



FINANCIAL REGULATOR
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Financial Reinsurance

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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 to outline and explain the regulatory requirements that will apply to those reinsurance undertakings carrying on "financial reinsurance", as defined herein.

1.2 Implementation

The requirements in this paper must be implemented in full no later than the 28th of September 2007.

1.3 Legal Basis

Chapter 3 contains a condition hereby imposed by the Financial Regulator under Regulation 12 of S.I. 380 on the authorisation of each authorised reinsurance undertaking established in the State in respect of any financial reinsurance business carried on by such a reinsurance undertaking. This condition is in addition to the minimum requirements of Schedule 1 of S.I. 380.

Chapter 4 contains a code of practice that the Financial Regulator proposes to be drawn up and issued under Section 117(1) of the Central Bank Act 1989. This code will apply to persons undertaking financial reinsurance, as defined herein, and subject to regulation pursuant to S.I. 380.

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

Any opinion in this paper may be amended or supplemented by the Financial Regulator from time to time.

Failure by a reinsurance undertaking to comply with the rules, standards and requirements 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.

Consultation Closed

2 Financial Reinsurance

2.1 Introduction

The Financial Regulator recognises that financial reinsurance has an important role to play in the reinsurance sector. The Financial Regulator does not wish to impose restrictions that will become a barrier to entry for legitimate reinsurance undertakings carrying on this business. As a result, the Financial Regulator needs to ensure that the sector is appropriately regulated and this paper outlines the regulatory regime for reinsurance undertakings carrying on financial reinsurance. Reinsurance undertakings that experience difficulties in interpreting specific elements of this paper should contact the Financial Regulator directly.

2.2 Definition

S.I. 380 defines reinsurance as the activity consisting of accepting risks ceded by an insurance undertaking, or by another reinsurance undertaking, and includes reinsurance.

S.I. 380 further defines finite reinsurance as reinsurance under which the explicit maximum loss potential, expressed as the maximum economic risk transferred, arising both from a significant underwriting risk and timing risk transfer, exceeds the premium over the lifetime of the contract by a limited but significant amount, together with at least one of the following two features:

- i) explicit and material consideration of the time value of money,
- ii) contractual provisions to moderate the balance of economic experience between the parties over time to achieve the target risk transfer.

For the purposes of this paper, financial reinsurance means reinsurance (as defined in S.I 380), whereby

- 1) there is not a sufficiently significant amount of underwriting and timing risk transfer to be classified as finite reinsurance (as defined in S.I 380), or
- 2) there is no underwriting and timing risk transfer but there is a financial risk transfer.

Reinsurance that is required to be accounted for, under generally accepted accounting principles (GAAP), as a deposit by the reinsurance undertaking comes within the scope of "financial reinsurance" except where such business falls within the parameters set by the reinsurance undertaking in its classification policy¹ for finite reinsurance.

¹ The requirements covering the classification of finite reinsurance are detailed in the papers "Non-Life Finite Reinsurance" and "Life Finite Reinsurance" issued by the Financial Regulator in June 2007.

3 Solvency Margin Condition

The Financial Regulator hereby imposes under Regulation 12 of S.I. 380 a condition on the authorisation of each authorised reinsurance undertaking established in the State where the required solvency margin ("Required Solvency Margin") to be held in respect of financial reinsurance business under Schedule 1 of S.I. 380 equals zero², then an additional solvency margin ("Additional Solvency Margin") must be held according to the provisions of this Chapter 3 below.

3.1 Additional Solvency Margin

An Additional Solvency Margin, where applicable, must be held according to the provisions of this Chapter 3, the calculation of which depends upon whether the financial reinsurance covers non-life or life classes of business.

3.1.1 Non-Life Financial Reinsurance

For financial reinsurance covering non-life classes of business ("Non-Life Financial Reinsurance"), the Additional Solvency Margin must be determined on the basis of the Augmented Solvency Model for non-life finite reinsurance ("ASM_{NLFR}"), as defined in and according to requirements of 4.1 Required Solvency Margin in the Financial Regulator paper entitled "Non-Life Finite Reinsurance", dated June 2007 (the "NLFR paper"). When making such a determination, the following principles must be adhered to:

- 1) When calculating the Investment Charge (A) under 4.2.1 of the NLFR paper, the reinsurance undertaking must calculate A using the

² Where the financial reinsurance is accounted as a deposit and the premium and reserve figures allowed by the Financial Regulator in the calculation of the required solvency margin under Regulation 23 (1) (b) of S.I. 380 are zero, then the required solvency margin will be zero.

- market value of the relevant assets held against business classified as financial reinsurance.
- 2) When calculating the Underwriting Charge (B) under 4.2.2 of the NLFR paper, the reinsurance undertaking must calculate B using estimates for the premiums (payments made to or due to the reinsurance undertaking by the cession undertaking) and reserves (payments made to or due to the cession undertaking by the reinsurance undertaking) in a manner consistent with the contractual agreement(s) in place with the cession undertaking(s), while always having regard to the prudent person principle.
 - 3) When calculating the Operational Charge (C) under 4.2.3 of the NLFR paper, the reinsurance undertaking must calculate C using estimates for the premiums and reserves as per 2) above.

The reinsurance undertaking may pool a number of financial reinsurance contracts together for the purpose of calculating the Additional Solvency Margin, provided the financial reinsurance contracts have similar transaction structures, coverages and terms. An estimate for the weighted average maximum possible present value rate on line for the pool may be calculated provided the estimate is tested for reasonableness. If the reinsurance undertaking uses a number of different calculations to arrive at the estimate for the pool, the calculation that results in the highest solvency must be used. Alternatively the lowest R (as defined in 2.3.2 of the NLFR paper) in the pool may be used.

3.1.2 Life Financial Reinsurance

For financial reinsurance covering life classes of business ("Life Financial Reinsurance"), the Additional Solvency Margin must be determined on the basis of the Augmented Solvency Model for life finite reinsurance ("ASM_{LFR}"), as defined in and according to requirements of 4.1 Required Solvency Margin³ in the Financial Regulator paper entitled "Life Finite

³ To include any protection components under 4.2 of the paper "Requirements for Reinsurance Undertakings carrying on Life Reinsurance including transitional requirements" that have a zero required solvency margin under Regulation 23 (1) (b) of S.I. 380.

Reinsurance”, dated June 2007 (the “LFR paper”). When making such a determination, the reinsurance undertaking may:

- 1) pool similar financial reinsurance contracts together for the sake of calculating the Additional Solvency Margin, provided the financial reinsurance contracts have similar transaction structures, coverages and terms.
- 2) only apply those stress tests of 4.1 in the LFR paper that are relevant to the contractual agreement(s) in place with the cession undertaking(s), while always having regard to the prudent person principle.

3.2 Disclosures

Reinsurance undertakings carrying on financial reinsurance must disclose to the Financial Regulator information on the credit risk and liquidity risk in their financial reinsurance business. This disclosure is required under Regulation 21 of S.I. 380 and is detailed in the Regulatory Returns section of this paper (Chapter 5).

Where any of the disclosures cover issues that are deemed to be material⁴ to the business of the reinsurance undertaking under the prudent person principle, the strategies developed by the reinsurance undertaking to counter any risks and, where available, the calculations used to quantify such risks must also be disclosed to the Financial Regulator.

⁴ Material here is material to the portfolio of financial reinsurance business of the reinsurance undertaking.

4 Code of Practice

The Financial Regulator proposes that the provisions of this Chapter will be drawn up and issued as a code of practice pursuant to Section 117(1) of the Central Bank Act 1989. This code will apply to persons undertaking financial reinsurance the subject of S.I. 380 or otherwise the subject of supervision by the Financial Regulator.

1. A reinsurance undertaking must be transparent in the conduct of financial reinsurance business.
2. A financial reinsurance contract must reflect the substance of the agreement between the reinsurance undertaking and the cession undertaking.
3. A financial reinsurance contract must be drafted in clear and comprehensive terms. At a minimum, the contract must detail the type of reinsurance provided by the reinsurance undertaking and the risks being covered, including the nature of any subsections, and terms and conditions of the contract must not be set out in a manner that confuses the substance of the transaction.
4. A financial reinsurance contract must contain provisions equivalent to those required for finite reinsurance contracts under Regulation 62 of S.I. 380.

5 Regulatory Returns

5.1 Disclosures

These disclosures are required under Regulation 21 of S.I. 380 for a reinsurance undertaking carrying on financial reinsurance. Where any of the following disclosures cover issues that are deemed to be material to the business of the reinsurance undertaking under the prudent person principle, the strategies developed by the reinsurance undertaking to counter any risks and, where available, the calculations used to quantify such risks must also be disclosed to the Financial Regulator.

The Financial Regulator may adjust the Additional Solvency Margin in section 3.1 of this paper based upon the following disclosures:

5.1.1 Credit Risk Disclosure

The Financial Regulator requires reinsurance undertakings carrying on financial reinsurance to disclose any significant credit risks that the reinsurance undertaking faces in its business. Credit risk in this context means the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion. In particular, the Financial Regulator requires reinsurance undertakings carrying on financial reinsurance to disclose in relation to their financial reinsurance business the number of counterparties, the credit ratings of the different counterparties, and the maximum possible loss in the event of default of each of the counterparties.

5.1.2 Liquidity Risk Disclosure

The Financial Regulator requires reinsurance undertakings carrying on financial reinsurance to disclose any significant liquidity risks that the reinsurance undertaking faces over the next 24-month period on their life finite reinsurance business and how these will be mitigated, controlled and monitored. Liquidity risk in this context means the ease with which an

asset can be converted into cash to pay its liabilities without negative impact.

5.2 Returns

Pursuant to Regulation 21 of S.I. 380, the returns, documents and information specified in this Chapter 5 are hereby required to be lodged with the Financial Regulator by an authorised reinsurance undertaking established in the State carrying on financial reinsurance.

By the 28th of September 2007, and thereafter within 4 months after the end of the reinsurance undertaking's financial year (beginning with the first financial year ending on or after the 31st of December 2007), the following information must be submitted to the Financial Regulator in relation to the most recently audited financial year:

- 1) Detailed calculations under Chapter 3: Prudential Rules, to include:
 - a) A description of the methodology and assumptions used in any of the calculations.
 - b) The disclosures required under section 3.2 (and detailed in section 5.1) of this paper.
- 2) A detailed breakdown of the financial reinsurance business by:
 - i) Geographical spread of business (including geographical spread of underlying business and domicile of cession undertaking).
 - ii) Type of financial reinsurance contract (i.e. whether the contract falls under 1) or 2) of the definition of financial reinsurance in Chapter 2 of this paper; also if under 2), the type of financial risk covered).
 - iii) Underlying class of business.
- 3) Any other material information (for example, actuarial and other relevant reports, hedging strategies against credit or financial risks, and the results of significant stress tests performed on the

reinsurance undertaking's portfolio of financial reinsurance business).

In an individual case or circumstance, the Financial Regulator may specify to a reinsurance undertaking carrying on financial reinsurance more frequent reporting intervals.

5.3 Prescribed Forms

The Financial Regulator will publish separately detailed forms required for the reporting of reinsurance undertakings that will set out the detail of information to be reported and the accounting basis to be applied.

Consultation Closed



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