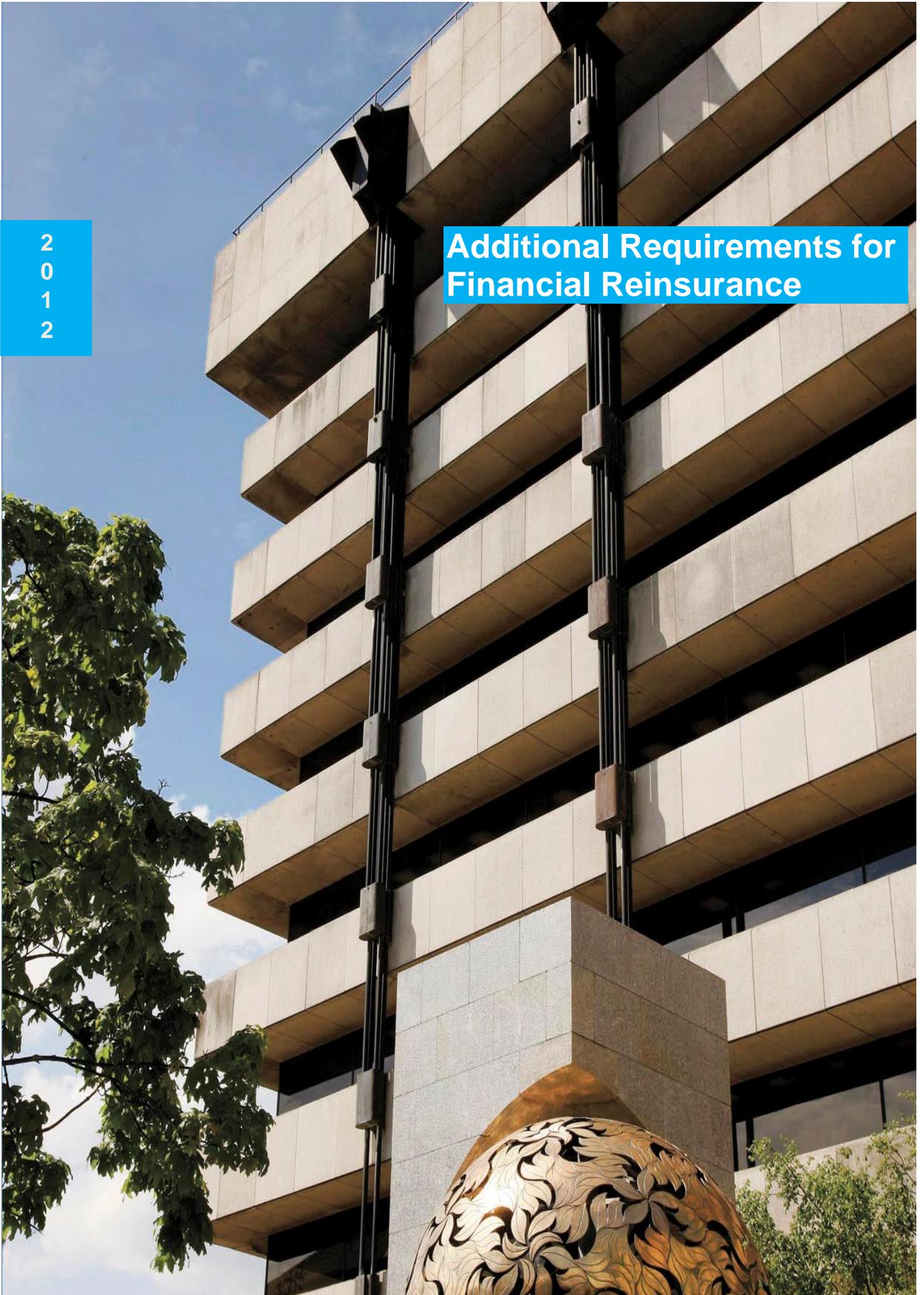


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## Additional Requirements for Financial Reinsurance



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# 1 Introduction

## 1.1 Scope

On the 15<sup>th</sup> of July 2006, Statutory Instrument 380 of 2006 ("S.I. 380") transposed into Irish law Council Directive 2005/68/EC ("Reinsurance Directive").

In addition to S.I. 380, reinsurance undertakings are also subject to the requirements<sup>1</sup> issued by the Central Bank of Ireland ("Central Bank").

All reinsurance undertakings, with the exception of captive reinsurance undertakings and special purpose reinsurance vehicles (SPRVs), are also subject to the opinion of the Central Bank for the purposes of Regulation 20 of S.I. 380 as outlined in the paper "Corporate Governance Code for Credit Institutions and Insurance Undertakings 2010" (hereinafter referred to as the "2010 Corporate Governance Code"). For the purposes of Regulation 20 of S.I. 380, captive reinsurance undertakings are subject to the Corporate Governance Code for Captive Insurance and Captive Reinsurance Undertakings 2011 ("Captive Code")<sup>2</sup>.

The Central Bank acknowledges that the term "financial reinsurance" as commonly used in industry encompasses a wide range of reinsurance contract structures. The International Association of Insurance Supervisors ("IAIS") Guidance Paper No 11 issued October 2006 entitled "Guidance Paper on Risk Transfer, Disclosure and Analysis of Finite Reinsurance" (available at [www.iaisweb.org](http://www.iaisweb.org)) illustrates the differing interpretations across and within the life and non-life reinsurance sectors. Appendix III of the IAIS paper highlights the differing definitions used by industry practitioners.

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<sup>1</sup> Please refer to the papers "Requirements for Non-Life Reinsurance Undertakings" "Requirements for Life Reinsurance Undertakings" or "Requirements for Composite Reinsurance Undertakings", whichever applicable, on the Central Bank of Ireland's website ([www.centralbank.ie](http://www.centralbank.ie)).

<sup>2</sup> References to the 2010 Corporate Governance Code and the Captive Code include any amended or updated papers that may supersede those papers and which are available on the Central Bank of Ireland's website ([www.centralbank.ie](http://www.centralbank.ie)).

As a supplement to the applicable requirements outlined above, the Central Bank is issuing this paper to outline the regulatory requirements that will apply to those reinsurance undertakings carrying on financial reinsurance, as defined herein. This paper dated December 2012 updates and replaces the paper dated January 2010 published by the Central Bank.

The Central Bank also acknowledges that reinsurance undertakings operate within an evolving global reinsurance marketplace. For reinsurance undertakings that currently do not carry on financial reinsurance, opportunities may arise in the future to do so, depending upon market circumstance. For such reinsurance undertakings, the requirements in this paper must be implemented as soon as is practical, but not later than their next reporting date to the Central Bank or otherwise as agreed by the Central Bank, following the entering into a financial reinsurance contract(s) that would make the reinsurance undertaking subject to the requirements of this paper.

Reinsurance undertakings that experience difficulties in interpreting specific elements of this paper should contact the Central Bank directly.

## 1.2 Legal Basis

Chapter 3 contains a condition hereby imposed by the Central Bank under Regulation 12 of S.I. 380 on 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 conditions hereby imposed by the Central Bank under Regulation 12 of S.I. 380 on each authorised reinsurance undertaking established in the State in respect of any financial reinsurance business carried on by such a reinsurance undertaking.

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

Any opinion in this paper may be amended or supplemented by the Central Bank 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.

## 2 Financial Reinsurance

For the purposes of this paper, the Central Bank hereby defines financial reinsurance to mean reinsurance, as defined in S.I. 380, where

- i) there is not a sufficiently significant amount of underwriting or timing risk transfer to be classified as finite reinsurance<sup>3</sup>, as defined in S.I. 380, or
- ii) there is no underwriting or timing risk transfer but there is a financial risk transfer.

An exemption to the definition above is proportional reinsurance business where i) or ii) applies and the loss potential of the business ceded under the reinsurance contract is proportionally transferred from the cession undertaking to the reinsurance undertaking. Such reinsurance is not subject to the requirements of this paper.

All references to a reinsurance contract herein includes the terms and conditions of the reinsurance contract combined with those of any related contract. A related contract in this context means a contract that alters the commercial effect of a reinsurance contract between parties without any close links and is entered into between the parties to the reinsurance contract, or between those parties and a person with whom either of those parties has a close link. Examples of a related contract include a side letter that link the economic performance of separate reinsurance contracts or a mirror reinsurance contract that negates, in part or in whole, the economic effect of the original reinsurance contract.

A retrocession contract, as defined in S.I. 380, between the reinsurance undertaking and another 3<sup>rd</sup> party reinsurance undertaking (or an SPRV) would not, in the Central Bank's opinion, fall within Regulation 62 of S.I.

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<sup>3</sup> Please refer to the papers "Additional Requirements for Non-Life Finite Reinsurance" or "Additional Requirements for Life Finite Reinsurance", whichever applicable, dated December 2012 (or any subsequent amended or updated papers that may supersede the 2012 papers) which are available on the Central Bank of Ireland's website ([www.centralbank.ie](http://www.centralbank.ie)).

380 as a related contract. Such a retrocession may become a related contract if the risk(s) covered by such a retrocession contract is further indemnified in whole or in part by another reinsurance undertaking controlled by the original reinsurance undertaking or any other undertaking or persons linked to the original reinsurance undertaking<sup>4</sup>.

A reinsurance undertaking that experiences a difficulty in determining whether a contract is a related contract should consult their legal advisor(s)<sup>5</sup> and, where such difficulties persist, may contact the Central Bank directly with a summary of the issue(s) from their legal advisor(s).

For the avoidance of doubt, “fronting” arrangements whereby the risk(s) assumed by a reinsurance undertaking from a cession undertaking is retroceded to another reinsurance undertaking through a retrocession contract is not, in the Central Bank’s opinion, a financial reinsurance contract provided:

- a) such a retrocession contract is not a related contract, and
- b) the reinsurance contract between the cession undertaking and the reinsurance undertaking does not fall within the meaning of financial reinsurance herein.

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<sup>4</sup> This refers to arrangements such as to circular contracts that are designed to look like an ordinary retrocession contract that cedes risk to a 3<sup>rd</sup> party retrocessionaire but where in fact the risk is retroceded again back to the original reinsurance undertaking or a party with close links to the original reinsurance undertaking.

<sup>5</sup> Such legal advisor may be an employee of the reinsurance undertaking, an affiliate of the reinsurance undertaking, or an external advisor.

## 3 Solvency Condition

Reinsurance undertakings must determine the required solvency margin ("Required Solvency Margin") to be held in respect of reinsurance business under Schedule 1 of S.I. 380 and as outlined in the requirements of the Central Bank<sup>1</sup>.

Although the risk profile of financial reinsurance business is by definition limited<sup>6</sup>, an adequate amount of solvency margin must be applicable to all financial reinsurance business as the definition of financial reinsurance, as per Chapter 2 herein, requires that some risk be present to comply with the definition of reinsurance, as per S.I. 380. As a result, the Central Bank hereby imposes, under Regulation 12 of S.I. 380, an additional solvency margin ("Additional Solvency Margin") condition on each authorised reinsurance undertaking, established in the State, where the Required Solvency Margin to be held in respect of financial reinsurance business under the applicable requirements of the Central Bank<sup>1</sup> equals zero<sup>7</sup>.

### 3.1 Additional Solvency Margin

The 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 where applicable must be determined on the basis of the Augmented Solvency Model for

<sup>6</sup> Although the amount of underwriting risk transfer may be insignificant, by definition, the amount of financial risk transfer may vary considerably depending upon the particular contract structure.

<sup>7</sup> Where the financial reinsurance is accounted for as a deposit and the premium and reserve figures allowed by the Central Bank in the calculation of the required solvency margin under Regulation 23 (1) (b) of S.I. 380 are zero, then the required solvency margin may be zero.

non-life finite reinsurance (“ASM<sub>NLFR</sub>”), or on the basis of an internal model, as outlined in the requirements of the Central Bank<sup>8</sup>.

When making such a determination using the ASM<sub>NLFR</sub>, the following principles must be adhered to:

- 1) When calculating the Investment Charge (A) under section 4.2.1 of the “Non-Life Finite Reinsurance” paper, the reinsurance undertaking must calculate A using the value of the relevant assets held against business classified as financial reinsurance.
- 2) When calculating the Underwriting Charge (B) under section 4.2.2 of the “Non-Life Finite Reinsurance” paper, the net written premium and the net outstanding claim reserve used for any calculation in this Chapter must be determined on the basis of the contractual provisions in place between the parties rather than how the contract(s) may be accounted for in the financial statements of the reinsurance undertaking. Where there is a difference in the contractual provisions and the accounting treatment, the reinsurance undertaking may make such a determination according to a reasonable and prudent methodology.
- 3) When calculating the Operational Charge (C) under section 4.2.3 of the “Non-Life Finite Reinsurance” paper, the reinsurance undertaking must calculate C using the determination of 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

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<sup>8</sup> Please refer to the paper “Additional Requirements for Non-Life Finite Reinsurance”, dated December 2012 (or any subsequent amended or updated paper that may supersede the 2012 paper), on the Central Bank of Ireland’s website ([www.centralbank.ie](http://www.centralbank.ie)).

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 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 where applicable must be determined on the basis of the Augmented Solvency Model for life finite reinsurance ("ASM<sub>LF</sub>"), or on the basis of an internal model, as outlined in the requirements of the Central Bank<sup>9</sup>. When making such a determination, the reinsurance undertaking may:

- 1) only apply those stress tests of 4.2 in the "Life Finite Reinsurance" 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. For example, if a life financial reinsurance contract only contains mortality risk then only those stress tests that apply to mortality risk need to be applied.
- 2) in the event that an add-on to the total additional capital ( $S_+$ ) is applicable, then  $S_+$  must be calculated on the basis of the quantifiable risks of the life financial reinsurance business (for the purpose of any submission to be made) or on the basis of the value of the relevant assets held against business classified as financial reinsurance (for the Investment Charge calculation).

Reinsurance undertakings that experience difficulties in applying the stress tests should contact the Central Bank directly<sup>10</sup>.

<sup>9</sup> Please refer to the paper "Additional Requirements for Life Finite Reinsurance", dated December 2012 (or any subsequent amended or updated paper that may supersede the 2012 paper), on the Central Bank of Ireland's website ([www.centralbank.ie](http://www.centralbank.ie)).

<sup>10</sup> Where a reinsurance undertaking is not in a position to apply some or all of the applicable stress tests due to data or technical difficulties, the reinsurance undertaking should contact the Central Bank in writing explaining the situation and detail how the reinsurance undertaking has assessed the risk(s) given the difficulties in applying the stress tests.

## 3.2 Disclosures

Reinsurance undertakings are subject to the standard reporting requirements of the Central Bank<sup>1</sup>.

Reinsurance undertakings carrying on financial reinsurance must disclose to the Central Bank supplementary information on the financial risk(s) 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).

The Central Bank may adjust the Additional Solvency Margin in section 3.1 herein based upon such a disclosure.

## 4 Conduct Conditions

The Central Bank hereby imposes, under Regulation 12 of S.I. 380, the conditions contained herein, concerning the conduct or carrying on of financial reinsurance, as defined herein, on each authorised reinsurance undertaking established in the State.

The conditions, specified herein, shall apply as soon as is practicable for all authorised reinsurance undertakings but, in any event, not later than the 1<sup>st</sup> of October 2008.

An authorised reinsurance undertaking established in the State shall not enter into a financial reinsurance contract<sup>11</sup> unless the following conditions have been satisfied:

- a) The financial reinsurance contract between the reinsurance undertaking and the cession undertaking reflects the substance of the agreement between the parties.
- b) The financial reinsurance contract must contain disclosure provisions equivalent to those required for finite reinsurance contracts under Regulation 62 of S.I. 380.

Furthermore, the Central Bank hereby imposes, under Regulation 12 of S.I. 380, a conduct requirement that a reinsurance undertaking, established in the State, carrying on financial reinsurance must have a written policy for the classification of financial reinsurance business, as defined herein (hereinafter referred to as the "Classification Policy").

The Board of Directors must approve the Classification Policy and any subsequent amendments to the policy. The classification of reinsurance contracts as financial reinsurance is a matter for the reinsurance undertaking to determine based upon the substance of the financial

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<sup>11</sup> All references to reinsurance contract herein includes the terms and conditions of the reinsurance contract combined with those of any related contract, as per Chapter 2 herein.

reinsurance contracts written or to be written by the reinsurance undertakings. The Board of Directors is responsible for ensuring that such a policy, and any procedures included therein, is implemented and monitored by the relevant professional staff throughout the organisation.

Upon approval by the Board of Directors, a copy of the Classification Policy, and any subsequent amendments to the policy, must be sent to the Central Bank as soon as is practicable.

# 5 Regulatory Returns

## 5.1 Annual Returns

Pursuant to Regulation 21 of S.I. 380, the information specified in this Chapter 5 is hereby required to be lodged with the Central Bank by an authorised reinsurance undertaking established in the State carrying on financial reinsurance under item 7) of the Annual Return, as per the standard reporting requirements of the Central Bank <sup>1</sup>.

The information required in respect of the financial reinsurance business of the reinsurance undertaking is as follows (and must be clearly marked as information pertaining to financial reinsurance business):

- 1) In respect of Chapter 3: Solvency Condition,
  - a. the calculations required under section 3.1 of this paper (such calculations to be supplied in electronic form where possible), and
  - b. the disclosures required under section 3.2 (and detailed in section 5.2) of this paper.
- 2) A copy of the Classification Policy under Chapter 4, if such has not already been submitted to the Central Bank, or details of any amendments or Board review of the Classification Policy.
- 3) Details of any material issues that have arisen in the preparation of the Annual Return or otherwise in respect of the financial reinsurance business of the reinsurance undertaking.

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

## 5.2 Disclosures

The Central Bank requires an additional financial risk disclosure under Regulation 21 of S.I. 380 for a reinsurance undertaking carrying on financial reinsurance.

Where the financial risk disclosure indicates an economic loss potential that is material<sup>12</sup> to the business of the reinsurance undertaking under the prudent person principle, the strategies developed by the reinsurance undertaking to counter any such risk(s) must also be disclosed to the Central Bank.

The Central Bank may adjust the Additional Solvency Margin in section 3.1 of this paper based upon the disclosure.

### 5.2.1 Financial Risk Disclosure

The Central Bank requires reinsurance undertakings carrying on financial reinsurance to disclose any significant financial risk(s) facing their business as a direct result of entering such financial reinsurance business.

Financial risk, in this context, shall mean any risk that may have an economic impact, other than the underwriting and timing risk, assumed by the reinsurance undertaking by entering into a financial reinsurance contract. For the purposes of the disclosure required herein financial risk shall include, at a minimum, credit risk and liquidity risk.

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 Central Bank 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

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<sup>12</sup> "Material" in this context must be determined by the reinsurance undertaking. The Central Bank's view is that material in this context is an economic loss potential that exceeds 5% of the reinsurance undertaking's available solvency margin. This view does not however imply that a lesser amount is necessarily immaterial.

counterparties, and the maximum possible loss in the event of default of each of the counterparties.

Liquidity risk in this context means the ease with which an asset can be converted into cash to pay its liabilities without negative impact. The Central Bank 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 financial reinsurance business and how these will be mitigated, controlled and monitored.

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