



ASSOCIATION ACTUARIELLE INTERNATIONALE INTERNATIONAL ACTUARIAL ASSOCIATION

July 19, 2001

Mr. Knut Hohlfeld
Secretary General
International Association of Insurance Supervisors
c/o Bank of International Settlements
CH-4002 Basel
Switzerland

Dear Knut:

Draft Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers

Further to my letter to you of May 17, 2001 forwarding the International Actuarial Association's (IAA) draft comments on the IAIS's *Draft Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers*, I am pleased to confirm that the IAA's due process is now complete and that the draft comments, as submitted, have been approved by the member associations for release as an IAA public statement.

Yours sincerely

Morris W. Chambers
President

A Commentary on the Draft Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers.

Published by the International Association of Insurance Supervisors: 22 December 2000

International Actuarial Association

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our member actuarial associations exceed forty in number, and represent more than 95% of all actuaries practicing around the world. The member associations of the IAA are listed in an Appendix to this statement. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact on the areas of expertise of actuaries. The IAA’s interest in the Draft Standard on the *Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers* issued for comment by the IAIS is to assist the IAIS in developing a high quality standard on this very important topic. The IAA appreciates the opportunity to provide comments on this Draft Standard.

Due Process

These comments have been prepared by a committee of the IAA, the members of which are listed below by name and association and were circulated for approval to the member associations of the IAA as part of our due process procedures.

Members of the IAA Insurance Regulation Committee

Nigel Masters	Chairperson
David Hartman	Vice-Chairperson
Félix Arias Bergadà	Col.Legi d'Actuaris de Catalunya
Morris Chambers	Canadian Institute of Actuaries
John Allan Feyter	New Zealand Society of Actuaries
Rainer Fürhaupter	Deutsche Aktuarvereinigung e. V. (DAV)
K S Gopalakrishnan	Actuarial Society of India
Thomas Karp	Institute of Actuaries of Australia
Won How Lo	Actuarial Institute of the Republic of China
Helge-Ivar Magnussen	Den Norske Aktuarforening
Ryoichi Nakamura	Institute of Actuaries of Japan
Gennaro Olivieri	Istituto Italiano degli Attuari
Thierry Poincelin	Institut des Actuaires Français
Jukka Rantala	Suomen Aktuaariyhdistys
Angus John Robertson	Faculty of Actuaries
Richard Roth	Casualty Actuarial Society
David Sandberg	American Academy of Actuaries
Simon Van Vuure	Het Actuarieel Genootschap
Robert E Wilcox	Society of Actuaries; Conference of Consulting Actuaries
Gyula Horvath	Hungarian Actuarial Society

The Insurance Regulation Committee of the IAA welcomes the IAIS's proposed approach to the supervision of the reinsurance programmes of primary insurers. Reinsurance programmes are an important aspect of the solvency of direct writing insurers and the Insurance Regulation Committee believes that the draft Standard correctly addresses the main issues. There are, however, a number of areas where the guidance might usefully be expanded and these points are discussed below.

- 1 Certain reinsurance treaties, sometimes referred to as "surplus relief" treaties, allow direct insurers effectively to take credit for future surpluses yet to emerge. Such treaties generally transfer little risk but can provide significant solvency enhancement at relatively little cost. While entirely legal, these treaties have the effect of undermining any "early warning" mechanisms built into the required solvency margins. This is because the treaties concerned may void or become valueless in circumstances where solvency margins are breached. In these cases it is possible that any financing of solvency may be reversed and thus the direct insurer not only breaches the required solvency margin but does so to a considerable extent. This potentially leaves the regulators unable to effect an orderly close down of the insurer. The draft Standard might alert regulators to the impact of such treaties on the solvency margin management of the direct insurers.
- 2 The above situation highlights a more general point, namely that regulators should be particularly careful in assessing the termination clauses of reinsurance treaties. It is important to understand the circumstances in which the reinsurance cover can be rescinded and the financial impact that such a withdrawal of cover might have at a critical time for a direct writer.
- 3 An additional consideration in the supervision of reinsurance programmes may be the existing contract law or legal precedent, in the jurisdiction in question, regarding the status of reinsurance contracts in the event of the insolvency or financial restructuring of the direct insurer.
- 4 In paragraph 4, the point is made that 'cosmetic' treaties should not be considered in the risk assessment of the company. It is worth noting that some financing reinsurance, which would not be considered as transferring insurance risk, would still be considered to be changing cash flows and changing liquidity risk. This is often one of the reasons for effecting the treaty. In this case, the treaty should be included in the overall assessment of the insurer's risk profile.
- 5 While many reinsurance treaties operate on an annual basis, some treaties especially for life business can operate for many years. In such cases, supervisors will wish to confirm that the reinsurer offering such cover is sufficiently capitalised to act as a long-term counterparty.
- 6 In paragraphs 22 to 24 of the draft Standard, a description is given of the information that supervisors should be prepared to review. We suggest that it

should be emphasised that the supervisor should exercise judgement in requesting this information, as the volumes of data involved in practice could be overwhelming. A fourth sentence might be added in paragraph 22 as follows: "Information appropriate to proper assessment should be gathered in a manner that is efficient and practical and its content should be appropriate and sufficient."

- 7 Supervisors may also wish to consider the controls that direct writers exercise over their reinsurance programmes. Sound governance requires, for example, that treaties are fully evidenced and signed. Many treaties are prepared in relatively short timescales and agreements are reached prior to full documentation being completed. While this is normal business practice, it is important that, in due course, the documentation is completed so that it is clear how the treaty will operate, particularly in circumstances where significant claims under the treaties become necessary.

Similarly the monitoring of any concentrations of risks, for example through retrocession programmes run by the reinsurers, will be important to sound governance.

Paragraph 10 of the draft Standard rightly emphasises the role of the Directors of a company in setting policy on reinsurance and its governance. We would suggest that the need for clear delegation of the implementation of this policy to senior management be also noted.

- 8 We note that the draft Standard accepts the use of collateral as a substitute for strong supervision standards for reinsurers. We understand that there may be a need for some requirements for collateral in the immediate future. Collateral can be seen as a more efficient way for a non-resident reinsurer to write business in a territory than having to complete full authorisation procedures.

However, we believe that the IAIS should set standards that are sufficiently high that those reinsurers that fully adhere to those standards should not be subject to the need to establish collateral. We take this view as the requirement for collateral can be seen to act as a barrier to cross border insurance treaties and can lead to capital inefficiency within the insurance industry.

- 9 In paragraph 8 of the draft Standard, it would be useful to describe what might be considered as collateral. For example, letters of credit might or might not be considered to be acceptable collateral.

MEMBER ASSOCIATIONS OF THE IAA

Consejo Profesional De Ciencias Económicas De La Capital Federal (Argentina)
Institute of Actuaries of Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Association Royale des Actuaires Belges (Belgique)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Canadian Institute of Actuaries (Canada)
Cyprus Association of Actuaries (Cyprus)
Ceská Spolecnost Aktuárů (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Suomen Aktuaariyhdistys (Finland)
Association des Actuaires de Bretagne (France)
Association des Actuaires Diplômés de l'I.S.F.A. (France)
Institut des Actuaires Français (France)
Deutsche Aktuarvereinigung e. V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Hungarian Actuarial Society (Hungary)
Félag Íslenskra Tryggingastærdfraðinga (Iceland)
Actuarial Society of India (India)
Society of Actuaries in Ireland (Ireland)
Israel Association of Actuaries (Israel)
Istituto Italiano degli Attuari (Italy)
Institute of Actuaries of Japan (Japan)
Japanese Society of Certified Pension Actuaries (Japan)
Colegio Nacional de Actuarios A. C. (Mexico)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Actuarial Society of the Philippines (Philippines)
Instituto dos Actuários Portugueses (Portugal)
Actuarial Society of South Africa (South Africa)
Collegi d'Actuaris de Catalunya (Spain)
Instituto de Actuarios Españoles (Spain)
Svenska Aktuarieföreningen (Sweden)
Association Suisse des Actuaires (Switzerland)
Actuarial Institute of the Republic of China (Taiwan R.O.C.)
Faculty of Actuaries (United Kingdom)
Institute of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Actuaries (United States)
Casualty Actuarial Society (United States)
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