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Collateralized Reinsurance Placements With CBRs In India: Update

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India Insurance

Introduction

The IRDAI had issued an exposure draft on "*Guidelines on Collateralized reinsurance transactions for placement of reinsurance business with CBR*" on 20 February 2024 ("Draft Guidelines") and invited comments from all concerned stakeholders.

Following comments received, the IRDAI has now issued guidance on the subject as a part of its "*Master Circular on Reinsurance, 2024*" of 31 May 2024 ("Master Circular"), which comes into force from the date of its issuance. This Master Circular has been issued in furtherance of: (i) the IRDAI (Registration and Operations of Foreign Reinsurers Branches and Lloyd's India) Regulations 2024 ("FRB Regulations"), and (ii) the IRDAI (Reinsurance) Regulations 2018 ("Reinsurance Regulations") and sets out procedures and requirements in terms of various aspects set out in these regulations.

The Master Circular is divided into two parts – Part I sets out guidance in relation to various operational aspects pertaining to 'branches of foreign reinsurers' ("FRBs") or a Lloyd's India Service Companies/Syndicates, and Part II sets out guidance for Cross Border Reinsurers ("CBRs") and it is in this Part II that the guidelines on collateralised placements have been set out.

The Master Circular specifies that the underlying objective for collateralized placements is to ensure that Indian Cedants "*maintain their ability to meet obligations towards policyholders in India, while continuing their growth trajectory.*"

Key Points of Difference from the Draft Guidelines

Broadly, as proposed under the Draft Guidelines [1], the Master Circular requires all Cedants placing reinsurance business with CBRs to collect collaterals for such reinsurance placement, either by way of an irrevocable Letter of Credit ("**LoC**") from the respective CBR or a withholding of the premium or funds by the Cedant from the respective CBR [2]]. We have discussed the various considerations proposed under the Draft Guidelines in our previous article on the subject, which can be accessed here.

While the Master Circular has, broadly, retained most of the requirements for collateralized placements (including specific requirements for the LoC or withholding of premium/funds) as set out in the Draft Guidelines (and as noted in our previous article), there are a few notable changes introduced under the Master Circular, which are as follows:

1. The Draft Guidelines proposed that the minimum amount of collateral required to be collected from CBRs varied between 80% to 100%, depending upon the rating of the concerned CBR [3]] where this percentage was based on the aggregate of outstanding claims liabilities and IBNR reserves). However, the Master Circular has now:
   a. Reduced the minimum collateral amount required to 75% [4]] if the CBR is rated A- or above from Standard and Poor or an equivalent credit rating agency, and
   b. Retained the minimum collateral amount required from CBR's rated below A- from Standard and Poor or an equivalent credit rating agency at 100%.
2. As a new stipulation, the Master Circular exempts the following reinsurance transactions from complying with the collateral requirements [5]:
   a. where the premium amount is retroceded by FRBs or Indian reinsurers to CBRs;
   b. where premiums are ceded to CBRs in respect of government schemes (such as PMFBY, PMJAY, PMJJBY and PMSBY); and
   c. where the total premium ceded by a cedant to CBRs is up to Rs.75 crores (c.US$ 9m), subject to the condition that the CBRs are rated 'A-' or above from Standard & Poor or any other equivalent credit rating agency.
3. As proposed in the Draft Guidelines, these provisions are applicable to all reinsurance programs in India from the financial year 2025-26 onwards [6].

Other Norms in Part II of the Master Circular

Apart from the guidance on collateralized reinsurance placements, Part II of the Master Circular also prescribes norms in relation to the following key stipulations:

1. **Issue of File Reference Numbers (FRNs) to CBRs**: The Master Circular specifies the process for issuing a 'File Reference Number' to CBRs for allowing them to participate on reinsurance of risks of Indian Cedants [7]. It is relevant to note that the process is,

broadly, similar to the IRDAI's "*Guidelines on issuance of File Reference Numbers (FRN) to Cross Border Re-insurers*" of 3 January 2023 ("Erstwhile FRN Guidelines"), which stand repealed by the Master Circular.

2. Advance Reinsurance Program: The Reinsurance Regulations requires Indian Insurers and FRBs to submit their proposed reinsurance programmes for the forthcoming financial year to the IRDAI, at least 45 days before the commencement of the financial year[8]. For this purpose, the Master Circular prescribes the format[9] (separately for Life and General Insurers (including standalone Health Insurers, Reinsurers, FRBs and Exempted Insurers)) in which Insurers/FRBs are required to file their reinsurance programme.

Concluding Remarks

The introduction of the requirement for collateralised placements appears to be one more step towards protection of policyholders' interests while promoting the growth and development of the Indian insurance sector. These norms appear to have been introduced in the Master Circular after taking into account some of the comments received from stakeholders.

Since the collateral placement requirement are only prescribed for CBRs, it remains to be seen whether overseas reinsurers that have obtained an FRN from the IRDAI and presently underwrite reinsurance risks in India as CBRs continue with their existing business structure or seek to obtain registration either as an FRB or an IIO.

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.

Footnotes

1 ¶4(a) of the Draft Guidelines.

2 ¶2(a) and ¶2(b) under Chapter III of Part II of the Master Circular.

3 ¶4(b)(iii) of the Draft Guidelines.

4 ¶2(b)(iii) under Chapter III of Part II of the Master Circular.

5 ¶3(d) under Chapter III of Part II of the Master Circular.

6 ¶4 under Chapter III of Part II of the Master Circular.

7 ¶17 under Chapter I of Part II of the Master Circular.

8 R3(3)(A)(b) of the Reinsurance Regulations.

9 ¶18(2) under Chapter II of Part II of the Master Circular.

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