FINANCIAL REGULATOR
Rialtóir Airgeadais

Run-off of Reinsurance Undertakings
August 2006

Consultation Paper | CP21

Contents

1. Introduction 3
1.1 Scope of this paper 3
1.1.1 Making submissions 3
1.2 Implementation 4
2.1 Introduction 5
2.2 Requirements on entering run-off 5
2.2.1 Submit a Run-Off Plan 5
2.2.2 Submit an actuarial opinion 7
2.2.3 Draft Run-off Plan 7
2.2.4 Groups 7
2.2.5 Composite reinsurance undertakings 7
2.2.6 Partial run-off 7
2.3 On-going run-off requirements 8
2.3.1 Reporting requirements 8
2.3.2 Changes to Run-off Plan 8
2.3.3 Approval/No objection/Notification 8
2.3.4 On-going prudential supervision 8
2.3.5 Material related party transactions 9
2.3.6 Reductions below solvency in the run-off plan 9
2. Run-off Mechanisms 10
3.1 Run-off the liabilities 10
3.2 Commutations 11
3.3 Portfolio transfer 11
3.3.1 Portfolio transfer approvals 12
3.4 Purchase of retrocession 13
3.5 Change in ownership structure 14
3.6 Closing down the reinsurance undertaking 14
3. Outsourcing 15
4. Technical Provisions 17
APPENDIX 1: Definitions 18

Consultation Closed

1. Introduction

1.1 Scope of this paper

The reinsurance sector in Ireland is now formally regulated following the signing into Irish law on the 15th of July 2006 of Statutory Instrument 380 ("S.I. 380") transposing Council Directive 2005/68/EC ("Reinsurance Directive") of the 9th of December 2005. The Irish Financial Services Regulatory Authority ("Financial Regulator") is issuing this paper to provide guidance to the sector on the regulatory requirements for reinsurance undertakings in runoff.

Article 62 of the Reinsurance Directive provides that reinsurance undertakings that by the 10th of December 2007 have ceased to conduct new reinsurance contracts and exclusively administer their portfolio in order to terminate their activity shall not be subject to the Reinsurance Directive.

The Financial Regulator intends to request Section 22 of the Insurance Act 1989 (the Act) to be amended. Section 22 of the Act will apply to reinsurance undertakings that enter run-off prior to the 10th of December 2007 and post the 10th of December 2007. It is intended that a run-off reinsurance undertaking's authorisation will be restricted. The restricted authorisation will restrict the reinsurance undertaking from entering into new contracts of reinsurance, enable the undertaking to run-off its reinsurance business and will attempt to amend the regulatory requirements to reflect the economic reality of the run-off. Furthermore there is specific guidance on outsourcing of functions of the operation.

The scope of this paper refers to life, non-life and composite reinsurance undertakings that are currently authorised or due to be authorised by the Financial Regulator.

1.1.1 Making submissions

Please submit your comments in hardcopy as well as softcopy. When addressing any issue raised in this paper, please use the corresponding

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numbers in this paper to identify the section you are referring to. If you are raising an issue that we have not referred to in this paper, please indicate this in your submission.

Submissions should be clearly titled 'Run-off Reinsurance Undertakings' and submitted to:
Reinsurance Section
Insurance Supervision
Financial Regulator
P.O. Box 9138
College Green
Dublin 2

Email: **reinsurance@financialregulator.ie**
Tel: 01 410 4757

All submissions should be received on or before the 29th of September 2006

1.2 Implementation

For reinsurance undertakings that are authorised by the Financial Regulator, the requirements detailed in this paper apply upon amendment of Section 22 of the Act.

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Run-off Reinsurance Undertakings

2.1 Introduction

The Financial Regulator recognises that reinsurance undertakings may take a decision to cease to conduct new reinsurance contracts and exclusively administer their existing portfolio in order to terminate their activity. For the purposes of this paper, the Financial Regulator shall view such a reinsurance undertaking entering into run-off as a run-off reinsurance undertaking.

In the context of a run-off reinsurance undertaking, the Financial Regulator views its role as one to ensure fairness to stakeholders involved in a run-off and to develop a responsive regulatory system that enables companies to be run-off in an orderly and efficient manner.

In principal, a run-off reinsurance undertaking must submit a run-off plan, an actuarial opinion on its reserves and a request for any regulatory approvals required for specific transactions (e.g. commutations.) On-going supervision will be achieved through regulatory reporting and ongoing meetings with the run-off reinsurance undertaking. Any significant changes to the run-off plan should be agreed with the Financial Regulator in advance.

Once agreed, the Financial Regulator will restrict the authorisation of a run-off reinsurance undertaking to exclusively administer their existing portfolio in order to terminate their activity.

The Financial Regulator may, if appropriate, subsequent to a review of a reinsurance undertaking's financial situation exercise its powers under Section 22 of the Act. In certain circumstances this may involve an application to the Courts.

2.2 Requirements on entering run-off

2.2.1 Submit a Run-Off Plan

Within 28 days of the decision of the Board of Directors to enter run-off, the reinsurance undertaking must submit a run-off plan ("Run-off Plan") to include (but not be limited to):

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- Undertaking's run-off strategy.
- Forecast Profit and Loss account (to include estimates of managements expenses, general expenses, commissions, income and expenditure in respect to reinsurance cessions and acceptances).
- Forecast Balance Sheet.
- Forecast Statement of Capital Resources to cover underwriting liabilities, and minimum guarantee fund and the solvency margin required if subject to the Reinsurance Directive.
- Forecast Cash Flow Statement on a Gross basis.
- Outline the assumptions underlying the forecasts and the basis for adopting those assumptions.
- Identify any proposed material transactions with any related party.
- The forecasts should cover the entire period of the run-off.
- Provide details of any commutation, portfolio transfer or retrocession intended to be transacted or any other transaction that would materially affect the reserves of the reinsurance undertaking.

The run-off strategy must include a description of the main risks of the existing business with the strategy for managing those risks. The amount of detail should reflect the scale and complexity of the reinsurance undertakings' operations and the degree of risks involved.

The Forecast Profit and Loss Account and Balance Sheet should be prepared in accordance with Statutory Instrument No. 23/1996: European Communities (Insurance Undertakings: Accounts) Regulations.

The Forecast Statement of Capital Resources should be prepared in accordance with Article 37 and Article 38 of the Reinsurance Directive for non-life reinsurance undertakings and life reinsurance undertakings respectively[1] and Article 40 with respect to non-life, life and composite reinsurance undertakings.

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[1] For reinsurers simultaneously conducting non-life and life reinsurance the solvency margin should be calculated in accordance with Article 37 and Article 38 of the Reinsurance Directive respectively and summed.

The Run-off Plan must be signed by at least two executive directors of the reinsurance undertaking

2.2.2 Submit an actuarial opinion

The independent actuary's report must be prepared in accordance with the standards set by the Societies of Actuaries in Ireland. If the reinsurance undertaking is a composite reinsurance undertaking a separate life and non-life opinion is required.

2.2.3 Draft Run-off Plan

A reinsurance undertaking may discuss its plan in draft with the Financial Regulator. A submitted Run-off Plan that does not satisfy the Financial Regulator may result in the Financial Regulator exercising its powers in accordance with Section 22 of the Act.

2.2.4 Groups

If the reinsurance undertaking is submitting a Run-off Plan that is part of a group the Financial Regulator may request additional information in relation to other undertakings in the group if this is necessary to establish how the reinsurance undertaking will restore or continue to meet its regulatory requirements. The reinsurance undertaking should discuss with the Financial Regulator the nature of such information.

2.2.5 Composite reinsurance undertakings

A composite reinsurance undertaking should submit separate Run-off Plans and actuarial opinions for its life and non-life business.

2.2.6 Partial run-off

If a reinsurance undertaking ceases a class or line of reinsurance business, the Financial Regulator expects to be advised of this development. A reinsurance undertaking may submit Run-off Plan if it deems appropriate and the Financial Regulator may request a Run-off Plan if it deems appropriate. The Financial Regulator will not restrict an authorisation if the reinsurance undertaking continues to carry on reinsurance business within the undertaking.

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2.3 On-going run-off requirements

2.3.1 Reporting requirements

Run-off reinsurance undertakings will have to comply with regulatory reporting requirements applicable to reinsurance undertakings that are not in run-off. The Financial Regulator will advise on these requirements in more detail in due course.

2.3.2 Changes to Run-off Plan

Any material changes to the Run-off Plan require prior approval of the Financial Regulator and the reinsurance undertaking must:

- Notify the Financial Regulator of any matter that has happened or is likely to happen which represent a significant departure from the Run-off Plan submitted;
- Explain the nature of the departure and the reasons for it and provide revised forecast financial information in the Run-off Plan for its remaining term; or
- Include an amended Run-off Plan and explain the amendments and the reasons for them.

2.3.3 Approval/No objection/Notification

Certain specific transactions, (e.g. change of ownership, business transfers) may require specific approvals/no objections/notifications. Depending on the nature of the transaction, the Financial Regulator may require certain documentation. Details of the documentation for certain transactions are included in Section 3 below. Certain transactions may require liaison with regulatory bodies outside of this jurisdiction.

2.3.4 On-going prudential supervision

The Financial Regulator intends to adopt a risk-based approach to on-going prudential supervision of run-off reinsurance undertakings. It is envisages that this will include a review of regulatory reporting submissions, a financial review and on-site visits.

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2.3.5 Material related party transactions

A run-off reinsurance undertaking must notify the Financial Regulator 28 days before entering into or carrying out any material related party transaction unless the transaction is in accordance with the most recent Run-off Plan submitted to the Financial Regulator.

2.3.6 Reductions below solvency in the run-off plan

If a run-off reinsurance undertaking's solvency margin subsequently falls below that estimated in its Run-off Plan, the reinsurance undertaking must submit a revised Run-off Plan within 28 days and an explanation of how the issue arose, and how if at all, and by when it expects this situation to be rectified.

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2. Run-off Mechanisms

Once the decision is made to enter run-off, there is a variety of strategies to run-off the liabilities. The various options may lead to transactions that require specific approval of the Financial Regulator. As such, the Financial Regulator is providing indicative guidance of its approach in relation to these options. This is not an exhaustive list of options available and the Financial Regulator is receptive to other approaches.

In administering the existing portfolio there is a number of options available to the reinsurance company including inter alia;

1. run-off the liabilities until satisfied in full,
2. commute the portfolio,
3. portfolio transfer,
4. purchase retrocession,
5. sale of the reinsurance undertaking, and
6. closing the reinsurance undertaking down in accordance with company law.

3.1 Run-off the liabilities

If a reinsurance undertaking currently and expects in the future to comply with solvency requirements as outlined in the Reinsurance Directive and intends to fully meet liabilities to all policyholders, no additional regulatory requirements are envisaged outside of the requirements outlined in section 2.

If a reinsurance undertaking currently or is not expected in the future to be in a position to comply with solvency requirements as outlined in the Reinsurance Directive or to fully meet the liabilities to all policyholders the Financial Regulator will

- Firstly, discuss as part of the process of agreeing the Run-off Plan how the reinsurance undertaking intends to comply with its solvency requirements.
- Secondly, if no further capital is available to comply with its solvency requirements under the Reinsurance Directive, request as part of process of agreeing upon the Run-off Plan, a policy

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approved by the Board of Directors on how the reinsurance undertaking intends to deal fairly with its policyholders.
- Thirdly, if the Financial Regulator is not satisfied with the approach adopted by the Board of Directors, it may exercise its powers under Section 22 of the Act.

3.2 Commutations

In principle the parties to any commutation of a reinsurance contract(s) are expected to have a full understanding of the processes, risks and financial impacts of a commutation. Notwithstanding this fact, the following are required:

- The Board of Directors of the reinsurance undertaking must approve any commutation of a material reinsurance contract. The rationale for the commutation, including the financial analysis of the commutation, must be documented and maintained for review by the Financial Regulator, if requested.
- The reinsurance undertaking can only obtain relief from regulatory capital requirements if, upon completion, the commutation fully removes the reinsurance undertaking from any future obligations. If the commutation does not fully remove the reinsurance undertaking from future obligations no relief from regulatory capital requirements is allowed unless prior written approval is received from the Financial Regulator. The extent of relief from regulatory capital will depend on the extent to which there is a reduction in future obligations.

3.3 Portfolio transfer

Run-off reinsurance undertakings, by definition, are not permitted to accept inward reinsurance portfolio transfers (i.e. not permitted to be a transferee). For the reinsurance undertaking purchasing an outward reinsurance portfolio transfer (i.e. transferor):

1. It is intended that the Financial Regulator would liaise with the relevant competent authority of the transferee.
2. The maintenance by the transferee of the required solvency margin would be indicative of the transferee having the necessary financial strength.

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3. The transferor must submit the relevant documentation relating to the portfolio transfer to the Financial Regulator for prior approval.
4. The Financial Regulator will object to any portfolio transfer if the remaining creditors of the reinsurance undertaking are disadvantaged or the financial impact of the portfolio transfer is detrimental to the financial strength of the reinsurance undertaking.
5. The Financial Regulator will also consider the assets to be transferred together with the nature of the reinsurance portfolio to be transferred.
6. The Financial Regulator will require a legal confirmation that the liabilities associated with the portfolio have been fully transferred.
7. The Board of Directors will be required to approve a statement that no one creditor will be disadvantaged by the portfolio transfer
8. The Board of Directors of any party to the portfolio that are located in Ireland must also approve any material portfolio transfer.

3.3.1 Portfolio transfer approvals

a) Outward transfers to accepting offices[2] in another Member State

For outward portfolio transfers, Article 18 of the Reinsurance Directive indicates that if the transferee is an accepting office in another Member State, the Financial Regulator **shall** approve the transfer, if the competent authority of the other Member State certifies that after the transfer has been made, the accepting office will maintain the solvency margin required by the Reinsurance Directive.

It is expected that the competent authority of the accepting office would liaise with the Financial Regulator prior to the issuance of a certification relating to the solvency of the accepting office. In any correspondence with the relevant competent authority and granting any approval if necessary points 1 to 8 in 3.3 above will guide the Financial Regulator.

[2] Accepting Offices are considered reinsurance undertakings only by the Financial Regulator *unless the competent authority in another member state permits an undertaking to conduct insurance and reinsurance business in the same undertaking. It should be noted that the competent authority must certify that after the transfer the undertaking possesses the necessary solvency margin referred to in Chapter 3 of the reinsurance directive.*

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b) Outward transfers to accepting offices in Ireland

For outward portfolio transfers, if the transferee and the accepting office are reinsurance undertakings operating in Ireland, in addition to the requirements from point 3 to 8 above

- The accepting office may not be in run-off.
- The accepting must submit to the Financial Regulator a statement of solvency prior to the transfer and after the transfer.

c) Outward transfers to accepting offices outside the Member States

Subject to Article 49 of the Directive, points 1 to 8 in 3.3 above will guide the Financial Regulator.

d) Outward transfers to non-reinsurance undertakings

Currently, the Financial Regulator is not minded to approve outward transfers to non-reinsurance undertakings. However, the Financial Regulator is open to proposals that facilitates innovation, competitiveness and growth and is reflective of trends in international reinsurance markets.

3.4 Purchase of retrocession

In principle, the parties to any retrocession contract would be expected to have a full understanding of the processes, risks and financial impacts of a transaction. A run-off reinsurance undertaking must submit as part of the Run-off Plan:

1. Details of the retrocession purchased or planned;
2. A consideration of the financial strength of the retrocessionaire.
3. Any ongoing activities undertaken by the reinsurance undertaking should be summarized. These matters should be submitted as part of the Run-off Plan to the Financial Regulator.

Consultation Closed

Article 37 and Article 38 of the Reinsurance Directive will apply in consideration of the Required Solvency Margin. Article 34 of the Reinsurance Directive will apply in the consideration of Assets covering Technical Provisions. The Financial Regulator requires the prudent person approach be applied in the consideration of Assets covering Technical Provisions. Where the Financial Regulator may exercise discretion relating to the consideration of the required solvency margin and the assets covering technical provisions, the Financial Regulator will consider inter-alia; the financial strength of the retrocessionaire as evidenced by international rating agencies and it's knowledge of the market.

If the run-off reinsurance undertaking wishes to purchase a retrocession contract that is not included in its Run-off Plan and such retrocession has a material impact upon its Run-off Plan, then it must receive the Financial Regulator's prior approval for the retrocession.

3.5 Change in ownership structure

Any change in ownership structure must comply with Articles 19 to 23 of the Reinsurance Directive. Any request for approval should comply with the relevant requirements as outlined in the Reinsurance Directive.

3.6 Closing down the reinsurance undertaking

While ultimately a matter for the courts under Irish Company Law, the Financial Regulator should be involved in considering any proposal that falls within its remit. In its consideration of any proposal the Financial Regulator will be guided by the principals of:

- Policyholder protection as appropriate to a reinsurance undertaking; and
- Fairness of a proposal; and
- Market integrity in Ireland.

The Commercial Court in Ireland at a hearing on 15 March 2005 sanctioned the first solvent scheme of arrangement in respect of a reinsurance undertaking pursuant to the relevant Companies Acts.

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3. Outsourcing

The process of run-off may include outsourcing a number of functions to another undertaking or undertakings. In considering the outsourcing of a function or functions, the Financial Regulator notes the work the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) in aligning outsourcing requirements with those of Committee of European Banking Supervisor (CEBS) and the Committee of European Securities Regulators (CESR) to reduce supervisory burdens and streamline processes[3]. In this context the Financial Regulator will be minded of the High Level Principles on Outsourcing in the Committee of European Banking Supervisors Consultation Paper, as follows:

1. Strategic and Core management responsibility and function cannot be outsourced.
2. The ultimate responsibility for proper management of the risks associated with outsourcing lies with an outsourcing institution's senior executive management.
3. An outsourcing institution should take particular care when outsourcing material activities, i.e. activities of such importance that any weakness or failure in the provision of these activities could have a significant affect on its ability to meet its regulatory responsibilities and/or to continue in business. In such cases the outsourcing institution should pre-notify its supervisory authority.
4. There should be no restrictions on the outsourcing of non-material activities of an outsourcing institution.
5. The Outsourcing institution should have a policy on its approach to outsourcing, including contingency plans and exit strategies.
6. An outsourcing institution's policies should require it to manage the risks associated with its outsourcing arrangements.
7. All outsourcing arrangements should be subject to a formal and comprehensive contract.

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[3] The '3 Level 3 Committees', consisting of the Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), published on 6 February 2006 common cross-sector work program for 2006 that included Outsourcing.

8. In managing its relationship with an outsourced service provider an outsourcing institution should ensure that a service level agreement (SLA) is in place

Furthermore the Financial Regulator will consider:

- Whether the Financial Regulator has a right to information, and to conduct, or order, on-site inspections in an outsourcing service provider's premises.
- The Financial Regulator will take account concentration risk, where one outsourcing service provider provides outsourcing services to several authorised outsourcing institutions.
- The Financial Regulator will consider the risks associated with "chain" outsourcing (whereby the outsourcing service provider sub-contracts elements of the service to other providers).

The above points are extracted from the CEBS consultation paper referred to above. Outsourcing service providers should be aware of the definition of reinsurance mediation as outline in the Insurance Mediation Directive (2002/92/EEC).

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4. Technical Provisions

The minimum requirements are as follows;

1) Technical Provisions

Unless agreed otherwise in advance with the Financial Regulator

- The available solvency margin should comply with Article 36 of the Reinsurance Directive; and
- The required solvency margin shall be calculated in accordance with Articles 37 to 39 of the Reinsurance Directive; and
- The required guarantee fund shall be calculated in accordance with Article 40 of the directive; and
- Any other guidance issued by the Financial Regulator.

2) Equalisation Provisions

Unless agreed otherwise in advance with the Financial Regulator

- Equalisation reserves shall be calculated in accordance with Articles 33 of the Reinsurance Directive; and
- Any other guidance issued by the Financial Regulator.

3) Assets covering Technical Reserves.

Unless agreed otherwise in advance with the Financial Regulator

- Assets covering technical reserves should comply with Articles 34 of the Reinsurance Directive; and
- Any other guidance issued by the Financial Regulator.

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APPENDIX 1: Definitions

Composite reinsurer – A reinsurer simultaneously conducting non-life and life reinsurance.

Materiality - In considering whether a transaction materially affects the reserves of an undertaking, if the effect of entering the transaction, or a series of similar transactions, impacts upon the reserves by 5% of the reserves prior to entering the transaction(s) it is considered material in this context.

New Contracts effected under terms in subsisting contracts of insurance- New contracts exclude contracts effected under a term in a subsisting contract of reinsurance.

Run-Off – a reinsurance undertaking that has ceased to conduct new reinsurance contracts and exclusively administers their existing portfolio in order to terminate their activity.

Related Party[4] - A party is related to an undertaking if:

(a) directly, or indirectly through one or more intermediaries, the party:

(i) controls, is controlled by, or is under common control with, the undertaking (this includes parents, subsidiaries and fellow subsidiaries);

(ii) has an interest in the undertaking that gives it significant influence over the undertaking; or

(iii) has joint control over the undertaking;

(b) the party is an associate (as defined in IAS 28 Investments in Associates) of the undertaking;

(c) the party is a joint venture in which the undertaking is a venturer (see IAS 31 Interests in Joint Ventures);

(d) the party is a member of the key management personnel of the undertaking or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d);

(f) the party is an undertaking that is controlled, jointly controlled or significantly influenced by, or for which significant voting power

[4] As defined in accordance with International Financial Reporting Standards - IAS 24 Related Party Disclosures

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in such undertaking resides with, directly or indirectly, any individual referred to in (d) or (e); or

(g) the party is a post-employment benefit plan for the benefit of employees of the undertaking, or of any undertaking that is a related party of the undertaking.

A **related party transaction**[5] is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

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[5] As defined in accordance with International Financial Reporting Standards - IAS 24 Related Party Disclosures

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