertaking must consider the substance of any administrative expenses incurred under a reinsurance contract when determining the solvency requirements rather than the form of any allowances between the reinsurance undertaking and the cession undertaking.

In addition to any such payments as described above, the reinsurance undertaking may incur expenses for the administration of a reinsurance

contract. Such expenses must also be included as administrative expenses for the purpose of determining the solvency requirements for life reinsurance undertakings insofar as they relate to life reinsurance business linked to investment funds where the reinsurance undertaking bears no investment risk and the allocation to cover management expenses is not fixed for a period exceeding five years.

Any apportionment of expenses in a reinsurance contract between lines of business must be carried out according to principles and guidelines approved by resolution of the Board of Directors of the life reinsurance undertaking.

5 Regulatory Returns

Pursuant to Regulation 21 of S.I. 380, the returns, documents and information specified in this Chapter are hereby required to be lodged with the Financial Regulator by a life reinsurance undertaking.

5.1 Annual Return

Beginning with the first financial year ending on or after the 31st of December 2007, an annual return (hereinafter referred to as “Annual Return”) must be sent to the Financial Regulator within 6 months¹⁷ after the end of the life reinsurance undertaking’s financial year, containing the 8 items listed below.

The Annual Return may be submitted in hard copy copy [except for the completed annual forms in item 4) below that must also be provided in electronic form] by post to:

Reinsurance,
Insurance Supervision Department,
PO Box No 9138,
College Green,
Dublin 2,
Ireland.

or in soft copy by email to: reinsurance@financialregulator.ie

¹⁷ This time interval is under continual review and the stated objective of the Financial Regulator is to reduce this interval to 4 months in conjunction with the introduction of electronic reporting for reinsurance undertakings. Industry will be notified in advance of any change in this regard.

1) Compliance Statement.

A compliance statement, as per [Appendix 6](#), signed by two Directors for and on behalf of the Board of Directors¹⁸.

2) Retrocession Strategy.

A statement of no change in the retrocession strategy as previously disclosed to the Financial Regulator, if applicable, or otherwise the details of any change in the retrocession strategy of the life reinsurance undertaking.

3) Financial Statements.

The most recently audited financial statements of the life reinsurance undertaking.

4) Annual Forms.

The completed annual forms, entitled "Annual Forms_Life 2007"¹⁰, consistent with the financial information from the most recently audited financial statements, as per Section 5.1.1 herein.

5) Statement of Actuarial Opinion.

A Statement of Actuarial Opinion ("SAO") in respect of the life reinsurance business of the life reinsurance undertaking, as per 5.1.2 herein.

6) Asset Information.

Information on the assets of the life reinsurance undertaking, as per 5.1.3 herein.

7) Strategic Solvency Target.

A statement outlining the strategic solvency target established by the Board of Directors, as per 5.2 herein, and the reasons behind the selection.

8) Other.

Details of any material issues impacting the business of the life reinsurance undertaking that have arisen in the preparation of the Annual Return or otherwise and such information as per 5.1.4 herein.

¹⁸ The Financial Regulator's opinion for the purposes of Regulation 20 of S.I. 380 is outlined in the paper entitled "Corporate Governance for reinsurance undertakings" (hereinafter the "Corporate Governance paper"). Life reinsurance undertakings are required to meet the timeframe laid down in 1.4 Implementation of the Corporate Governance paper. For the purposes of the Compliance Statement in [Appendix 6](#), the Financial Regulator will accept the opinion of the Board of Directors in this regard until such time as the Financial Regulator's opinion is applicable as per the Corporate Governance paper.

The Financial Regulator reserves the right to request additional information¹⁹ from a life reinsurance undertaking in the future as part of the Annual Return or otherwise.

In an individual case or circumstance, the Financial Regulator may specify to a life reinsurance undertaking more frequent intervals of reporting for all or part of the information required in the Annual Return.

5.1.1 Annual Forms

The annual form, entitled "Annual Forms_Life 2007"¹⁰, must be completed in the reporting currency of the life reinsurance undertaking. Where the solvency required equals the MGF and the reporting currency of the life reinsurance undertaking is a currency other than the Euro, a life reinsurance undertaking must ensure that currency movements do not negatively impact upon its compliance with its obligations under S.I. 380 and the requirements of the Financial Regulator.

A life reinsurance undertaking must fill out the following forms:

- 1) Form LR1 (Underwriting Revenue Account – Life Reinsurance),
- 2) Form r10 (Balance Sheet),
- 3) Form r10a (Aged Debtor Analysis),
- 4) Form r11 (Profit and Loss Account),
- 5) Form LR30 (Solvency Margin Calculation - Life Reinsurance – Article 28 calculation), and
- 6) Form LR30 (Life Reinsurance – Solvency I Calculation and Total Solvency Margin Required).

In order to receive an insight into the liquidity position of a life reinsurance undertaking, the Financial Regulator requires a monthly cash-flow statement (of actual figures, where possible, and projections, where

¹⁹ For example, additional information is required from life reinsurance undertakings that carry on finite reinsurance or financial reinsurance as detailed in separate papers published by the Financial Regulator in the reinsurance section of the Financial Regulator's website (www.financialregulator.ie) under CONSUMER PROTECTION AND OTHER REQUIREMENTS.

necessary) for 12 months from the balance sheet date of the most recently audited financial statements of the life reinsurance undertaking. Form r11a (Cash-Flow Analysis) provides a template for life reinsurance undertakings to use. This template is not mandatory and a life reinsurance undertaking may submit a similar statement, based upon what is available from its internal system, that, in the opinion of the life reinsurance undertaking, provides an equivalent insight into the actual and projected liquidity position of the life reinsurance undertaking.

Annual Returns submitted to the Financial Regulator are currently not required to be audited by an external auditing firm. However, the information submitted as part of the Annual Returns should be consistent with externally audited financial statements (reconciliations and/or explanations should be provided where consistency is not demonstrable). The life reinsurance undertaking must ensure that all information submitted as part of the Annual Returns is checked and verified, to the highest standard possible, within its internal control system.

To ensure a consistent basis across industry, in the absence of specific requirements for the valuation of assets or liabilities issued by the Financial Regulator (e.g. such as those outlined in this paper), Irish Generally Accepted Accounting Principles ("GAAP") is the default basis for reporting financial information to the Financial Regulator. For those life reinsurance undertakings that report their financial statements on a basis other than Irish GAAP, the Financial Regulator reserves the right to apply prudential filters on items of material difference between the accounting standards, particularly in relation to the valuation of assets. Any such filters will be applied on the basis of any reconciliation with Irish GAAP, as presented in the audited financial statements or as otherwise presented to the Financial Regulator. A life reinsurance undertaking that has difficulty in providing any such reconciliation with Irish GAAP should contact the Financial Regulator directly to discuss the matter further.

An electronic version of the completed annual form, entitled "Annual Forms_Life 2007"¹⁰ must be submitted to the Financial Regulator as part of the Annual Return herein.

5.1.2 Statement of Actuarial Opinion (SAO)

A SAO in respect of the life reinsurance business of the life reinsurance undertaking is required. The SAO should be prepared in the agreed format²⁰, signed by an actuary holding a current practising certificate to act as a signing actuary in respect of life reinsurance business, as issued by the Society of Actuaries in Ireland. The Financial Regulator may request a copy of any external or internal report prepared to support a SAO.

The Financial Regulator will only consider a written request for an exemption from the provision of a SAO that clearly states the detailed reasons for any such request. The criteria currently used by the Financial Regulator for life reinsurance business is materiality. Any exemption is only valid if confirmed to the life reinsurance undertaking in writing by the Financial Regulator.

5.1.3 Asset Information

To comply with Regulation 27 (1) (b) of S.I. 380 and pursuant to Regulation 21 of S.I. 380, the Financial Regulator hereby directs that a life reinsurance undertaking must submit information on total assets, including those covering technical provisions, as follows:

- 1) For the following items included under INVESTMENTS in Form r10 (Balance Sheet):
 - a. An outline of the valuation basis for "Investments in Group Undertakings", and
 - b. An outline of the ring-fencing arrangements (as per 3.4.1 herein), if any, applicable for "Loans to Group Undertakings", and

²⁰ The standard format for the SAO for life reinsurance is available from the Society of Actuaries of Ireland's website (www.actuaries.ie).

- c. A breakdown of "Other Financial Investments" as per the format in [Appendix 8](#).
- 2) For the following items included under CURRENT ASSETS in Form r10 (Balance Sheet):
- a. A breakdown of "Amount due from retrocessionaires" by financial strength as per the credit grade in [Appendix 7](#), and
 - b. A breakdown of "Funds Withheld by cedants" as per the format in [Appendix 8](#), if available²¹. Also, the amount of such Funds Withheld that are classified as a non-admitted asset under 3.2 herein should also be noted in this breakdown with an explanation as to why the asset is non-admitted as per the requirements of this paper.
 - c. A breakdown of any other items classified as a non-admitted asset herein, with an explanation as to why each such asset is non-admitted as per the requirements of this paper.

Where any of the information required herein is not available, the life reinsurance undertaking must contact the Financial Regulator directly with an explanation as to why the required information is not available.

5.1.4 Other

Any other information that the life reinsurance undertaking considers material or otherwise informative into their business should be included here. Other items to be considered here include those such as the disclosure required in 4.2.3 herein. Amongst the items that may be considered under this heading are the regulations applicable to insurance and reinsurance groups under Statutory Instrument 366 of 2007 ("S.I. 366") that came into effect on the 1st of June 2007, including Regulation 11 of S.I. 366 requires the reporting of intra-group transactions.

²¹ An explanation must be provided as to why such a breakdown is not available and an outline of the controls the life reinsurance undertaking has in place to monitor the performance of the assets must also be provided.

5.2 Ongoing Compliance

Life reinsurance undertakings are required under S.I. 380 and the requirements herein to maintain an available solvency margin at or in excess of the MGF or 100% of the required solvency margin, whichever is the greater. The Financial Regulator is of the view that it is prudent for life reinsurance undertakings to maintain capital cover at more than 100% of the required solvency margin as per requirements of the Financial Regulator herein, to avoid unintentionally falling below the solvency required.

The responsibilities of the Financial Regulator, in the event that the available solvency margin of a life reinsurance undertaking falls below the solvency requirements herein, are prescribed in Regulation 58 of S.I. 380 and include the requirement to notify the supervisory authorities of the Member States in which the life reinsurance undertaking carries on reinsurance business.

It is for the Board of Directors to establish a level of capitalisation above the required solvency margin that they believe is prudent and sufficient (subject to the minimum requirements in 4.3 herein), hereinafter referred to as the "strategic solvency target". In order that the Financial Regulator can monitor solvency levels in the sector, the life reinsurance undertaking must notify the Financial Regulator immediately in each of the following circumstances:

- 1) Where the available solvency margin falls below 150% of the required solvency margin, and
- 2) Where the available solvency margin falls below the strategic solvency target (if less than 150%).

Upon such a notification, the Financial Regulator may require such a life reinsurance undertaking to report its solvency status to the Financial Regulator on a more frequent basis thereafter. The frequency and extent

of this reporting will depend on the exact circumstances of an individual life reinsurance undertaking.

The Financial Regulator must be informed as soon as possible of any changes in the strategic solvency target, with an explanation as to the reasons behind the change.

Appendix 1: Guidelines on Retrocession

**GUIDELINES ON THE REINSURANCE
COVER OF PRIMARY INSURERS AND
THE SECURITY OF THEIR
REINSURERS**

Prudential Supervision - Insurance
Irish Financial Services Regulatory Authority
January 2004

Guidelines on the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers

In July 2000, the Monetary and Exchange Affairs Department of the International Monetary Fund, in conjunction with the World Bank, completed an assessment of the regulation of the financial sector in Ireland. In relation to the insurance sector, the assessment was carried out by reference to standards and guidelines laid down by the IAIS (International Association of Insurance Supervisors).

They noted a number of areas not adequately addressed vis-a-vis the IAIS standards. The then supervisor (Department of Enterprise, Trade & Employment) subsequently, July 2001, issued guidelines to address the issues raised and to ensure full compliance with the existing IAIS standards and guidelines. In order to stay up to date with new IAIS standards the Authority²² will periodically issue guidelines as required. Therefore the following guideline is based very closely on the 'Supervisory Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers' as issued by the IAIS, January 2002. The level of documentation required for compliance with the guideline will be reflective of the complexity of the underlying policies issued and the consequential reinsurance purchased. It is considered vital that companies however small address the issues contained in this document, evaluate their compliance, and formalize policies and procedures.

If the self-evaluation reveals that the company is non-compliant with the requirements of this document then the company will need to develop a draft plan that will bring it into full compliance. This plan may be discussed with the Authority prior to finalisation.

The Authority would not expect every company to have a fully documented reinsurance strategy document during the early part of 2004. However, would expect this to be in place going into the January 1, 2005 renewal season.

²² "Authority" means the Financial Regulator

Guidelines on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers

This document provides guidance to insurers on the policies and procedures that companies should have in place for evaluating the adequacy of each company's reinsurance cover.

In addition, in recent years reinsurance has evolved with the introduction of many new products. These are commonly known as alternative risk transfer (ART) products. Although this subject will be dealt with in the future by a separate paper, we believe that much of the guidance provided in this document will also apply in the case of ART products.

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1. Introduction

1. Insurance companies assume risk on behalf of policyholders. They mitigate these risks by acquiring insurance with reinsurers. Through the use of reinsurance, an insurer can reduce risk, stabilise its solvency, use available capital more efficiently and expand underwriting capacity. Reinsurance helps an insurer obtain a desired, prudent risk profile (i.e. relationship between the risks a company runs and its financial strengths). An insurer may purchase reinsurance direct, or with the assistance of an intermediary. However, irrespective of the reinsurance obtained, the primary insurer remains contractually responsible for paying the full claim amounts to policyholders.

Accordingly the quality of the reinsurers selected is pivotal to the financial stability of the ceding insurer.

The guideline is laid out in the following manner:

- Section 2 sets out to explore the general subject of managing reinsurance security (N.B. this is for background purposes only);
- Section 3 addresses the strict regulatory requirements, which represent the minimum acceptable legal standard;
- Section 4 outlines the Authority requirements for a ceding insurer's reinsurance strategy and related corporate governance; and,
- Section 5 describes how the Authority intends to administer this guideline.

2. Managing Reinsurance Security

Reinsurance purchased at the best terms and the lowest price means nothing if the reinsurance company is no longer in business when the claim payment for indemnification comes due.

Selection of Reinsurers

The four most important criteria used for selecting reinsurers are availability, price, security, (financial ability to meet its obligations), and service. These factors involve inverse relationships; e.g., the weakest reinsurers in terms of security and service may be most attractive with regard to availability and price. As selecting reinsurers involves tradeoffs among these four criteria the insurer needs to evaluate which tradeoffs are most suitable.

In practice it is understood that insurers need to tradeoff criteria and therefore some flexibility is required in the selection process. If the insurer sets the criteria for security too strictly, it may not be able to obtain adequate reinsurance, or the price may be too high. Similarly, if the insurer sets the criteria for price too strictly, adequate reinsurance may not be available; or the security may be imprudently weak. How these tradeoffs are handled is a reflection of the expertise and experience of the ceding insurer's management. It is usually beneficial to make several successive attempts to determine an optimal tradeoff. However, from a regulatory perspective security is of primary importance.

Role of Intermediaries

The role of the intermediary, if one is involved, is not to select reinsurers for the company, but merely to introduce them based on predefined quality criteria. Unless the intermediary accepts the responsibility for selection, it remains with the ceding insurer. If the company fails to define any criteria of its own and simply accepts whatever reinsurers the intermediary introduces, it has not delegated the responsibility for the selection of the reinsurers, and remains responsible for whatever

reinsurers it accepts. This could potentially compromise the financial security of the company and would certainly not be in compliance with the requirements of this guideline.

Establishing Criteria for Evaluating Security of Reinsurers

The evaluation of a reinsurer's security can involve many complex considerations. To standardize this evaluation, insurer should establish certain initial criteria. Special circumstances may suggest some modifications of the initial criteria, but the more structured the process, the sounder the evaluation. The most important and widely used initial criteria for security are size, rating, and ownership.

The influence of size on security is evidenced by the fact that the majority of insolvencies occur amongst the smaller reinsurers, rather than the larger reinsurers whose business is more diversified both geographically and across class of business.

The rating of a reinsurer by an independent source is a second security criterion that may be used in conjunction with size. A rating is a relative benchmark, based on rigorous, objective and independent analysis and opinions developed using a consistent and predictable methodology by experts in the complex field of global financial markets. However, a knowledge of how rating agencies rate reinsurers is useful in fully understanding the ratings and in evaluating the significance of changes in ratings. A significant limitation of ratings is the time lag in issuing reports.

An insurer that selects only premier reinsurers is likely to have fewer problems with uncollectible reinsurance and needs to spend less time and resources evaluating its reinsurers. This does not mean that this insurer is a better evaluator of reinsurers than other insurers or the rating agencies. It means that *this* insurer places a higher priority on security relative to price and availability.

Insurers often modify security criteria under two circumstances:

- (1) for some kinds of reinsurance, especially long-tail lines; and,
- (2) for maintaining continuity of relationships with existing reinsurers.

Long-tail reinsurance, such as excess of loss liability involves a longer time frame and requires more expertise than property catastrophe and pro-rata reinsurance. Accordingly, many insurers use stricter security criteria for long-tail reinsurance or restrict the amount of reinsurance placed with each reinsurer.

Many ceding insurers modify their security criteria, within reasonable limits, to include reinsurers that have served the ceding insurer well in the past. Continuity is an important element of good service. This is especially true for reinsurers that accommodated the ceding insurer during periods when availability of reinsurance coverage was a problem. Continuing such relationships helps to assure the insurer of adequate capacity during future periods of capacity contraction.

Limiting the Amount of Reinsurance Exposure with Selected Reinsurers

Many insurers limit the amount of their reinsurance exposure with any one reinsurer according to the size of the reinsurer's shareholders' surplus. They do so in order to reduce the chance the reinsurer will retrocede part of its business. The greater the participation in relation to the reinsurer's surplus, the greater the reliance on retrocessionaires. If a reinsurer uses a large amount of retrocessions, the financial security of the retrocessionaires becomes as important to the primary reinsurers as the reinsurer's financial security. Generally, a reinsurer is more likely to retrocede substantial portions of a block of business it has assumed when that block is more than 1 percent of its own shareholders' surplus. The existence of retrocessions may, potentially, lead to delays on claim payments, while the failure of a retrocessionaire may cause the reinsurer to become insolvent. It is therefore important that ceding insurer recognizes that the quality of retrocessionaires is an essential component in the evaluation of the reinsurer.

Exceptions to the limit that insurers cede to a reinsurer in relation to the shareholders' surplus of the reinsurer may be merited when backup security is obtained.

Many insurers also limit the amount they cede to any one reinsurer on the basis of their own shareholders' surplus. This is especially true when ceding to other than premier reinsurers, where the risk of insolvency is more significant. The amount of exposure to any one reinsurer, especially non-premier reinsurers, in terms of both the amount of one risk and the accumulation of balances recoverable, should not exceed the largest amount that the insurer is willing to retain on any one primary risk or catastrophe.

Another way to reduce the credit risk is to insert a right of offset clause in the reinsurance contract. Then, to the extent that uncollectible recoverables are due to the insurer, the insurer can reduce any payment that may be due the reinsurer.

When the insurer uses an unrated reinsurer from the same group of companies a concentration risk is created. Cut-through and insolvency clauses to retrocessionaires are only effective if the reinsurer accepting the insurer's risk is in turn retroceding a significant portion of the risk it is accepting to rated reinsurers. Another consideration is the volume of other reinsurance business the unrated group reinsurer is assuming, and the extent to which claims from these other sources will exhaust limits and aggregate retrocession cover provides.

Backup security or collateral is sometimes used (1) to make acceptable a reinsurer that otherwise would not meet the security criteria of the ceding insurer or (2) to cede greater amounts to one reinsurer than the usual limitations of the insurer allow. Backup security can take several forms, including letters of credit, funds withheld, and trust funds.

Monitoring Reinsurers

A prudent insurer monitors its reinsurers during the life of the reinsurance agreements and for as long as any obligations remain outstanding. If a reinsurer's financial condition deteriorates during the term of the agreement, the insurer may consider a mid-term cancellation. If such trouble develops while balances remain outstanding, the insurer may wish to negotiate a commutation while the reinsurer is still trying to retain its status in the marketplace.

The insurer should follow a systematic program for monitoring changes in the ratings, surplus, assets, reserves, premium volume, ownership, and management, for monitoring news reports, the timeliness of claim payments, and other information from miscellaneous sources. This information helps prepare the insurer to take timely corrective action if unexpected financial problems arise with its reinsurers.

Documentation

In addition to substantive documentation of the reinsurance cover in the form of:

- copies of contracts and amendments;
- copies of slips and cover notes; and
- written contract descriptions and summaries;

the ceding company should be careful to document their compliance with those internal control procedures that it considers necessary and adequate to (a) evaluate the financial responsibility and stability of the assuming company, and (b) provide reasonable assurance of the accuracy and reliability of information reported to the reinsurer and amounts due to or from the reinsurer.

As the insurer increases its use of second and third-tier reinsurers, and especially unrated, new and little-known reinsurers, it increases its need for information and analysis. This is particularly true if the insurer does not obtain available backup security and does not use prudent limitations. The insurer will be subject to a greater potential for loss from uncollectible reinsurance.

3. Regulations and Guidelines for their Interpretation

Insurance Act 1989 [1989 No. 3] Part II Supervision of Insurers, Article 12.

The Minister (now the Authority) may make regulations for the proper exercise of his functions under the Insurance Acts in respect of the following -

- e) reinsurance cessions of authorised undertakings including information which undertakings must supply in respect of their reinsurance arrangements,

Article 13 (4) of the European Communities (Non-Life Insurance) Framework Regulations, 1994 (S.I. No 359 of 1994) deals with the allowance of a reduction of technical reserves arising from reinsurance.

Technical reserves may, subject to sub-article (3) be established and maintained after the deduction of reinsurance cessions, ***provided such reinsurance arrangements are acceptable to the Minister (now the Financial Regulator)***. However, any reduction in technical reserves arising from reinsurance shall be restricted to the extent of the insurance risk transferred under the reinsurance arrangements. Where the reinsurance arrangements are not acceptable, the Minister (now the Authority) may require that, in respect of the insurance contracts covered by such arrangements, reserves be maintained before the deduction of reinsurance cessions.

To provide context to the italicised phrase in the above paragraph, it is the undertakings themselves which are primarily responsible for the appropriateness and security of their reinsurance arrangements.

Sub-article (3) provides that, if more than 90% of the gross premiums written in any accounting class of insurance business adopted for the purpose of the annual returns is ceded by the insurer, then the insurance undertaking will be required to maintain technical reserves representing a minimum 10% of gross premium income or 10% of gross

technical reserves relating to such business, whichever is the greater, in that class and to hold assets representing that amount accordingly.

Similarly, to the treatment of reinsurance on Non-Life insurers as noted above, the European Communities (Life Assurance) Framework Regulations, 1994 (S.I. No 360 of 1994), Article 12 (5) together Annex VII discusses the suitability of reinsurance cessions and the acceptability of reducing technical reserves by reinsurance. Again, the primarily responsible for the appropriateness and security of their reinsurance arrangements rests with the insurer and must be acceptable to the Minister (now the Authority). The reduction, in the case of Life reinsurance, is limited to 75% of the gross premiums written.

Admissibility of Reinsurance Recoverables as support for Technical Reserves.

Annex III, Article 5, 1 & 4 (Non-Life), provides that the value of any debt due the insurance undertaking under any contract of reinsurance to which the insurance undertaking is a party shall be the amount which can reasonably be expected to be recovered in respect of that debt (valued net of all amounts owed to the same third party) provided that no account shall be taken of any debts arising out of reinsurance operations which are owed by intermediaries and which have been outstanding for more than three months.

Annex III, Schedule 2, Part 1 (Non-Life) limits the admissibility of reinsurance recoverable, on paid claims, to 50% of net technical reserves, based on the reasonable expectation that the debt will be recovered.

Annex V, Article 5, 1 & 4 (Life), contain the same provisions for the valuation of debt due the insurance undertaking under contracts of reinsurance as in the Non-Life Regulations. Schedule 7 (Life) limits the admissibility of reinsurance recoverable, on paid claims, to 1% of net technical reserves for each reinsurer, and 2.5% in aggregate, again, based on the reasonable expectation that the debt will be recovered.

Impact of Reinsurance on Minimum Solvency

Annex II, Part A, 4 (a) (v) & 4 (b) (vii) (Non-Life), reduces the required solvency margins calculations based on the reinsurance recoverable in the last financial year, capped at a maximum of 50%. Similarly, Annex II, Part A, 3 (Life), limits the reinsurance reduction factor to a maximum of 15% for the solvency margin calculation based on mathematical reserves, and to a maximum of 50% for the solvency margin calculation based on the capital at risk.

4. Reinsurance strategy and corporate governance

Board of Directors

It is expected that every insurer should have a reinsurance strategy, approved by the company's Board of Directors, that is appropriate to the company's overall risk profile. The reinsurance strategy will be part of the company's overall underwriting strategy. The Board should review the reinsurance strategy annually. In addition, the reinsurance strategy should be reviewed when there have been changes in the company's circumstances, its underwriting strategy, or the status of its reinsurers.

The reinsurance strategy should define and document the insurer's strategy for reinsurance management, identifying the procedures for:

- the reinsurance to be purchased;
- how reinsurers will be selected, including how to assess their security;
- what collateral, if any, is required at any given time; and
- how the reinsurance programme will be monitored (i.e. the reporting and internal control systems).

The Board should ensure that all legal and regulatory requirements are met. It should set limits on:

- the net risk to be retained; and
- the maximum foreseeable amount of reinsurance protection to be obtained from the approved reinsurers.

Senior management

Senior management should document clear policies and procedures for implementing the reinsurance strategy set by the Board of Directors. This includes:

- setting underwriting guidelines that specify the types of insurance to be underwritten, policy terms and conditions, and aggregate exposure by type of business;
- establishing limits on the amount and type of insurance that will be automatically covered by reinsurance (e.g. treaty reinsurance); and
- establishing criteria for acquiring facultative reinsurance cover.

In order to avoid uncovered risks, the terms and conditions of the reinsurance cover should be compatible with those of the underlying business.

Limits on the net risk to be retained should be set either per line of business or for the whole account. The insurer may also set limits per risk or per event (or a combination thereof). The limits must be based upon an evaluation of its risk profile and the cost of the reinsurance. In particular, the insurer should have adequate capital to support the risk retained. Some insurers may use the results of dynamic financial analysis techniques (using the reinsurance cover as one of the variables) as input into these operating decisions.

The ceding insurer should ascertain whether the proposed reinsurer intends to retrocede any of the assumed business. If this is the situation it is then essential that the ceding insurer is equally satisfied as to the quality of the retrocessionaires used.

The insurer should maintain an up-to-date list of reinsurers that it has approved. For each approved reinsurer the appropriate level of exposure should be specified. To do this, the insurer should evaluate the ability and willingness of the reinsurer to fulfil its contractual obligations as they fall due (i.e. its security). Such assessment is required whether collateral is posted or not. The assessment should take into account the effects of any collateral the reinsurer has posted in favour of other insurers. The insurer's credit guidelines should describe the system for controlling exposures to each reinsurer.

To improve the security of the overall reinsurance cover, insurers may choose to use a number of different reinsurers. Diversification by the insurer reduces the impact of counterparty credit risk; or withdrawal of capacity on reinsurance renewal in periods of capacity contraction.

Generally speaking, the fewer the number of reinsurers used, the more an insurer should pay importance to the security of its reinsurers. If a company takes advice on the strength and security of a reinsurer, then it should satisfy itself that the advice given is sound. Similarly, if reinsurance cover is acquired through an intermediary, the company should evaluate the operational risk associated with the transaction.

Senior management should ensure that the management information system in place meets all Board requirements with respect to reporting frequency and level of detail. In addition, there should be adequate systems of internal control to ensure that all underwriting is carried out in accordance with company policy and that the planned reinsurance cover is in place. The underwriting control systems should be able to identify and report on a timely basis where underwriters infringe authorised limits, breach company guidelines or otherwise assume risks exceeding the ability of the company's capital base and reinsurance cover to service.

If an insurer in Ireland is part of a global insurance group the reinsurance strategy should include information on the global reinsurance strategy. The information should identify the control mechanisms and detail the reporting arrangements for monitoring the reinsurance arrangements of the group, including where the responsibility resides for the monitoring; i.e. at the local insurer level; or, with the foreign parent. The strategy should also include the reporting arrangements between Irish and foreign operations, the monitoring of Irish insurer's operations by the foreign parent and the home regulator's supervisory arrangements regarding reinsurance. Where elements of the strategy are controlled by parent these should be identified and detailed.

The following mandatory contract terms should appear in all reinsurance policies:

- Insolvency Clause requiring the reinsurer to perform its contract obligations without diminution in the event of the ceding insurer becoming insolvent.
- A policy provision stating that the reinsurance agreement constitutes the entire contract between the parties.
- A policy provision requiring reinsurance recoveries to be paid to a cedent without delay and in a manner consistent with the orderly payment of claims by the ceding insurer.
- A policy provision providing for reports, no less than quarterly, regarding premiums and paid and incurred losses.

Internal control

There should be internal control systems in place to ensure that claims are reported to the appropriate reinsurer and that reinsurance claims payments are being promptly collected.

The underwriting control may include an actuarial assessment of the risk and whether it has been transferred as presumed. This assessment may also include a review of the reinsurance contracts. The Board of Directors should receive regular and comprehensive reports on the effectiveness and performance of the claims system and the reinsurance protection. Companies' internal control systems should be subject to regular audit examination.

5. Supervisory monitoring of compliance with the guideline

The supervisor may verify that the Board of Directors has established an overall strategy framework – addressing, *inter alia*, underwriting and reinsurance. This will include evaluation of reinsurance cover, reinsurer security and collateral that may be posted. The supervisor will take a risk-based approach – ensuring that the company has appropriate policies, systems and procedures in place and focusing more detailed examination work on areas posing specific and significant concern.

Before granting a license, the supervisor must be satisfied with the company's planned risk management and reinsurance strategies, and accompanying policies. When examining the business plan of an insurance company, the supervisor will evaluate if the proposed reinsurance covers maximum foreseeable loss. In the business plan the company must describe how, and to what extent, future policies will be reinsured.

Companies should maintain adequate reinsurance cover at all times based on their risk profile. While many reinsurance treaties operate on an annual basis, some treaties especially for life business and some ART contracts can operate for many years. In such cases, assurance that the reinsurer offers sufficient security to act as a long-term counterparty will be required. The supervisor should be made aware of the security and adequacy of the reinsurance or ART coverage for long-tail business (where claims development is slow) and the top layers of catastrophe programmes (where amounts involved can be large).

Sufficient and relevant information should be available on the reinsurers used and the reinsurance cover arranged. Relevant information may include:

- reports prepared by the ceding insurer describing the reinsurance cover, reinsurance programmes or treaties; and,

- the ceding insurer's financial statements, detailing the result of reinsurance, any amounts outstanding from reinsurers and the effect of the ART techniques, including financial reinsurance.

The company should have available on a timely basis:

- copies of contracts and amendments;
- copies of slips and cover notes;
- financial statements of reinsurers used; or
- written contract descriptions and summaries.

Using this information and other relevant information received during on-site inspection, the supervisor will evaluate:

- the prudence of the company risk profile including an evaluation of any risk concentration, i.e. an aggregate exposure with the potential to produce losses large enough to threaten the insurer's financial health or its ability to maintain core operations;
- compliance with the company's reinsurance strategy;
- the sufficiency of the reinsurance cover and the insurance company's financial strength, in particular under extreme, but plausible loss scenarios;
- the sufficiency of the reinsurance security, taking into consideration a wide range of factors including financial strength, whether reinsurers are properly supervised and whether or not collateral is posted; and,
- the appropriateness of any ART techniques, such as securitisation, used.

The choice of reinsurance cover is a business decision made by management within the overall reinsurance strategy of the insurer. However, where insufficient or inappropriate reinsurance cover affects the company's ability to pay policyholders' claims, the supervisor will enter into discussions with the management of the company.

The supervisor may disallow credit in whole or in part for reinsurance when calculating solvency requirements or technical provisions on a net basis or when determining the coverage of gross technical provisions by reinsurance recoverables. As well, the supervisor may require the insurer to:

- obtain additional reinsurance cover;
- provide additional capital;
- establish additional technical provisions; and,
- have additional collateral posted, if applicable.

Reinsurance recoveries in excess of 90 days overdue will generally not be admissible as assets; and in addition, for the reinsurers with balances that fall into this category, absent adequate collateral only 80% of the reinsurance recovery reserve from these reinsurer will be admissible. However, the Authority is cognisant of the fact that disputes/differences in interpretation do occur; as such it will extend the 90 days to 180 in the case of disputes on specifically referenced claims. The Authority will permit offsetting provided that the offsetting is with the same counterparty, there is provision in the reinsurance contract for offsetting, and that the offsetting actually occurs within a prescribed period of time. This is an important but necessary tightening of the position as laid out in the regulations.

Within a reasonable period after their finalisation, significant changes in reinsurance arrangements (including the panel) must be notified to the supervisor, who may request sight of all relevant documentation in assessing the appropriateness and adequacy of the changes.

Appendix 2: Guidelines on Asset Management

**GUIDELINES FOR INSURANCE
COMPANIES ON ASSET
MANAGEMENT**

Insurance Financial Supervision Section

Department of Enterprise, Trade & Employment

July 2001

Guidelines for Insurance Companies on Asset Management

In July 2000, the Monetary and Exchange Affairs Department of the International Monetary Fund, in conjunction with the World Bank, completed an assessment of the regulation of the financial sector in Ireland. In relation to the insurance sector, the assessment was carried out by reference to standards and guidelines laid down by the IAIS (International Association of Insurance Supervisors).

With regard to the Insurance sector they noted that the safekeeping and the liquidity of assets were not explicitly addressed in the regulations. These issues can be either defined very narrowly, or, indeed very broadly. In attempting to rectify the situation it was considered preferable to adopt a broad approach and to provide all-inclusive guidelines for insurance companies on asset management rather than fill the specific gaps identified in a narrow way. Therefore the following is based very closely on the 'Supervisory Standard on Asset Management by Insurance Companies' as issued by the International Association of Insurance Supervisors. In an effort to provide a comprehensive view of the subject, the Guidelines include both current Regulations and previously issued guidance notes.

The implementation of the Guidelines needs to be tailored to the particular circumstances of the individual companies. For example, the Supervisor¹ does not expect that smaller insurance companies, such as captives, will have the same level of formalization as implied by the Note. Still, it is considered vital that companies however small address the issues contained in this document and formalize policies and procedures no matter how briefly.

Commencing with the financial year ended 31st December 2001, an expanded Directors' Certificate for Life Companies and a similar certificate for Non-Life Companies will be introduced. All insurance companies will be required to submit this Directors' Certificate with their Annual Returns. This Certificate will state, inter alia, that the company's practice in relation to the management of assets comply with this Guidelines Note.

1 At present, the Department of Enterprise, Trade & Employment. In future, the Financial Regulator

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1. Preamble

1. The nature of the insurance business implies the formation of technical provisions, and investment in and the holding of assets to cover these technical provisions and a solvency margin. In order to ensure that an insurer can meet its contractual liabilities to policyholders, such assets must be managed in a sound and prudent manner taking account of the profile of the liabilities held by the company and, indeed, the complete risk-return profile. The complete risk-return profile should result from an integrated view on product and underwriting policy, reinsurance policy, investment policy and solvency level policy. The liabilities profile of a company with respect to term, and the predictability of the size and timing of claims payments, may differ significantly according to the nature of the insurance business conducted. It thus follows that the need, for example, to maintain a high degree of liquidity within the asset portfolio will similarly differ between insurers

2. The objective of this guidance document, in addition to detailing the relevant Regulations, is to describe the essential elements of a sound asset management system and reporting framework across the full range of investment activities. Given the wide variation in the nature of companies, it is acknowledged that the extent of the application of the practices described in this document by any given insurer may differ according to the size and structure of an insurance company and the type of business it conducts. However, the basic principles of Board of Directors' responsibility, the need for an investment policy, segregation of duties and control will be applicable to all insurance companies

2. Introduction

2.1 Asset Liability Management

3. A key driver of the asset strategy adopted by an insurer will be its liabilities profile, and the need to ensure that it holds sufficient assets of appropriate nature, term and liquidity to enable it to meet those liabilities as they become due. Detailed analysis and management of this asset/liability relationship will therefore be a pre-requisite to the development and review of investment policies and procedures which seek to ensure that the insurer adequately manages the investment-related risks to its solvency. The analysis will involve, inter alia, the testing of the resilience of the asset portfolio to a range of market scenarios and investment conditions, and the impact on the insurer's solvency position.

2.2 The Investment Process

4. Depending upon the nature of their liabilities insurers will typically hold, in varying proportions, four main types of financial assets either directly, via other investment vehicles (such as UCITS [Undertakings for Collective Investments in Transferable Securities]), or through third party investment managers:

- a. Bonds and other fixed income instruments;
- b. Equities and equity type investments;
- c. Debts, deposits and other rights;
- d. Property.

5. The holding of a given asset portfolio carries a range of investment-related risks to technical provisions and solvency which insurers need to monitor, measure, report and control. The main risks are market risk (adverse movements in, for example, stocks, bonds and exchange rates), credit risk (counterparty failure), liquidity risk (inability to unwind a position at or near market price), operational risk (system/internal control failure), and legal risk.

6. The actual composition of an asset portfolio at any given moment should be the product of a well structured investment process itself, which for the purposes of this document is regarded as a circular movement characterised by the following steps:

- a. Formulation and development of a strategic and tactical investment policy;
- b. Implementation of the investment policy, in a suitably equipped investment organisation, and on the basis of a clear and precise investment mandate(s);
- c. Control, measurement and analysis of the investment results which have been achieved and the risks taken;
- d. Feedback to the appropriate level of authority on points a, b and c.

7. Regulations impose restraints on the investment policies and procedures of insurers by placing restrictions on the type of, and extent to which, certain asset classes may be used to cover technical provisions, and specific requirements on the matching of assets and liabilities vis-à-vis currency. Nevertheless, insurers should develop and operate overall asset management strategies, which take account of the need to ensure the existence of:

- a. The definition of a strategic investment policy by the Board of Directors, based on an assessment of the risks incurred by the company and its risk appetite;
- b. On-going Board and senior management oversight of, and clear management accountability for, investment activities;
- c. Comprehensive, accurate and flexible systems which allow the identification, measurement and assessment of investment risks, and the aggregation of those risks at various levels, for example for any separate portfolios held, for the insurance company and, as appropriate, at group level, at any given time. Such systems will vary from company to company, but should be:
 - sufficiently robust to reflect the scale of the risks and the investment activity undertaken;
 - capable of accurately capturing and measuring all significant risks in a timely manner;

- understood by all relevant personnel at all levels of the insurer;
- d. Key control structures, such as the segregation of duties, approvals, verifications, reconciliations;
- e. Adequate procedures for the measurement and assessment of investment performance;
- f. Adequate and timely communication of information on investment activities between all levels within the insurance company;
- g. Internal procedures to review the appropriateness of the investment policies and procedures in place;
- h. Rigorous and effective audit procedures and monitoring activities to identify and report weaknesses in investment controls and compliance.
- i. Procedures to identify and control the dependence on and vulnerability of the insurer to key personnel and systems.

3. Regulations and Guidelines for their Interpretation

8. Annex III of the European Communities (Non-Life Insurance) Framework Regulations 1994 (S.I. No. 359 Of 1994), and Annex V of the European Communities (Life Assurance) Framework Regulations 1994 (S.I. No. 360 Of 1994) aim to set standards for the valuation of assets appropriate to compliance with statutory solvency requirements, based essentially on realisable value.

9. Also, Annex III, together with Schedule 2 (Non-Life); and, Annex V, together with Schedule 7 (Life), are intended to encourage a prudent spread of insurance/assurance business assets without imposing undue restraints upon investment selection and management which might be disadvantageous to the company, or its policyholders. Regulations of this kind can be expected to achieve such a purpose only in a fairly broad manner. The mere fact that investments are within the permissible limits is no guarantee as to their suitability. The companies' management are responsible for their investment decisions which must be presumed to be dictated by, in addition to sound asset allocation policy, commercial profitability and, the policyholders' interests. It remains the duty of management, at all times, to satisfy themselves and, if required, to satisfy the Supervisor as to the suitability of a company's investment portfolio.

10. Schedules 2 (Non-Life Regulations) & 7 (Life Regulations) specify maximum percentage limits, on both individual and aggregate bases, on the admissibility of different categories of assets for representing technical reserves. The purpose of these limitations is to restrict the amounts acceptable as cover for technical reserves where there is considered to be too great a concentration of investment, either individually or in aggregate, in a particular asset or type of asset. It is important to note that the holding of amounts in excess of these limits is by no means prohibited but excess amounts must be left out of account for the purpose

of covering technical reserves. However, such "excess " assets may be readmitted for solvency purposes.

11. Where, in the case of a particular asset, a valuation rule is not explicitly given in the Regulations a nil value must be assigned to it. Accordingly, such items such as advance commission and goodwill must be excluded.

12. Life assurance linked assets are not required to be valued in accordance with Annex V (Life Regulations). Linked assets, including approved derivative instruments held in linked funds, are required to be valued in accordance with generally accepted accounting concepts, bases and policies appropriate for life assurance companies and in practice would be valued on the same basis as that adopted for the calculation of the corresponding property linked benefits. The definition of linked assets refers only to life assurance business as sets which are identified in a company's records as being as sets by reference to the value of which property linked benefits are to be determined - it should be noted that the definition of property linked benefits does not comprehend benefits linked to an index of the value of assets not so held and identified with the consequence that such index linked assets are treated as non-linked as sets.

4. Definition of the Investment Policy and Procedures

4.1 Board of Directors

13. The Board of Directors should be responsible for the formulation and approval of the strategic investment policy, taking account of the analysis of the asset/liability relationship, the insurer's overall risk tolerance, its long-term risk-return requirements, its liquidity requirements and its solvency position.

14. The investment policy, which should be communicated to all staff involved in investment activities, should in principle address the following main elements:

- a. The determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories;
- b. The establishment of limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency;
- c. The formulation of an overall policy on the selection of individual securities and other investment titles;
- d. The adoption of passive or more active investment management in relation to each level of decision making;
- e. In the case of active management, definition of the scope for investment flexibility, usually through the setting of quantitative asset exposure limits
- f. The extent to which the holding of some types of assets is ruled out or restricted where, for example, the disposal of the asset could be difficult due to the illiquidity of the market or where independent (i.e. external) verification of pricing is not available;
- g. An overall policy on the use of financial derivatives as part of the general portfolio management process or of structured products that have the economic effect of derivatives ;
- h. The framework of accountability for all asset transactions. refer to 'Guidelines for Insurance Companies on the Risk Management of Derivatives' issued by the Supervisor

15. The Board of Directors should also be responsible for establishing policies on related issues of a more operational nature, including:

- a. The choice between internal or external investment management, and, for the latter, the criteria for selection of the manager(s). Also, in case of external management, a choice usually needs to be made between having a segregated (discretionary) portfolio managed, or participating in a collective or pooled fund, or other indirect investment vehicles;
- b. The selection and use of brokers;
- c. The nature of custodial arrangements;
- d. The methodology and frequency of the performance measurement and analysis.

16. The Board of Directors should authorise senior management to implement the overall investment policy. The Board of Directors must, however, always retain ultimate responsibility for the company's investment policy and procedures, regardless of the extent to which associated activities and functions are delegated or, indeed, outsourced.

17. As part of the development of the asset management strategy the Board of Directors must also ensure that adequate reporting and internal control systems are in place, designed to monitor that assets are being managed in accordance with the investment policy and mandate(s), and legal and regulatory requirements.

The Board of Directors must ensure that:

- a. They receive regular information, including feedback from the company's risk management function, on asset exposures, and the associated risks, in a form which is understood by them and which permits them to make an informed judgement as to the level of risk on a mark-to-market basis;
- b. The systems provide accurate and timely information on asset risk exposure and are capable of responding to ad hoc requests;

- c. The internal controls include an adequate segregation of the functions responsible for measuring, monitoring and controlling investment activities from those conducting day to day asset transactions;
- d. Remuneration policies are structured to avoid potential incentives for unauthorised risk taking.

18. Where external asset managers are used, the Board of Directors must ensure that senior management is in a position to monitor the performance of the external managers against Board approved policies and procedures. External managers should be engaged under a contract that, inter alia, sets out the policies, procedures and quantitative limits of the investment mandate. The insurer must retain appropriate expertise and ensure that, under the terms of the contract, it regularly receives sufficient information to evaluate the compliance of the external asset manager with the investment mandate.

19. The Board of Directors should collectively have sufficient expertise to understand the important issues related to investment policy and should ensure that all individuals conducting and monitoring investment activities have sufficient levels of knowledge and experience.

20. At least annually, the Board of Directors should review the adequacy of its overall investment policy in the light of the insurance company's activities, and its overall risk tolerance, long-term risk-return requirements and solvency position.

4.2 Senior Management

21. The responsibility for the preparation of a written investment mandate(s) setting out the operational policies and procedures for implementing the overall investment policy established by the Board of Directors will frequently be delegated to senior management. The precise content of the mandate will be different for each insurance company but the level of detail should be consistent with the nature of the current regulatory constraint and complexity and volume of investment activity, and should specify as appropriate:

- a. The investment objective, and the relevant limits for asset allocation, and the currency allocation and policy; any relevant investment benchmarks should also be specified;
- b. An exhaustive list of permissible investments and, as appropriate, derivative instruments, including details of any restrictions as to markets (e.g. only securities listed at specified stock exchanges), minimum rating requirements or minimum market capitalisation, minimum sizes of issues to be invested in, diversification limits and related quantitative or qualitative limits;
- c. Details of whom is authorised to undertake asset transactions;
- d. Any other restrictions with which portfolio managers have to comply, for example maximum risk limits within the overall investment policy (or in terms of limits on the duration of the portfolio in the case of a fixed-income portfolio), authorized counterparties;
- e. The agreed form and frequency of reporting and accountability.

22. Supporting internal management procedures should be documented and include:

- a. Procedures for seeking approval for the usage of new types of investment instruments: the desirability of retaining the flexibility to utilise new investment instruments should be balanced with the need to identify the risks inherent in them and ensure that they will be subject to adequate controls before approval is given for their acquisition. The principles for measuring such risk, and the methods

of accounting for the new investments should be clarified in detail prior to approval being given for their acquisition;

- b. Procedures for the selection and approval of new counterparties and brokers;
- c. Procedures covering front office, back office, measurement of compliance with quantitative limits, control and reporting;
- d. Details of the action which will be taken by senior management in cases of noncompliance;
- e. Valuation procedures for risk management purposes;
- f. Identification of who should be responsible for the valuation.

Valuations should be carried out by individuals independent of those responsible for trade execution or, if this is not possible, valuations should be independently checked or audited on a timely basis.

Accounting and taxation rules should be taken into consideration in developing the above operational policies and procedures.

23. Senior management should ensure that all individuals conducting, monitoring and controlling investment activities are suitably qualified and have appropriate levels of knowledge and experience.

24. At least annually, senior management should review the adequacy of its written operational procedures and allocated resources in the light of the insurance company's activities and market conditions.

5. Monitoring and Control

5.1 Risk Management Function

25. Insurers should be capable of identifying, monitoring, measuring, reporting and controlling the risks connected with investment activities. This process should be performed by a risk management function with responsibility for:

- a. Monitoring compliance with the approved investment policy;
- b. Formally noting and promptly reporting breaches;
- c. Reviewing asset risk management activity and results over the past period;
- d. Reviewing the asset/liability and liquidity position

26. The risk management function should also assess the appropriateness of the asset allocation limits. To do this, regular resilience testing should be undertaken for a wide range of market scenarios and changing investment and operating conditions. Once an insurer has identified those situations to which it is most at risk, it should ensure that it feeds back appropriate amendments to the policies and procedures defined in its investment mandate in order to manage those risk situations effectively.

27. The risk management function should regularly report to appropriate levels of senior management and, as appropriate, to the Board of Directors. The reports should provide aggregate information as well as sufficient detail to enable management to assess the sensitivity of the company to changes in market conditions and other risk factors. The frequency of reporting should provide these individuals with adequate information to judge the changing nature of the insurer's asset profile, the risks that stem from it and the consequences for the company's solvency.

5.2 Internal Controls

28. Adequate systems of internal control must be present to ensure that investment activities are properly supervised and that transactions have been entered into only in accordance with the insurer's approved policies

and procedures. Internal control procedures should be documented. The extent and nature of internal controls adopted by each insurer will be different, but procedures to be considered should include:

- a. Reconciliations between front office and back office and accounting systems;
- b. Procedures to ensure that any restrictions on the power of all parties to enter into any particular asset transaction are observed. This will require close and regular communication with those responsible for compliance, legal and documentation issues in the insurer;
- c. Procedures to ensure all parties to the asset transaction agree with the terms of the deal. Procedures for promptly sending, receiving and matching confirmations should be independent of the front office function;
- d. Procedures to ensure that formal documentation is completed promptly;
- e. Procedures to ensure reconciliation of positions reported by brokers;
- f. Procedures to ensure that positions are properly settled and reported, and that late payments or late receipts are identified;
- g. Procedures to ensure asset transactions are carried out in conformity with prevailing market terms and conditions;
- h. Procedures to ensure that all authority and dealing limits are not exceeded and all breaches can be immediately identified;
- i. Procedures to ensure the independent checking of rates or prices: the systems should not solely rely on dealers for rate/price information.

29. The functions responsible for measuring, monitoring, settling and controlling asset transactions should be distinct from the front office functions. These functions should be adequately resourced.

30. Regular and timely reports of investment activity should be produced which describe the company's exposure in clearly understandable terms and include quantitative and qualitative information. The reports should,

in principle, be produced on a daily basis for senior management purposes; less frequent reporting may be acceptable depending on the nature and extent of asset transactions. Upward reporting by senior management is recommended on at least a monthly basis. Reports should at least include the following areas:

- a. Details of, and commentary on, investment activity in the period and the relevant period end position;
- b. Details of positions by asset type;
- c. An analysis of credit exposures by counterparty;
- d. Details of any regulatory or internal limits breached in the period and the actions taken thereto;
- e. Planned future activity;
- f. Details of the relative position of assets and liabilities.

5.3 Audit

31. Auditors should be expected to evaluate the independence and overall effectiveness of the insurer's asset management functions. In this regard, they should thoroughly evaluate the effectiveness of the internal controls relevant to measuring, reporting and limiting risks. Auditors should evaluate compliance with risk limits and the reliability and timeliness of information reported to senior management and the Board of Directors.

32. Auditors should also periodically review the insurer's asset portfolio and written investment policies and procedures to ensure compliance with the insurance company's regulatory obligations.

Appendix 3: LOCs and Inter-company Loans

Stand-by letters of credit or bank guarantees (hereinafter referred to as a “LOC”) are commonly used in the reinsurance sector as a secondary payment mechanism to guarantee performance or to strengthen credit worthiness. There are three principal parties to a LOC – the beneficiary, the applicant and the issuer. The beneficiary is the party entitled to receive payment under the LOC upon producing evidence of a failure to perform a contractual obligation. The applicant is the party that arranges for the issuance of the LOC and the issuer is the financial institution that contracts to pay the beneficiary. For the purposes of this paper and the Financial Regulator’s requirements herein, a LOC must comply with the following conditions:

- 1) the LOC must be direct, explicit, unconditional and irrevocable containing an evergreen clause whereby expiry is only allowed with a minimum of a 90 day prior notice by the issuer, and
- 2) the issuer is an undertaking without any close links to the life reinsurance undertaking and is an EEA or equivalent supervised credit institution with a long-term debt rating by a recognized rating agency of at least a Grade 3, as per [Appendix 7](#)

The following are examples of two ring-fencing arrangements involving the use of a LOC that meet the Financial Regulator’s requirements for the purposes of 3.4.1 herein:

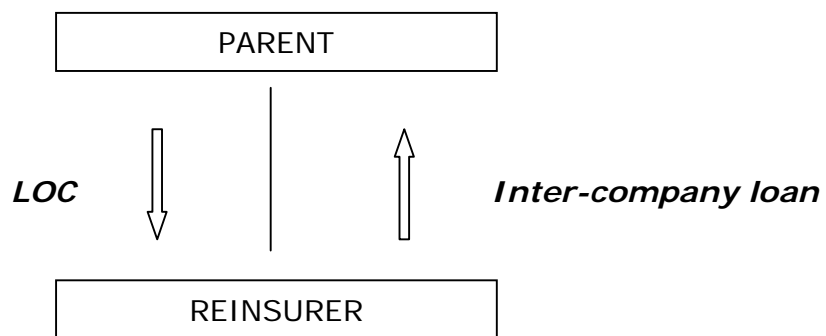
A) Arrangement A

Arrangement A is where a LOC is used to mitigate the credit risk of the borrower of the inter-company loan and where:

1. the life reinsurance undertaking is the beneficiary of the LOC, and
2. an undertaking other than the life reinsurance undertaking (e.g. the parent of the life reinsurance undertaking) is the applicant of the LOC, and

3. the LOC may be drawn-down by the life reinsurance undertaking without restriction, in the event of a failure of the borrower (as per 3.4.1 herein) to meet its obligations under the contractual arrangements governing the inter-company loan, and
4. the life reinsurance undertaking does not have a corresponding liability to repay the issuer or the applicant of the LOC the amount of any draw-down.

An example of this arrangement is where a life reinsurance undertaking loans a portion of its liquid assets back to its parent and the parent arranges for an LOC to be drawn up with the life reinsurance undertaking as the beneficiary in an amount equal to the loan. This arrangement is represented as follows:



B) Arrangement B

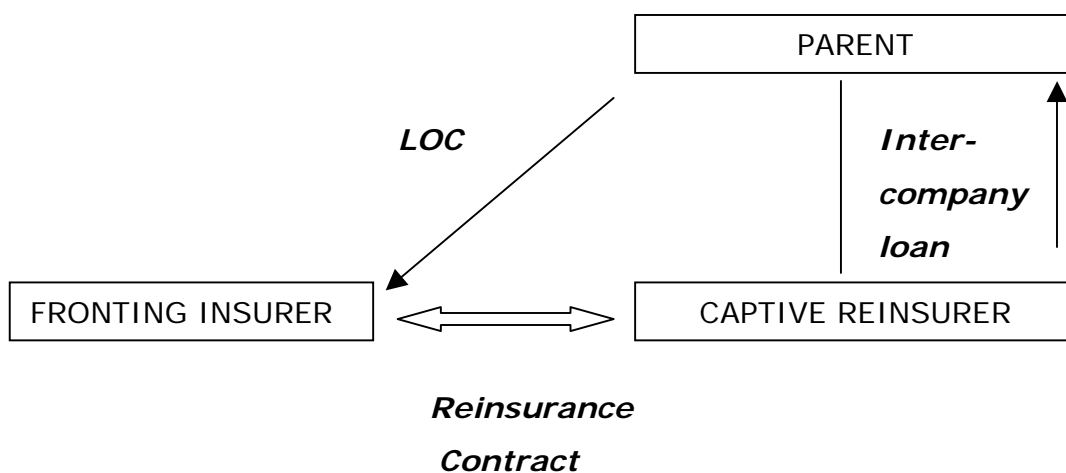
LOCs are sometimes used by life reinsurance undertakings, particularly captive reinsurance undertakings, to meet collateral requirements, to guarantee reinsurance contract performance and/or to strengthen credit worthiness. Arrangement B is where a LOC is used to support technical provisions due to a cession undertaking under a reinsurance contract issued by a life reinsurance undertaking. For the purposes of ring-fencing an inter-company loan, such a LOC may be “held” against an inter-company loan asset of a life reinsurance undertaking in an amount equal to the technical provision liability supported by the LOC where:

- a) the cession undertaking (e.g. fronting insurer) is the beneficiary of the LOC, and

- b) an undertaking other than the life reinsurance undertaking (e.g. the parent of the life reinsurance undertaking) is the applicant of the LOC, and
- c) in the event of a draw-down of the LOC by the cession undertaking, the corresponding technical provision liability of the life reinsurance undertaking is contractually extinguished by an amount equal to the draw-down, and
- d) the life reinsurance undertaking does not have any additional liability or assets pledged to repay the issuer of the LOC the amount of any draw-down.

An example of this arrangement is where a captive reinsurance undertaking enters into a reinsurance contract with a fronting insurer and the fronting insurer requires an LOC to be issued to it as the beneficiary to support any recoveries due under the reinsurance contract. The captive reinsurance undertaking may use this LOC to ring-fence an inter-company loan or deposit held against its technical provision liability to the fronting insurer provided there is a contractual arrangement (e.g. an addendum to the reinsurance contract) with the fronting insurer that in the event that it draws down on the LOC, the captive reinsurance undertaking's corresponding liability to the fronting insurer is extinguished (i.e. if it draws down on the LOC in relation to a particular liability then it cannot claim for this liability again on the reinsurance contract).

This arrangement is represented as follows:



Where the life reinsurance undertaking is the applicant of the LOC in Arrangement B above, the LOC may only be treated as a ring-fencing arrangement in an amount net of any collateral provided to the issuer by the life reinsurance undertaking and net of any future liability of the life reinsurance undertaking to repay the issuer any amounts drawn-down on the LOC.

Appendix 4: Available Solvency Margin Examples

The following examples are shown here for illustrative purposes only. They do not set down requirements or rules but merely set out how the available solvency margin may be calculated in the hypothetical cases outlined.

EXAMPLE 1

Assets	€ millions	Non - Admitted
Cash & Financial Investments	1	
Inter-company Loan	8	2
Other	1	
TOTAL	10	2
Liabilities		
Technical Provisions	7	
Corporation Tax Payable	1	
Shareholder Equity	2	
TOTAL	10	0
<i>"Net" Non-Admitted Asset</i>		0

In this example, the life reinsurance undertaking has an LOC of €6M to support an arrangement that meets the criteria of Arrangement B in [Appendix 3](#) and therefore €6M of the inter-company loan is deemed "ring-fenced" and may be admitted as an asset. The life reinsurance undertaking therefore has €8M of admitted assets, made up of cash & financial instruments of €1M plus €6M of admitted inter-company loan plus €1M of other admitted assets (e.g. debtors < 90 days).

The required solvency margin is the MGF of €1M and therefore the life reinsurance undertaking must have an available solvency margin of at least €1M. The life reinsurance undertaking decides that it is not prudent to net the inter-company loan that is not deemed to be "ring-fenced" (i.e. €2M) against the corporate tax payable. Therefore, when the shareholders funds are reduced by non-admitted asset of €2M, the available solvency margin of the life reinsurance undertaking is zero. The life reinsurance

undertaking must therefore ensure that €1M of the remaining €2M of non-admitted inter-company loan is ring-fenced or repaid by the borrower to meet its solvency requirements.

EXAMPLE 2

Assets	<i>€ millions</i>	Non - Admitted
Cash & Financial Investments	40	
Funds Withheld	20	10
Debtors	10	5
	70	15
Liabilities		
Technical Provisions	40	
Creditors from reinsurance operations	10	
Accruals	5	5
Shareholder Equity	15	
	70	5
<i>"Net" Non-Admitted Asset</i>		10

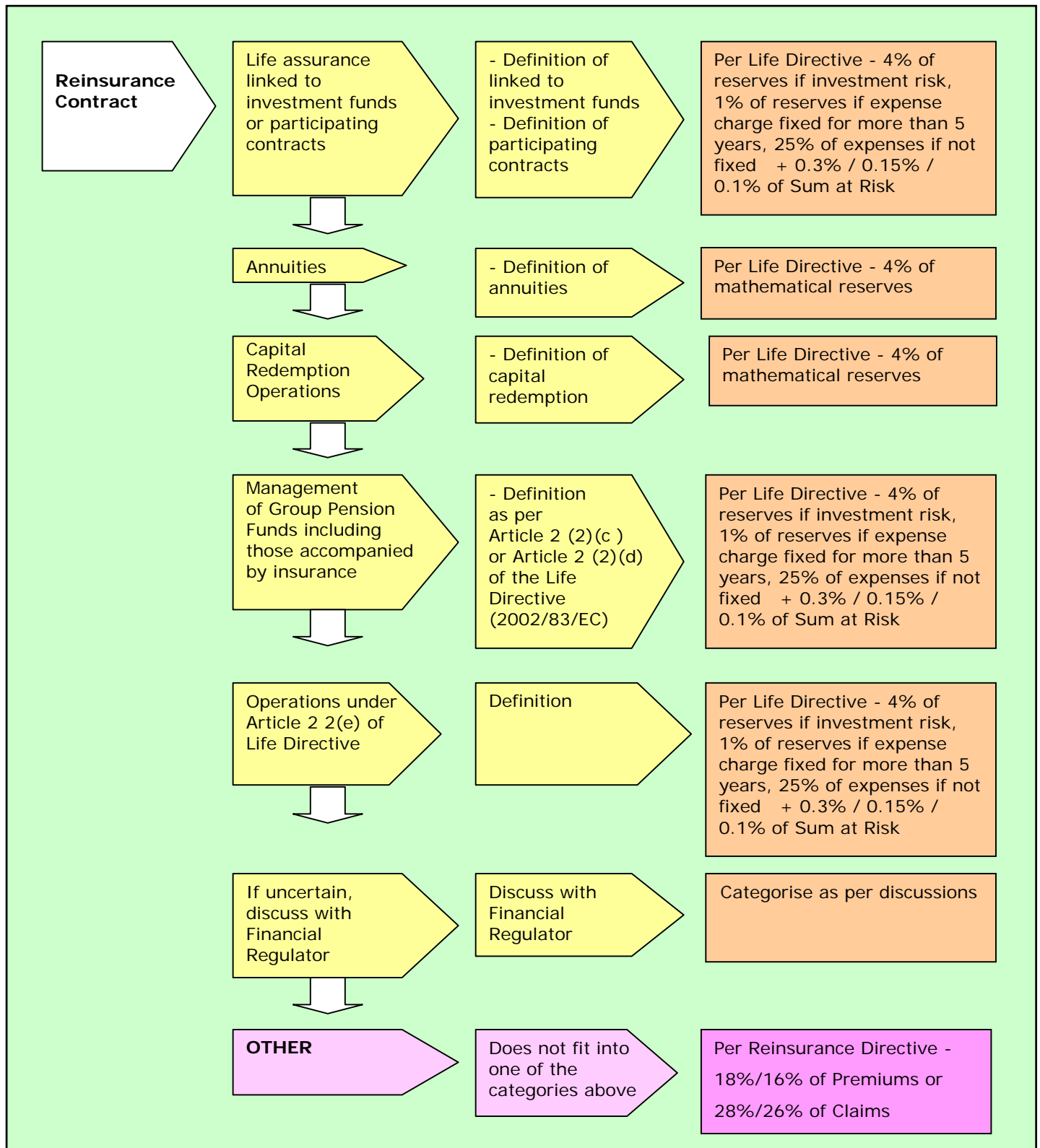
In this example, the life reinsurance undertaking has €5M out of the €10M of debtors that are non-group debtors that are 90 days overdue and therefore only €5M of the debtors can be used as admitted assets. The life reinsurance undertaking also has a funds withheld asset with a group company that does not meet the requirements in Chapter 3 (i.e. no letter of no objection has been received) and therefore only €10M of the Funds Withheld asset can be used as admitted assets. The total of the non-admitted assets is €15M and the total admitted assets is €55M.

The required solvency margin is €5M and therefore the life reinsurance undertaking must have an available solvency margin of at least €5M. In determining how much of the €15M of non-admitted assets should be deducted from shareholders equity, the life reinsurance undertaking makes the following decisions consistent with its prudent person approach:

- the life reinsurance undertaking decides that the €5M of accruals can be prudently netted against the €5M of non-admitted debtors.
- the life reinsurance undertaking decides that the remaining €10M of the non-admitted assets [i.e. the Funds Withheld] cannot be prudently netted against any of the remaining €10M of non-technical provision liability (e.g. creditors) on the basis that the Funds Withheld asset is contract specific and therefore cannot be prudently netted against non-related creditors.

Therefore, the non-admitted assets to be deducted from shareholders equity in this example is €10M (i.e. €15M less €5M) and the available solvency margin equals €5M, being the shareholders equity of €15M less €10M. In this example, the available solvency margin of €5M equals the required solvency margin and the life reinsurance undertaking is therefore in compliance with its solvency requirements.

Appendix 5: Methodology for determining solvency



Source: Watson Wyatt report "Solvency margin and reserving requirements for life reinsurance business", February 2006, commissioned by the Financial Regulator (a copy of this report is available on the Financial Regulator's website www.financialregulator.ie).

Appendix 6: Compliance Statement

The Board of Directors (the "Board") confirms that

- 1) The Board has reviewed the Annual Return for _____
("the Company") for the period ending _____.
- 2) Based on the Board's knowledge, the Annual Return does not contain any material errors or omissions.
- 3) Based on the Board's knowledge, the Annual Return, all regulatory forms and other information presented in the Annual Return fairly represents, in all material aspects, a true and fair picture of the condition of the Company.
- 4) Based on the Board's knowledge, the Company complies in all material respects with the requirements of Statutory Instrument 380 of 2006 and the requirements of the Financial Regulator relating to reinsurance undertakings.

Signed for and on behalf of the Board

(Signature)

(Print Name)

Date:

(Signature)

(Print Name)

Date:

Appendix 7: Credit Grades

The Grades applied by the Financial Regulator as follows²³:

Key	S&P	Moody's	AM Best	Fitch
Grade 1	AAA	Aaa	A++	AAA
Grade 2	AA+	Aa1	A+	AA+
	AA	Aa2		AA
	AA-	Aa3		AA-
Grade 3	A+	A1	A	A+
	A	A2	A-	A
	A-	A3		A-
Grade 4	BBB+	Baa1	B++	BBB+
	BBB	Baa2		BBB
	BBB-	Baa3		BBB-
Grade 5	BB+ or below	Ba1 or below	B+ or below	BB+ or below

²³A life reinsurance undertaking may nominate one or more of the rating agencies above to be used in determining all of its asset classifications. If there is more than one credit assessment available from the nominated rating agencies, then the lowest credit assessment must be selected.

Appendix 8: Asset Breakdown

	Grade 1	Grade 2	Grade 3	Grade 4	Grade 5	Valuation Basis
<i>Short-term Investments</i>						
<i>Government Bonds</i>						
<i>Municipal Bonds</i>						
<i>Corporate Bonds</i>						
<i>Residential Mortgage-Backed Securities</i>						
<i>Commercial Mortgage-Backed Securities</i>						
<i>Asset-Backed and Collateralised Securities</i>						
<i>Equity Shares (e.g. common stock)</i>						
<i>Preference Shares</i>						
<i>Other (please provide detail)</i>						

Notes:

- Short-term investments include securities bought and held for sale to generate income on short-term price differences.
- Examples of valuation basis include at cost, at fair market value, at intrinsic value, at amortized value, etc. Assets should be broken down between different valuation bases with each heading, if necessary.
- Where “Asset-backed and Collateralised Securities” is significant, a summary by underlying asset classes should be provided.
- Corporate credit ratings generally apply to debt in the capital structure of an undertaking. Some ratings apply to the financial strength of the undertaking (e.g. claims paying ability for insurance undertakings). Where there is no credit rating for equity or preference shares, the amounts should be inserted under Grade 5 above.





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