# 29th India Fellowship Seminar

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## Reinsurance - Life post Registration & Operations of branches of foreign reinsurers (Regulations 2015)

...Changing approach to Product pricing, Business plan, Solvency management

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# Agenda

- Reinsurance regulations
- Prior to October 2015
- Objectives
- FRB regulations 2015
- Draft 2018 regulations
- Operational changes
- Broad impacts
- Pricing
- Solvency
- Business plan
- Looking ahead
- Future opportunities
- Q&A

*Disclaimer: All the views presented in this presentation are of individuals and not of any company.*

# Reinsurance Regulations

*Evolution over years*

Insurance Act 1938, Section (101): no limit on reinsurance ceded

IRDAI Life Insurance (Reinsurance) Regulations ,2000: Additional controls introduced

2013 regulations: Limits on reinsurance ceded

2015 IRDAI Registration & Operations of Branch Offices of Foreign Reinsurers other than Lloyd's Regulations, 2015: Regulation for reinsurers

Reinsurance Executive committee report, 2017

Exposure Draft IRDA (Reinsurance) Regulations, 2018

# Prior to October 2015

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**Life Reinsurance governed by-**

- IRDAI (Life Insurance-Reinsurance) Regulations 2000
- IRDAI (Life Insurance-Reinsurance) Regulations 2013

**Insurers can reinsure subject to-**

- Retain minimum amount of business
- Retention limits prescribed based on
    - the age of the insurance company
    - number of years elapsed since introduction of the risk
    - percentage of premium separately for savings and term business
- Reinsurer credit rating of at least BBB over a period of the past 5 years
- No reinsurance with promoter company or associate/group company
- Specific approval from authority in case the above condition not met

# IRDAI Objectives

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1. Maximize retention within India
2. Better control over directly monitored branches
3. Secure best reinsurance arrangements, protect policyholders & insurers' interests
4. Give boost to Indian reinsurers
5. Developing expertise within India
6. Ease of doing business

# FRB Regulations 2015/2016

IRDAI (Registration and Operation of Branch Offices of Foreign Reinsurers other than Lloyd's) Regulation, 2015

First Amendment, 2016

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## Eligibility

- Retain 50% (30% in case of 4 (b) category) of the Indian reinsurance business, the remaining 50% could be retroceded to the parent office
- Minimum 10 years in business already
- Minimum credit rating, good financial security for the last 3 years

## Capital requirements & Surplus

- Net owned-funds - INR 5,000 Cr at any time
- Infuse minimum capital of Rs 100 crore into the branch office
- Solvency margin as stipulated by its Indian regulator
- Repatriation of Surplus is allowed, subject to meeting certain requirements

## Operational aspects

- Registered/certified in a country having DTA with India
- Retain core activities - Underwriting, Claims settlement, Investments & Regulatory compliance
- Outsourcing possible – Back office servicing & IT
- Appointments & Remuneration of senior management, needs IRDAI approval
- Investment and accounting as per IRDAI regulations

# FRB Regulations 2015/2016...contd

**Through an amendment regulation in 2016, An order of preference for cessions by Indian insurers was put in place**

Insurers need to follow the following order of preference while offering participation in their facultative and treaty surpluses

- Indian re-insurer
- Foreign reinsurer - under regulation 4 (a) i.e. retaining minimum 50% of business within India
- Holding certificate of registration as per regulation 4 (b) i.e. retaining minimum 30% of business within India
- Branch offices of foreign reinsurers set up in Special Economic Zone, only after having offered to all entities in 4(a) and 4(b) above
- To Indian Insurers and overseas reinsurers

# Draft Regulations 2018

**Draft Exposure, IRDAI (Reinsurance) Regulations, 2018**

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## Key highlights

- Indian Life insurer's to maintain minimum retention of 50% of sum-at-risk at an overall life insurance portfolio level
- Overall limit of all cessions of a cedant with a particular Cross Border Reinsurer (CBR)
- Obtaining best term for sessions and offer for participation excluded for Indian life insurers
- However, Indian insurer's endeavor to utilize Indian capacity before CBR's
- Formation of domestic Insurance/Reinsurance pools
- Allowance of submission of proposals on Alternative Risk Transfer (ART) solutions to the authority for examination and approval.
- No large change to submission of information

# Life FRBs in India

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RGA

Munich RE

SCOR

hannover re

AXA

Swiss Re

Gen Re

LLOYD'S

XL CATLIN

# Operational changes

| Area | Before FRB | After FRB |
|---|---|---|
| **Structure** | Service companies or Representative offices | Registered branches |
| **Risk Carrier** | Premiums & Claims booked in overseas branch | Risk written in books of Indian Branch |
| **Earnings** | Fee based compensation | Branches generate their own surplus |
| **Authority** | Key decision with overseas branch | Indian branch - greater authority |
| **Transactions** | All payments in agreed currency, USD or Euros, currency fluctuations | Now in INR, no fluctuations |
| **Reserves/Capital** | • Was maintained at overseas branch<br>• Under the purview of the regulatory regime where branch operated | • Maintained in India<br>• Calculated as per IRDAI's regulations |
| **Regulation** | All Regulatory reporting to the overseas regulator | Regulatory Reporting to the IRDAI |
| **Life & Non-Life** | Separate service/representative offices | Mostly composite branches |
| **Indian Market** | No differentiation b/w Indian & Overseas reinsures | Currently different treatment of Indian Reinsurers, FRBs and Overseas Reinsurers |
| **Investments** | Were determined by overseas branch | By the Indian branch, in India |
| **Tax** | • Technically, payable only on service company's profits (fee income less expenses)<br>• Tax Authorities later imposed - additional tax on gross premium collected | **Tax Payable on the surplus generated by the FRB as per Indian Tax rules.** |

# Broad impacts

### Regulated Presence

- Branch becomes a regulated entity in India
- More legal/regulatory presence than through service companies/representative offices

### Service Standards

- More authority with the local branches now, shortens the decision chain
- Improves TAT & overall service standards
- Insurers engaging reinsurers more for expertise on pricing & underwriting
- Comprehensive solutions to insurers (more potential than actual)

### Order or Preference for Cessions

- Insurer had to follow an order of preference for reinsurance business that placed Indian Reinsurer at the top, followed by FRBs and then others.
- Creates a Non-Level playing field in the reinsurance business
- Treaty negotiations - more cumbersome due to this preference
- This has not yet resulted in FRBs losing a large part of their life business

### Tax

- Highest corporate tax bracket. FRBs taxed @43.26%

# Broad impacts...continued

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## Capital

- Local RSM might be different than original overseas requirement
- High capital relative to the premiums
- Needs strict capital & expense management
- Close monitoring & frequent capital infusions
- The imminent RBC regime in India can bring the requirements at par with global levels

## Shareholder's Value

- Higher Tax - Decreased value of business to shareholder

## Regulatory Reporting Requirements

- Increased compliance requirements
- Evolving regulatory framework for statutory reporting

## Business Synergies

- Greater Business Synergies between Life & Non-Life Reinsurers
- Greater cost efficiencies due to composite branch setup

# Pricing

***Reinsurance pricing depends on following key considerations-***

**Mortality/Morbidity –** No change in underwriting processes and market data, pricing mainly is driven by incidence rates. No change expected.

**Lapse -** No change in assumption, driven by actual insured portfolio experience.

**Reserves/Capital**

- Based on ALSM regulations, no change in methodology, UPR & IBNR still relevant
- IBNR delay of 6-9 months expected, significant UPR (prudent than GPV)
- Premium deficiency reserves (PDR) if loss ratio > 100% for 1-year renewable group schemes

**Investment Yields**

- No larger accumulation of assets to back liabilities
- Reserves as above will earn now higher interest rate
- If RSM is higher then secondary impact on pricing, but not significant in price sensitive Indian market
- Overall not much significant impact

# Pricing...continued

## Expenses

- Initial set up costs (if not absorbed by parent company) - Administration, systems, finding expertise, audit
- Key consideration – recovery time, how much to load in premium
- Expense optimization through synergy of core activities being done in India

## Tax

- Now, FRB has to pay tax as per Indian regulations, earlier SG/Dubai
- Significantly higher - May lead to lower post tax profits for reinsurers
- e.g. Overseas Singapore branch @10% versus India branch @43.26%

## Volumes

- Critical role, linked to insurance volumes
- No direct impact of regulations except for preference order
- May get nullified by more innovation and increased volumes in future

## Impact on Profits

- Higher tax/solvency requirement
- Higher impact & costs not yet passed to the clients
- Might lead to lower profitability or higher premium rates
- Increased competition after the 2015 regulations
- May restrict increase in premium rates
- Effectively means, profitability might come down

# Solvency

- FRBs to comply with ALSM regulations
- Standard formula (factor based approach) for capital requirement
- Very similar to EU requirement under S-1 regime
- x% of reserves & y% of sum at risk
- Coupled with a higher retention limit of 50%/30%
- Might lead to different/higher capital requirements if parent company is calculating on Risk based capital (RBC)/S-2 approach
- Some challenges –
  - e.g. required solvency (at 150%) is 1.5 per 1000 sum-at-risk for one-year group insurance
  - In many schemes the life insurer's premium itself is less than this
  - Reinsurance risk premium is almost one-third of Required Solvency Margin
- Moving towards RBC regime, allowing appropriately for risks and rewarding for better risk management is expected to be welcomed by many reinsurers

# Business Planning/Financial projections

- Initially submit at license stage, monitor on regular basis versus actual performance
- Driven by insurer business plans/products mix
- Innovation from reinsurers will also drive
- Consider business after 1st Feb 2017 only in new branch
- Will take time for volumes to build up-
  - increased retention by insurers
  - no new players in insurance market
  - more players in reinsurance market
- Key components – Volumes, Product Mix, Premium income, Investment income, Expenses, Taxes, Reserves, Required solvency
- Business plan & subsequent capital requirements gets impacted by –
  - changes in regulation (including preference order)
  - changes in market dynamics, e.g. Online Term
  - level of expertise available, e.g. Critical illness

# Business Planning…continued

- Order of preference regulations which gives first right of refusal to Indian reinsurers is challenging from Foreign reinsurer's perspective, But..

  …unlikely to be a major deterrent for reinsurer growth
- With global expertise available in areas of underwriting, pricing new risks etc. foreign reinsurers may have big advantage for new growth prospects if supported
- May need more aligned approach in areas like cession limits, solvency and capital requirements for creating positive impact on Business Planning and move towards having higher penetration in the country
- Expected higher capital requirements relative to other countries
- This position also inhibits FRB's ability to take on large life risks like large groups or mass market protection schemes
- In composite branches there is a stark difference between the capital / premium ratio of Life business (150% - 250%) and Non-Life business (50% - 80%)

# Looking ahead..

**Reinsurance –**

- Essential part of the insurer's risk management toolkit
- Long-term partner & co-creating life insurance products
- Underwriting and Claims support
- Viable and sustainable reinsurance business model needed

The recent Reinsurance draft regulations have taken many steps in direction of creating such an ecosystem.

- Unified life and non-life regulations
- Removal of the Order of Preference for Cessions by Indian Life Insurers
- Introduction of broad guidelines on overall risk retention at a portfolio level in place of the prescriptive retention levels
- ART solutions – Examine and approve on a case by case basis
- In case of branches of foreign reinsurers in India, the reference to the "Board" in the regulations now mean "Executive Committee" of the FRBs

# Looking ahead…continued

*Other areas where the regulator could provide support*

## Capital Requirements

- Key concern for the FRB's Life business
- The REC had recommended moving to a RBC regime. Until then, it had recommended that the YRT group business be treated akin to the Non-Life miscellaneous line of business, for the specific purpose of calculation of required capital

## Actuarial Reporting

- Reporting formats & frequency
- Evolving area. All the forms applicable to insurers may not be directly applicable to the reinsurers
- Reserving for Actuarial Liabilities ; Actuarial Reports & Abstract
- Investment Management - Outsourcing / Investment management / Investment Trusteeship

## Tax

- FRB's are taxed at the highest tax bracket at 43.26%

# Future Opportunities

- Huge potential for growth in the Indian protection market, highest protection gap in Asia at 92%
- India has one of the lowest SA to GDP ratios at 55% (Malaysia-150%, developed countries – 250%+)
- Scope for innovation in insurance products & solutions
- Alternative source of capital: Explore non-traditional reinsurance, Financial Reinsurance & Quota share solutions
- Global reinsurance hub & Large capital inflows
- Reinsurance plays a crucial role in providing expertise & capacity to insurance market
- Regulatory support and environment will play the key role here

*Questions?*

*Thank you*