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IRDAI's Second Exposure Draft on Reinsurance of 2022

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Introduction

On 21 October 2022, the IRDAI had issued an exposure draft on the IRDAI (Re-insurance) (Amendment) Regulations 2022 ("***October Draft***") with an aim to reduce the requirements on placement of reinsurance, revise the existing Order of Preference to be followed by a Cedant[1] while reinsuring its risks and increase the limits placed on cessions to Cross Border Reinsurers ("***CBRs***"), while continuing the existing principle of maximising retention[2] within India. Our article on the key changes proposed under the October Draft can be accessed here.

Following comments received from various stakeholders on the October Draft, the IRDAI has issued a revised exposure draft on the IRDAI (Re-insurance) (Amendment) Regulations 2022 of 25 November 2022 ("***Draft Amendment***"), in consultation with the Insurance Advisory Committee. The Draft Amendment broadly retains the key changes proposed to (i) the IRDAI (Re-insurance) Regulations 2018 ("***Reinsurance Regulations***"), (ii) IRDAI (Registration and Operations of Branch Offices of Foreign Re-insurers other than Lloyd's) Regulations 2015 ("***FRB Regulations***"), and (iii) IRDAI (Lloyd's India) Regulations 2016 ("***Lloyd's Regulations***") as contained in the October Draft, and provides clarifications to some of the proposed changes.

Proposed Changes

A brief summary of the key changes proposed in the Draft Amendment in terms of the Reinsurance Regulations and the October Draft, to the extent applicable, are set out below:

1. The Draft Amendment now proposes that the Reinsurance Regulations shall be reviewed by

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1 R2(5) of the Reinsurance Regulations defines Cedant as follows:

> *"'Cedant' means an Indian Insurer who underwrites direct insurance business and contractually transfers (cedes) a portion of the risk;"*

2 R2(20) of the Reinsurance Regulations defines Retention as follows:

> *"'Retention' means the portion of the risk, which an Indian Insurer assumes for its own account;"*

the IRDAI once every three years from the date of the notification, unless a review, repeal or amendment is considered necessary before such time.

2. The Draft Amendment proposes to amend the manner in which Cedants must seek reinsurance support. The proposed changes are as follows:

   a. As a notable departure from the terminology used in the Reinsurance Regulations presently, the phrase "*obtain best terms*" has been substituted with the phrase "*secure lead terms"* and the relevant heading for R5 is proposed to be changed from "*Obtaining best terms for Cessions"* to "*Seeking lead reinsurance support*", potentially indicating that the prescribed norms only apply in relation to a Cedant obtaining the "*lead*" reinsurance support for each risk.

   b. Similar to the October Draft, instead of the present requirement for seeking terms from Indian reinsurers, it is proposed that a Cedant obtain terms from at least three "*Category 1*" reinsurers (which includes Indian Reinsurers, Foreign Reinsurers' Branches ("***FRBs***"), Lloyd's India and International Financial Service Centre ("***IIOs***") per R5(2)(A)(a) of the Reinsurance Regulations). However, the Draft Amendment proposes that in the event a Cedant has been unable to secure lead terms from three "*Category 1*" reinsurers, the Cedant is required to maintain on its record the evidence of having approached to all "*Category 1*" reinsurers.

   c. In the Draft Amendment, it is reiterated at both R5(1) and R5(2) that except for facultative reinsurance[3], no Cedant shall offer participation to any Indian Insurer, which is not registered with the IRDAI to "*exclusively*" transact reinsurance business.

   d. The Draft Amendment continues to prohibit seeking best terms from CBRs/IIOs having a credit rating below "A-" from Standard & Poor's or equivalent credit rating from other agencies. However, as a departure from the present norms and the October Draft, the Draft Amendment expressly clarifies that this prohibition shall not be applicable where "*an IIO is a subsidiary /branch of an Indian Insurer.*"

3. The Draft Amendment proposes certain changes to the categories laid out in the Order of Preference (which Cedants are mandatorily required to follow for all Cessions[4]) proposed under the October Draft. The amended Order of Preference and the categories thereunder are as follows:

   a. Category 1: Indian Reinsurers, FRBs (including Lloyd's India) and IIOs;

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3 R2(10) of the Reinsurance Regulations defines Facultative Reinsurance as follows:

> "*"Facultative Reinsurance" means reinsurance for a single risk or a defined package of risks, where neither the cedant is obliged to submit these risks to the reinsurer nor the reinsurer is obliged to provide reinsurance protection;"*

4 R2(6) of the Reinsurance Regulations defines Cession as follows:

> "*'Cession' means the part of risk passed to a Re-insurer by the cedant;"*

b. Category 2: CBRs with rating A+ and above and which *“retains minimum 50% of the premium in India in the manner as specified by the Authority*”. This is a departure from the October Draft which proposed that the retained premium be held by way of deposit with the Cedant in a designated/escrow account as well as to invest such amount in Government securities, or that the CBR agree to provide collaterals/letter of credit/bank guarantee for such retained premium to Cedant, or that the CBR maintain a dollar denominated account in an IFSC bank holding for such retained premium.

c. Category 3: To other Indian Insurers (only in respect of per-risk facultative placements) and other CBRs.

4. Similar to the October Draft, the Draft Amendment proposes that the retrocession[5] of up to 20% to the IIOs will be “*reckoned*” or counted towards the retention requirements of Indian reinsurers, FRBs and Lloyd's India. Presently, every Indian reinsurer, FRB and Lloyd's India is required to retain at least 50% of its Indian business.

5. In terms of compliance requirements, the Draft Amendment proposes to do away with the requirement to obtain Board approval for the reinsurance programme and retention policy for the forthcoming year, instead requiring that such details be provided to the IRDAI in a “*summary*” format as may be specified by the IRDAI. In addition, the requirement to submit retention policy and soft copies of “*each and every re-insurance contract*” is proposed to be removed.

6. Additionally, the Draft Amendment proposes to extend the period for filing the Board approved final reinsurance programme as mentioned under R3(3)(A)(c) of the present Reinsurance Regulations, from 30 days to 45 days of the commencement of the financial year. The final re-insurance programme needs to be submitted by specifically “*highlighting the variations*” from the previous reinsurance programme. The present requirement to submit a declaration of the CEO in case there are no changes to the reinsurance program is proposed to be removed.

7. As an additional requirement, the Draft Amendment proposes to specifically require a confirmation that all treaty arrangements have been received by the Insurer in original, duly stamped and signed form. In this regard, the proposed R3(3)(A)(e) of the Reinsurance Regulations is as follows:

> *“Within 90 days from the commencement of Financial Year, submit to the Authority a certification from the CEO of the Insurer confirming that all Re-insurance Treaty Agreements associated with the Re-insurance Programme of the Financial Year have been received in original, duly stamped and signed, from all Re-insurers.”*

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5 R2(21) of the Reinsurance Regulations defines Retrocession as follows:

> “*‘Retrocession' means a re-insurance transaction whereby a part of assumed reinsured risk is further ceded to another Indian Insurer or a CBR;*”

8. As a deviation from both the present provisions of the Reinsurance Regulations as well as the October Draft, the Draft Amendment proposes to increase the overall cession limits for a financial year (for other than life insurance business), in the following manner:

    a. For CBRs with rating greater than A+: From the present 20% to "*such amount as may be specified by the Authority from time to time*" or 30%, whichever is higher, instead of the flat 25% suggested in the October Draft. The amount proposed to be specified at present is noted as Rs. 200 crores.

    b. For CBRs with rating greater than BBB+ and up to A+: From 15% to 20%, instead of the 17.5% suggested in the October Draft.

    c. For CBRs with rating BBB+ and BBB, the cession limit of 10% remains unchanged.

    Additionally, the foregoing limits on CBR cessions are proposed to be not made applicable for reinsurance placements with "*Category 2*" CBRs (ie, CBRs with ratings A+ and above and maintaining 50% retention), and instead shall only apply to other CBRs.

9. The foregoing cession limits continue to be calculated on the "*total reinsurance premium ceded outside India to all CBRs*" instead of on a per risk or segment basis.

10. The Draft Amendment proposes to insert R12(4) in the Reinsurance Regulations as follows:

    > *"(4) The Chairperson of the Authority may issue guidelines on issuance of File Reference Number (FRN) to CBR, conditions of renewal of FRN (Regulation 4), ART (Regulation 8), concentration limits of CBR in India, the manner in which Category 2 CBRs retains premium as per Reg. 5, sub regulation (2)(A) (b) and regulatory framework of domestic Insurance Pools".*

11. The Draft Amendment proposes to amend the FRB Regulations and the Lloyd's Regulations. In addition to reckoning retrocessions to IIOs in computing the minimum retention of FRBs and Lloyd's India, it is also proposed to reduce the assigned capital requirements from ₹100 crores to ₹50 crores in respect of opening of new FRBs (but this change has not been suggested in respect of Lloyd's India branches, as earlier proposed in the October Draft).

Concluding Remarks

Compared to the October Draft, the Draft Amendment has broadly suggested minor clarificatory changes.

The IRDAI has invited comments on the Draft Amendment from various stakeholders and the general public by 16 December 2022. It remains to be seen whether the Draft Amendment will be notified in the present form, or if there are additional changes yet to be seen subject to comments from stakeholders across various forums.

If notified, the Draft Amendment would come into force from 1 April 2023.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

For further information on this topic please contact Tuli & Co

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