

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS



GUIDANCE PAPER ON THE MUTUAL RECOGNITION OF REINSURANCE SUPERVISION

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Guidance Paper on the Mutual Recognition of Reinsurance Supervision

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1. Introduction and scope

1. This guidance paper follows the IAIS DISCUSSION PAPER ON THE MUTUAL RECOGNITION OF REINSURANCE SUPERVISION, dated October 2007. The purpose of this paper is to provide guidance on cross-border recognition of reinsurance supervision. It identifies criteria that supervisors should consider when making judgements as to whether to recognise supervision of reinsurers by other jurisdictions and to strengthen trust and cooperation between cross border supervisors. It also includes aspects to be evaluated in the course of creating any supervisory recognition arrangement.

2. The purpose of mutual or other forms of supervisory recognition is to facilitate the international supply of reinsurance (whether cross-border, through branches or via subsidiaries) by fostering the development of a framework for efficient and effective international supervision. For a number of years, the IAIS has used the term “mutual recognition” to refer to this process, but the objective can be achieved through unilateral, bilateral and multilateral approaches to recognition.

- Unilateral recognition refers to a situation where a supervisor recognises the supervision exercised by another, without requiring that the latter recognise the supervision exercised by the former.
- Bilateral recognition refers to a situation where two supervisors recognise each other's supervision.
- Multilateral recognition refers to a situation where several supervisors (3 or more) recognise the supervision exercised by the others.

For the purposes of this guidance paper, all of these approaches are collectively referred to as “supervisory recognition”.

3. Any supervisory recognition approach should be sufficient to allow a supervisor to recognise the value of the supervision exercised by another jurisdiction and thus remove significant amounts of unnecessary regulatory and supervisory requirements for reinsurers.

2. Reinsurance Supervisory Recognition

4. The guidance in this paper refers to a situation where supervisors choose to recognise aspects of the work of other supervisory authorities. There are a number of different approaches which could be adopted in order to achieve this recognition, which are not restricted to a certain form or to certain prescriptive contents.

5. Supervisory recognition may take place either with or without the use of a formal agreement. For instance, a supervisor can choose to place unilateral reliance on the work of another, which could be done with or without an agreement, or supervisors could negotiate a specific form of recognition between them.

6. Issues which need to be considered in recognising a jurisdiction and drawing up any agreement are set out within this paper. It is important to note here, however, that all approaches to supervisory recognition rest on an assessment of the

acceptability of the counterpart regime. This assessment of acceptability need not involve full or exact equivalence, but some jurisdictions may require equivalence or comparability of regulatory regimes whereas others may choose to place unilateral reliance on other jurisdictions. This paper does not favour any one basis and refers to the term “acceptable” for that reason.

3. The reinsurance industry and how it is currently supervised

7. The IAIS DISCUSSION PAPER ON THE MUTUAL RECOGNITION OF REINSURANCE SUPERVISION sets out the structure of the reinsurance industry and the way in which it is currently supervised. It highlights that in some cases there is a mismatch between the operation of the supervisory system and the economic reality of how the market functions.

8. Standards and practice in reinsurance supervision differ significantly between jurisdictions, with approaches varying from direct supervision of reinsurers, indirect supervision through cedents, and, in some cases, little or no regulation of reinsurance activities.

9. Regulation can either be specific to reinsurers, or an adapted version of that which is applied to primary carriers, taking into account the fact that the business is conducted between informed market participants. Whilst precise modes of supervision vary, supervisory objectives are normally similar, aimed at ensuring that there is confidence in reinsurers’ ability and willingness to meet their contractual obligations to ceding insurers so that cedents can, in turn, fulfil their obligations to policyholders.

10. In cases where supervisory action occurs through cedents, it often takes the form of restricting the circumstances in which cedents are able to take financial credit (for solvency or other purposes) for reinsurance cover they have purchased. This may arise where the supervisor of the ceding entity does not believe it is able to recognise the work of the foreign reinsurance supervisor, and therefore considers that the most appropriate way to discharge its supervisory obligations is to impose conditions on its ceding entities’ reinsurance programmes.

11. One of the principal constraints to fully effective supervision of the reinsurance market is that supervision tends to be restricted to legal entities in individual jurisdictions. Although this form of stand-alone regulation is valuable, it does not reflect the economic realities of the way in which many reinsurance businesses operate in practice. In particular, stand-alone regulation does not fit well with the model where local risk-gathering subsidiaries are reliant on a variety of means, such as internal retrocession, parental guarantees, etc., on a head office or central entity, often based in a different country.

4. Benefits of reinsurance supervisory recognition

12. There are a number of readily identifiable benefits associated with an effective system of supervisory recognition, which, if implemented properly, would serve the objectives of all of the various parties involved. A number of these are outlined below; however, parties should also be aware of potential risks and drawbacks of supervisory recognition, which are discussed further in the IAIS DISCUSSION PAPER ON THE MUTUAL RECOGNITION OF REINSURANCE SUPERVISION.

13. Reinsurance companies' business models generally are based on the widest possible distribution of risks (through geographic and business line diversification, as well as writing large numbers of individual risks). It is therefore crucial for reinsurance companies with adequate expertise, appropriate risk-management tools and capital commensurate with the risks they assume, to enjoy open access to global markets and the benefits of a level playing field.

14. An effective system of supervisory recognition could reduce duplication of efforts by those supervisors. This could bring about reduced compliance costs for the (re)insurance industry, including fewer requirements placed on cedents. In this sense, a system of supervisory recognition can be seen as a mechanism to facilitate market access and, in turn, enhance market efficiency (e.g. through an increase in capacity at an economic price).

15. As part of a system of supervisory recognition, licensing systems could be developed that would more easily facilitate market participation of reinsurers in individual jurisdictions, mitigating the administrative costs to supervisors. Regulators could devote less resources to supervise reinsurance placed with foreign companies if there is assurance that such activities would be adequately supervised by the other regulator under a supervisory recognition agreement. This would allow regulators to reallocate such resources to more effectively supervise entities operating within their jurisdictions.

16. Aside from enhancing market access, supervisory recognition also offers some steps towards the enhancement of group supervision. Group supervision is the subject of other IAIS papers and will therefore not be covered in detail here, but the main areas of interest are:

- assessment of group-level functions, such as risk management, internal audit, etc, where the home supervisor may well undertake significant work which would be to the benefit of host supervisors;
- considerations of the extent to which intra-group reinsurance arrangements are acceptable, taking into account the potential for contagion from other parts of the group; and
- assessments of the appropriate level of regulatory capital at group level.

17. As the reinsurance market becomes more complex and international in nature, there is an increased need for supervisors to facilitate the exchange of information pertinent to the prudential supervision and regulation of such entities. Enhanced information sharing among supervisors resulting from supervisory recognition would reduce the risk of regulatory arbitrage and encourage effective risk management and measurement.

5. Assessment of acceptability of reinsurance supervisory regimes

18. Supervisors wishing to recognise another jurisdiction should carry out an assessment of the acceptability of the counterpart jurisdiction's regulatory regime. Whilst these assessments would be easier to make between jurisdictions where regulatory regimes are similar, exact equivalence is not a prerequisite to supervisory recognition. The assessment should seek to establish the acceptability of a counterpart's regime by an analysis of the outcomes it achieves and not necessarily by an analysis of the process by which it achieves them. Supervisors should resolve any differences between them in an efficient way.

19. The precise format of any acceptability assessment is a matter of jurisdictional discretion, but supervisors should take into account some or all of the following:

- the other jurisdiction's adherence to IAIS Standard No. 8, Standard on Supervision of Reinsurers and Principle No. 6, Principles on Minimum Requirements for Reinsurance Supervision and any other relevant IAIS supervisory papers applicable to reinsurance;
- the other jurisdiction's international assessment (e.g. Financial Sector Assessment Programme) where such documents are available;
- the other jurisdiction's self-assessment where one has been undertaken;
- the terms of any existing Memorandum of Understanding (MoU) or Multilateral Memorandum of Understanding (MMoU);
- the legal framework in the other jurisdiction, including whether ceding insurers receive equal and fair treatment under insolvency laws;
- the technical competence, capabilities and efficiency of the other jurisdiction, including, but not limited to, such items as legal protections and financial resources; operational independence; accountability; maintenance of and access to sufficient human resources;
- the appropriate treatment of confidential information; and
- the transparency of regulatory systems and decision making processes.

20. Self assessments and the assessments and opinions of third parties (e.g. IMF/World Bank) may be available for consideration in the course of a supervisory recognition process. However, such assessments may lack the intensity and level of detail parties may require when pursuing supervisory recognition.

6. Reinsurance supervisory recognition agreements

21. A formal agreement is not a pre-requisite to any form of supervisory recognition, but formal agreements have a number of benefits, including clarification of terms and obligations and facilitation of cooperation between jurisdictions.

22. The precise content and format of any supervisory recognition agreement entered into will depend on a number of factors. The following are examples of elements that should be considered:

- an outline of the basis of the cooperation and/or reliance;
- consideration of the scope of the agreement;
- definition of terms;
- provisions for the language(s) in which the agreement is written and/or used for the exchange of information;
- clarification of who are the parties to the agreement and the parties that monitor and enforce the agreement;
- an outline of what will and will not be done by each of the parties;
- a statement of the benefits to the respective stakeholders;
- conditions under which the agreement becomes effective and its duration;
- provisions of supervisory accountability;
- provisions regarding confidentiality of information exchanged under the agreement;
- provisions to inform the other party of any significant developments in their respective jurisdictions;
- reference other relevant agreements (e.g. free trade, MoU) between the jurisdictions;
- provisions regarding the contractual or other legal obligations between the parties;
- provisions for resolving disputes that may arise under the agreement and for enforcement of any resulting corrective action;
- provisions for the review and termination of the agreement and any related consequences; and
- provisions for clear responsibilities in sharing information, making decisions and taking enforcement action during emergency situations.

23. The parties should assess whether the supervisory recognition agreement is operating as envisaged after an appropriate length of time (e.g. 3 years). Where the anticipated benefits of supervisory recognition are not apparent, the agreement may be modified.

24. Care should be taken to ensure that provisions within a supervisory recognition agreement are consistent with any requirements in a bilateral or multilateral trade agreement, or other domestic or international legal provisions.

25. In order to facilitate supervisory recognition arrangements among IAIS members or their representatives, the IAIS Secretariat should maintain a record of all existing arrangements and make available such arrangements or parts thereof, as appropriate. The IAIS Secretariat should track the progress towards supervisory recognition, including the identification of obstacles and challenges, as well as successful examples in achieving recognition arrangements. Moreover, the appropriate IAIS bodies should further facilitate and encourage supervisory recognition among Members.