INSURANCE - INDIA

Overview of Reinsurance Expert Committee's 2017 report

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AUTHORS

Celia Jenkins

Priya Misra

Introduction

The Indian insurance sector has witnessed significant development over the past couple of years. By way of the Insurance Laws (Amendment) Act 2015, the establishment of branch offices of foreign reinsurers was permitted. In this regard, the Insurance Regulatory and Development Authority of India (IRDAI) subsequently issued the IRDAI (Registration and Operations of Branch Offices of Foreign Reinsurers other than Lloyd's) Regulations 2015 (Branch Office Regulations) and the IRDAI (Lloyd's India) Regulations 2016 (Lloyd's India Regulations), prescribing the procedure for setting up and operating foreign reinsurer branches and Lloyd's in India.

Through the Branch Office Regulations (and subsequent amendments to the same), the IRDAI prescribed the order of preference for cessions in order to prescribe the hierarchy between various entities with which an Indian insurer reinsures the business written. However, it was clarified that the provision stipulating the order of preference for cessions would be re-evaluated by the IRDAI after one year.

By way of a May 5 2017 order, the IRDAI set up the Reinsurance Expert Committee to make recommendations for, among other things, the efficient implementation and operation of the order of preference for cessions specified under the Branch Office Regulations. The committee released its report on November 14 2017, providing its analysis and recommendations on the terms of reference prescribed under the order.

Significant recommendations

The extant provision prescribing the order of preference stipulated under the Branch Office Regulations requires Indian insurers to obtain the best terms for their facultative and treaty surpluses from Indian reinsurers that have the minimum prescribed credit rating for the previous three years and at least three foreign reinsurer branches registered under Category I prescribed under the Branch Office Regulations. Subsequently, the Indian insurer must offer the best terms for participation in the following order:

- qualifying Indian reinsurers;
- Category I foreign reinsurer branches;
- other Indian reinsurers or Category II foreign reinsurer branches;
- foreign reinsurer branches set up in special economic zones; and
- Indian insurers and overseas or cross-border reinsurers (if any balance is left).

The committee has, by way of its report, now recommended that Indian insurers be permitted to obtain best terms simultaneously from Indian reinsurers, at least three foreign reinsurer branches, Lloyd's India and from any cross-border reinsurer satisfying the eligibility criteria prescribed (minimum security rating of A minus). It has been recommended that Indian insurers and their offices in the special economic zones (SEZs) be prohibited from offering competitive terms for domestic reinsurance risks, treaties and contracts.

After obtaining best terms, the committee has recommended that reinsurers be classified into two categories to offer participation in the following order of preference:

- the General Insurance Corporation of India and then simultaneously to:
  - other Indian reinsurers;
  - cross-border reinsurers, if any, which provided lead terms with a meaningful capacity;
  - foreign reinsurer branches registered under Category I;
  - Lloyd's India; and
  - Indian insurers; and
- reinsurers in SEZs, joint venture partners of the Indian insurers, reinsurers and other cross-border reinsurers satisfying the eligibility criteria (including overseas reinsurance entities of foreign reinsurer branches' parent group).

Therefore, the committee has recommended a mechanism for cross-border reinsurers to be brought up to par with foreign reinsurer branches in India. However, the committee has also recommended that a limit be prescribed with respect to the total cessions made to all cross-border reinsurers by any Indian insurer, and appropriate safeguards (including collaterals) be put in place by Indian insurers with respect to reinsurance placements with cross-border reinsurers.

The committee has further recommended that stipulations of order of preference for reinsurance cessions be waived for life insurance, aviation, marine hull, large infrastructure projects, petrochemical and refinery plants, large power plants, oil and energy, specialised, emerging and volatile risks with high loss potential, retrocessions, and any other line of business as prescribed by the IRDAI.

With respect to life insurance, the committee has also recommended that life reinsurance business be placed only with reinsurers (incorporated, foreign reinsurer branches and Lloyd's India) registered in India.

Other key changes

The committee has recommended the following:

- Cession limits should be prescribed to check single reinsurer risk concentration. However, the cap on cessions will not apply to Indian reinsurers, foreign reinsurer branches or Lloyd's India.
- Application of cession limits should be waived for foreign reinsurer branches, Lloyd's India and SEZ reinsurers, provided that the retrocession premium is paid only to the parent entity and not to any other entity.
- Structured reinsurance proposals should be permitted in certain instances, where risk transfer tests are satisfied. The committee has also recommended that financial reinsurance be permitted for life insurers on a case-by-case basis.
- Simplified reporting requirements and the formats for filing such reports and returns should be set out for all reinsurers.
- Reinsurers should be able to receive waivers from the IRDAI (Maintenance of Insurance Records) Regulations 2015, the IRDA (Insurance Advertisements and Disclosure) Regulations 2000 and the IRDAI (Protection of Policyholders Interest) Regulations 2017.
- Domestic insurance or reinsurance pools should be administered by an Indian reinsurer, any other insurer, a foreign reinsurer branch or Lloyd's India as per IRDAI directions.
- Indian insurers should be prohibited from accepting domestic reinsurance treaties from other Indian insurers and retrocession of facultative risks, to avoid market spirals from domestic risks.

Comment

The IRDAI will now consider the recommendations made by the committee. While at this stage it is unclear whether the committee's recommendations will be accepted and, if so, to what extent they will be incorporated into the applicable regulations, it is certain that the IRDAI will have to balance the need for transparency and healthy competition in the reinsurance market by encouraging foreign reinsurers to open branch offices in India.

For further information on this topic please contact Celia Jenkins or Priya Misra at Tuli & Co by telephone (+91 11 4593 4000) or email (celia.jenkins@tuli.co.in or priya.misra@tuli.co.in). The Tuli & Co website can be accessed at www.tuli.co.in

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