



GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

2 April 2013

Chairman T S Vijayan  
Insurance Regulatory and Development Authority  
Parishram Bhavan, 3rd Floor  
Basheer Bagh  
Hyderabad 500004  
India

## **Re: Comments on the “IRDA’s (Life Insurance-Reinsurance) Regulations, 2013”**

Dear Mr Chairman Vijayan,

I am writing on behalf of the Global Federation of Insurance Associations (GFIA) which through its 32 member associations represents insurers that account for around 88% of total insurance premiums worldwide. GFIA is active on a broad range of issues affecting the international insurance industry.

GFIA would like to congratulate you on your new position as Chairman of the Insurance Regulatory and Development Authority of India. We are looking forward to seeing the Indian insurance industry grow under your leadership.

We also want to let you know of our support for the proposed reduction in mandatory non-life cession to GIC from 10% to 5%. We believe this is a move in the right direction and we encourage the IRDA to consider abolishing this regime entirely.

However, GFIA would like to take this opportunity to express our concerns relating to the recently introduced “(Life Insurance-Reinsurance) Regulations, 2013”. In our view these regulations, in their current form, risk harming the development of the life (re)insurance industry in India and we are concerned that they have been approved without a transparent public notification and consultation process.

### **IRDA’S LIFE INSURANCE – REINSURANCE REGULATIONS, 2013**

In Article 4 of the “(Life Insurance-Reinsurance) Regulations, 2013”, the IRDA states that the objectives of the reinsurance programmes should be “to maximize retention within the country, develop adequate capacity, and secure the best possible protection for the reinsurance cost incurred”.

As currently drafted we believe that the regulations would constrain insurers' freedom to access reinsurance support and obstruct the delivery of these objectives. The purpose of reinsurance is to provide flexibility for insurers in terms of the size and types of risk and the volume of business they can reasonably underwrite. It can also allow the insurer to enter into new business or expand from a class or line of business and/or geographical area within a short period. Furthermore, the use of reinsurance helps smooth wide fluctuations in the insurer's underwriting results, and reduces their own amount of funds at risk, hence improving their solvency margin.

Limiting access to reinsurance constrains insurers' ability to reduce their risk exposure, whilst simultaneously necessitating an increase in their capital requirements. Higher retention limits also result in the aggregation of risks within insurers, compromising their underwriting performance. These factors individually, and more so in conjunction, hinder the development of capacity of existing Indian insurers, and deter new investors from entering the insurance sector.

Reinsurance is used to spread risks around the world, instead of maximizing risk retention within a country. Diversification of risk is the fundamental function through which reinsurers create value, ultimately providing efficient and effective cedant protection. This is achieved by writing a mix of business that is exposed to different, not totally connected, risk factors. This can arise from different lines of business, but also from different geographical locations. A wise reinsurance program can increase an insurer's financial standing; whereas counterproductive regulatory restrictions on the reinsurance program can produce financial instability.

An open reinsurance market is an important factor in making insurance markets more competitive, providing price and product advantages to consumers and creating opportunities for diversification of risk so that ceding insurers do not end up with reinsurance recoverable concentrations from a small number of reinsurers. At a time when the IRDA has highlighted the need for new capital inflows into the Indian insurance sector, having supported an increase of the Foreign Direct Investment (FDI) ceiling in insurance to 49 per cent, the recently approved retention limits that reduce capital flexibility and increase underwriting result volatility will act as a disincentive to investment in the Indian insurance sector.

In addition, the current regulations mandate a minimum level of reinsurance to be placed locally with an "Indian reinsurer", of which there is only one in the market, the General Insurance Corporation of India (GIC Re). We think that this deprives the market from access to some of the strongest balance sheets in the world, thus compelling them to have recoverables that come with more balance sheet risk than otherwise would be the case. Moreover, this would also contrast with the situation enjoyed by GIC Re in other jurisdictions where it competes on a level playing field with the local participants.

We would also like to draw your attention to IAIS ICP 13, which sets out principles for the indirect supervision of reinsurance and is often referred to as the "cedant responsibility model". Under this Core Principle, instead of imposing retention limits on insurance, the regulator focuses its attention on ensuring

that the ceding insurer has adopted a prudent approach to the purchase of reinsurance and to the management of risk associated with purchasing reinsurance, as per the previous regulations in India. According to this model, the choice of reinsurance cover should be a commercial decision made by management within the overall reinsurance strategy of the ceding insurer. In other words, the cedant should be left to judge whether the risk profile - including the experience, expertise and solvency position - of all the reinsurers to which it cedes is acceptable and in line with its operating strategy.

While we understand the regulatory concerns on Fronting, we propose that the regulator manages the same through an effective assessment of the annual reinsurance programme submitted by each insurer. In case of an insurer not adhering to the general approach on avoiding fronting, the regulator can always penalise the insurance with lower credit on solvency. The general limit to evaluate the case of fronting should not arise at all if the ceding limit is above Rs. 5,00,000 in any category. Additionally, we believe that the restrictions on quota share reinsurance arrangements, forbidden by these regulations for companies older than 2 years or for risks which the insurers have been writing for more than 2 years, should be reconsidered. This is an effective way for insurers to manage large risks. Subjecting insurers to forcefully hold such risks would not be prudent.

## **CONCLUSION**

We would therefore strongly recommend the IRDA to return to its previous principles-based regulation on retention limits, which conformed with the supervisory approach adopted internationally. We would further recommend that when foreign reinsurance branches are permitted to operate in India, they should be permitted to invest funds outside of the country. Insurers should be able to determine their retention limits based on an overall risk assessment of their operations, taking into account factors such as their risk appetite, the distribution channel through which a particular risk is sold, and their underwriting and claims experience with specific classes of business. Such an approach would contribute to the development of the Indian insurance sector and encourage investors.

GFIA is committed to work with the IRDA in order to develop an appropriate (re)insurance framework. To this end, and given the lack of official public consultation to the "Life insurance-reinsurance regulations, 2013", GFIA urges the IRDA to engage a diverse group of (re)insurers, including foreign-invested, in the IRDA group implementing these regulations.

In addition, GFIA would stand ready to discuss with IRDA this reinsurance regulation and others in future planned new insurance regulations.

Yours sincerely,

*Frank Swadlow*

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**Cc:**

Mr. Palaniappan Chidambaram, Finance Minister

Mr. Rajiv Takru, Secretary, Department of Financial Services