

RESPONSE TO FEEDBACK RECEIVED – CONSULTATION PAPER ON PROPOSED FRAMEWORK FOR REINSURANCE MANAGEMENT

1 Introduction

1.1 In June 2010, the Monetary Authority of Singapore (“MAS”) conducted a consultation on the proposed supervisory and regulatory framework governing reinsurance management of insurers, including requiring direct insurers to submit information on their outward reinsurance arrangements on an annual basis, and removing the need to seek MAS’ approval before entering into financial reinsurance arrangements in respect of life insurance business.

1.2 The consultation period closed on 30 July 2010. Various parties commented on the consultation paper and MAS would like to thank all respondents for their contributions. The respondents are listed in Annex 1.

1.3 We have carefully considered the feedback received and incorporated the relevant feedback into the proposed framework for reinsurance management. Comments that are of general interest, together with MAS’ responses, are set out below.

2 Applicability of the Rules stated in the Consultation Paper

2.1 The proposed Notice MAS 114 sets out the proposed supervisory and regulatory framework governing reinsurance management of insurers, including MAS’ expectations in respect of the reinsurance management strategy. A few respondents opined that the requirements and guidelines stated in the consultation paper would be more applicable for a direct insurer rather than a reinsurer and sought clarification on the applicability of the rules.

2.2 The consultation paper and the proposed Notice MAS 114 also described the role of the Board of Directors and senior management in determining the reinsurance management strategy of an insurer. A few respondents sought clarifications on how the term “Board of Directors and senior management” would apply in the context of a registered insurer in Singapore which is a branch of an overseas-incorporated insurer.

MAS’ Response

2.3 The requirements and guidelines mentioned in the consultation paper and proposed Notice MAS 114 applies to all insurers registered in Singapore except for paragraph 5 of Notice MAS 114 in respect of the mandatory submission of the

reinsurance management returns. While the submission of the reinsurance management returns would apply only to direct insurers, MAS may request for similar information from reinsurers on an ad-hoc basis, e.g. in the course of an inspection.

2.4 In the case of a branch of a registered insurer incorporated outside of Singapore, MAS expects the Head Office to determine the reinsurance management strategy, and for the senior management in the Singapore branch to execute the reinsurance management strategy set by Head Office personnel. The reinsurance management strategy mentioned here could be demonstrated on a global level if that is deemed to be appropriate for the insurer or reinsurer in Singapore that is part of a global insurance group.

3 Good Risk Management Practices

3.1 Several unsatisfactory practices in the area of reinsurance management that was observed by MAS were highlighted in the consultation paper. A few respondents hence sought clarification on what would constitute acceptable risk management practices. In particular, the respondents sought clarification on MAS' expectation on when the reinsurance treaties should be signed. One of these respondents pointed out that the signing of treaties can typically take a period of time after the effective date of the treaty contract and the two parties would rely on a more informal confirmation of the coverage in the interim.

MAS' Response

3.2 MAS' guidelines on reinsurance management have been set out in the Guidelines on Risk Management Practices for Insurance Business – Core Activities issued in November 2007. The frequency of review of the reinsurance management strategy will depend on the risk profile of the insurer, and whether there had been any relevant significant developments. As such, it was recommended in the Notice MAS 114 for the Board of Directors to review the reinsurance management strategy at least once a year to ensure relevance.

3.3 In terms of contract certainty, all insurers should have documentation of the treaty or facultative arrangements that will provide sufficient evidence of the arrangement between the two parties. The agreement should clearly state what is to be covered, period of coverage, the terms and conditions of the coverage and should be legally enforceable to avoid ambiguity and minimise legal disputes. Insurers are expected to obtain the signatures of both contracting parties for contract certainty, regardless of whether an intermediary is involved.

3.4 Also, MAS strongly encourages all insurers to strive to have their reinsurance agreements signed by the date of inception of the risk to avoid unnecessary disputes in future which may have a severe financial impact.

4 Reporting Requirements for Reinsurance Management

Audit and Disclosure Requirements

4.1 The proposed Notice MAS 114 mandates direct insurers to submit information on their outward reinsurance arrangements on an annual basis. A number of respondents sought clarification on the need for the information to be audited and if the information would be disclosed publicly.

MAS' Response

4.2 To clarify, the reinsurance management returns do not need to be audited. The information contained in the reinsurance management returns will also not be published on the MAS website nor will the information be available for public inspection.

Submission Deadline

4.3 The direct insurers are required to submit the new returns under Notice MAS 114 within 5 months from the end of an accounting period. One of the respondent sought clarification on the definition of accounting period while a few respondents opined that 5 months may be too short a time frame for the insurers to obtain the necessary information and compile it for the returns. One respondent further suggested extending the timeline for the first year submission from May 2011 to June 2011.

MAS' Response

4.4 The accounting period referred to in Notice MAS 114 is in accordance with the definition stated in the Insurance (Accounts & Statements) Regulations 2004 ("A&S Regulations"), i.e. 1 January to 31 December.

4.5 To clarify, the deadline of 5 months after the end of the accounting period (i.e. 31 May) to submit the returns is not meant to be an indication of when insurers have to finalise details of their reinsurance contracts. The proposed deadline of 31 May for each year will avoid coinciding with the deadline for the submission of annual audited returns and the first quarter returns, and at the same time, ensure that the information remains relevant for our supervision purposes.

Having said that, given that the revised notice will only be issued in March, insurers will be given 6 months to submit the returns for the first year, i.e. the first set of returns will be due 30 June 2011.

4.6 Should there be any details that are not finalised by the submission deadline, the insurer should disclose under 'Remarks' what are still outstanding (e.g. signatures by reinsurers) and the mitigating measures taken. Insurers which require more time to compile the information may apply to the MAS for an extension which would be considered on a case by case basis.

Purpose of Information Submitted

4.7 Two of the respondents sought clarification on how the information would be used by MAS and what MAS would do if it identifies any inappropriate risk management practices, e.g. concentration of reinsurance contracts with a single reinsurer.

MAS' Response

4.8 The information obtained from the annual reinsurance management returns will provide MAS with greater insights on the risk profile of individual insurers. This will then be factored into the risk assessment process under the CRAFT methodology. Should there be any prudential concerns noted from the review of the information provided, MAS will engage individual insurers.

4.9 The amount of capital currently required under the Risk Based Capital ("RBC") framework would vary depending on the reinsurance arrangements and the reinsurance counterparties. In general, MAS will not intervene in the commercial decisions made by the insurer on its risk tolerance level. However, if MAS detects any excessive risk taking by an insurer that is not commensurate with the amount of financial resources, we will engage the insurer separately.

5 Roles and Responsibilities of External Auditors and Actuaries

5.1 The consultation paper proposed to place reliance on the professional opinions of the external auditors and approved actuaries in determining whether a reinsurance arrangement involves significant risk transfer and consequently if capital relief should be given. In particular, insurers are required to report financial reinsurance contracts, with or without significant insurance risk transfer, in the statutory returns in accordance with the Accounting Standards.

5.2 One respondent sought clarifications on whether the intent of the recommendation is for external auditors to verify all transactions and validate the risk transfer therein. The respondent expressed concern that the interpretation of complicated reinsurance contracts is not a core skill set of the external audit profession in many regions. It was suggested instead for the external auditors to audit the procedures and controls in place in relation to risk transfer arrangements rather than the individual transactions.

5.3 A few respondents also raised concerns on the increase in responsibilities for the approved actuary where verification of risk transfer in all reinsurance contracts is not a core skill set of the actuarial profession and this may affect their ability to discharge their statutory and management duties effectively. One respondent also sought clarification on whether the Principal Officer should provide a confirmation on the amount of risk transfer of the transactions.

MAS' Response

5.4 As in the normal course of auditing, MAS does not expect external auditors to verify all transactions. MAS expects external auditors to audit the procedures and controls, supplemented with a sample audit of selected transactions (in the context of reinsurance management, arrangements that are not traditional) in order to provide the certification as required in Form 25 and Form 26 of the A&S Regulations. On the same note, we expect the Principal Officer to be aware and agreeable to the amount of risk transfer reported in the statutory returns in order to provide the Principal Officer's and Directors' certification in Form 24 of the A&S Regulations.

5.5 An actuary approved under Section 37 of the Insurance Act is currently required to provide a certification on the value of the policy liabilities of an insurer, calculated net of outward reinsurance arrangements. In this regard, MAS is merely clarifying the expectation that the actuary should exercise due diligence to ensure that the amount of reduction in the value of the policy liabilities commensurate with the amount of risk transferred under the reinsurance arrangements. In most contracts, it would be apparent that significant insurance risk transfer exists without the need to perform extensive quantitative testing. As such, we envisage that the approved actuary would only need to verify the amount of risk transfer in a small number of reinsurance arrangements.

5.6 To clarify, the intention is that an insurer should enjoy capital relief for risk transfer under the reinsurance arrangements that commensurate with the amount of insurance risk transferred. MAS is thus leveraging on the independent assessment of the external auditors and approved actuaries in their course of

auditing the financial statements and assessing the adequacy of the policy liabilities set up by the insurer respectively. To the point on the lack of expertise in Singapore, we are of the view that the external auditors and approved actuaries have the expertise within their organizations and would be able to tap internally on the expertise of their colleagues in other countries.

6 Assessment of Significant Risk Transfer and Unfair Terms and Conditions

6.1 The proposed Notice MAS 114 states that a contract should not be classified as a reinsurance contract if it contains certain unfair terms and conditions. It also sets out guidelines on the assessment of significant insurance risk transfer. A number of respondents hence sought further guidance on what would be regarded as “unfair terms and conditions” and what would constitute “significant risk transfer”. Two of the respondents also raised the example of a reinsurer having an option to increase the premium rates due to deteriorating experience of the portfolio and asked if such an option would be considered as an unfair term and condition.

6.2 One respondent highlighted that there may be instances where “significant insurance risk transfer” would be difficult to ascertain as it is highly subjective. The respondent then suggested for MAS to consider granting credit that commensurate with the amount of risk transfer, rather than looking at the significance of the amount of risk transfer.

MAS’ Response

6.3 The principles stated in the proposed Notice MAS 114 have been set out taking into consideration other international regulations and the guidelines in other established jurisdictions. There is no universally accepted definition or guidelines on “significant risk transfer” or “unfair terms and conditions”, hence reliance would have to be placed on the assessment of the external auditors and approved actuaries. Insurers are therefore encouraged to engage the external auditors and approved actuary early if there are any doubts or concerns.

6.4 To clarify, MAS would not consider the example given by the respondents (given in paragraph 6.1) as an unfair term and condition as it is a prudent business practice to set the premium rates in accordance to the experience of the risk portfolio taken on. Instead, provisions that allow the reinsurer the right to expose the cedant to financial difficulties such that the risks originally reinsured would fall back on the cedant would be deemed as an unfair term and condition. We will bear in mind to share more examples of such unfair terms and conditions

during the regular dialogues with the industry when we come across more examples of such

6.5 MAS is aware that there can be differing views in terms of significance of the amount of risk transfer of a reinsurance arrangement. As such, MAS expects the external auditors and approved actuaries to make the determination based on prevailing standards, practices or guidelines issued by the respective professional bodies.

7 Treatment of Contracts with Long Settlement Term

7.1 MAS had given an example of a contract with an extended settlement term as one of the contracts that would not be granted capital relief in the consultation paper. A few respondents had wanted to better understand MAS' concerns on such arrangements and suggested for MAS to address the credit and liquidity risks posed by such contracts under the RBC framework instead as these arrangements typically involves significant insurance risk transfer. One respondent further pointed out that deals where financing is up-front but the actual loss event is expected at a much later date are allowed in the United Kingdom and asked why the same treatment would not be extended in Singapore. They opined that while the rest of the revised legislation increases the responsibility of the insurer to appropriately manage their business, this example seems to be in contrary to that.

MAS' Response

7.2 As mentioned earlier, the principles stated in the consultation paper have been set out taking into consideration the guidelines in other established jurisdictions, e.g. the United Kingdom had recently revised its rules to not allow capital relief for cashless reinsurance transactions going forward. As such, long settlement terms can be unfair to the ceding insurer but insurers may still engage MAS on the structure of any financial reinsurance arrangements and we will take into consideration any factors that may effectively mitigate the credit and liquidity risks posed to the ceding insurer, such as letters of credit or cash call provisions, in determining the amount of capital relief to be granted.

8 Disclosure Requirements

8.1 Insurers will be required to disclose in the statutory returns as 'Additional Information to Form 1' any reinsurance financing contract that does not involve significant risk transfer. Two respondents sought clarification on the need for this information to be audited and one of them indicated that disclosing the details of such deals could lead to a competitive disadvantage for the insurer.

MAS' Response

8.2 Under the existing Notices MAS 208 and MAS 316, insurers are already required to disclose any financial reinsurance transactions separately in Forms 1 and 6 of the A&S Regulations. There is no change to the current practice.

9 Power for MAS to Adjust Capital Relief for Outward Reinsurance Arrangements

9.1 It was stated in the consultation paper that MAS may reduce the amount of capital relief an insurer can enjoy with respect to a reinsurance arrangement should MAS be of the view that the arrangement does not involve significant insurance risk transfer, or contains terms and conditions or characteristics that may jeopardise the ability of the ceding insurer to meet its policy liabilities.

9.2 A number of respondents had highlighted the uncertainty arising from MAS having the discretionary power to disagree with the external auditors' and approved actuaries' assessments and to adjust the amount of capital relief. They commented that they may incur significant expenses if they were to unwind the arrangement. They had hence sought clarification on the mechanics of MAS' assessment and queried if they would be given time to adjust the reinsurance arrangements.

MAS' Response

9.3 MAS acknowledges that there may be some subjectivity in the assessment of significant risk transfer and unfair terms and conditions. In this regard, insurers could approach MAS to discuss about the amount of capital relief in respect of a proposed reinsurance arrangement. However, insurers should first make their own assessment together with the external auditor and actuary and engage MAS only if they are uncertain.

9.4 In assessing the reinsurance arrangement, MAS will take into consideration how the proposed transaction fits into the insurer's reinsurance management

strategy, as well as the views of the external auditors and the approved actuaries. MAS will engage the insurer concerned to formulate the appropriate supervisory action on a case by case basis and sufficient time will be given to unwind the transactions or to top up the financial resources to meet the additional capital requirements.

MONETARY AUTHORITY OF SINGAPORE
1 APRIL 2011

**RESPONDENTS TO THE CONSULTATION PAPER ON PROPOSED
FRAMEWORK FOR REINSURANCE MANAGEMENT**

- (1) Asia Capital Reinsurance Group Pte Ltd
- (2) Atradius Credit Insurance NV (Singapore)
- (3) Institute of Certified Public Accountants of Singapore
- (4) Liberty Mutual Insurance Europe Ltd
- (5) Life Insurance Association¹
- (6) MSIG Insurance (Singapore) Pte Ltd
- (7) Muenchener Ruckversicherungs Gesellschaft, Singapore branch
- (8) Singapore Reinsurer's Association²
- (9) Singapore Actuarial Society

¹ The Life Insurance Association submitted comments on behalf of 9 insurers, namely, AIA, Aviva, Friends Provident, HSBC Insurance, Manulife, Prudential/Pru Life, TM Asia Life and Transamerica.

² The Singapore Reinsurers Association submitted comments on behalf of 5 reinsurers who were not separately identified.