Practice of Reinsurance - 2016 and Forward : Indian Market

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In the recently amended legislation related to insurance, quite a few change related to reinsurance practice is introduced. It is also seen from the communique from the Indian regulator that there will be impact upon overseas reinsurers' access to Indian reinsurance cessions. This article takes a closer look at the recent regulatory developments and its likely impact on reinsurance practices in India.

New Direction

The new government in India has set in motion many policy changes through legislative actions. One was the legislation relating to insurance. This has given rise to introduction of a profound change in reinsurance practice in India and will have a serious impact upon overseas reinsurers access to Indian reinsurance cessions.

It is not just the Foreign Direct Investment (FDI) which is increased but the permission for foreign reinsurers to set up direct branches on Indian soil with a capacity that will locally compete with the long established GIC Re. Such business is not required to incorporate as a company in India and therefore will not have a local share capital.

The implication of this change to practice of reinsurance within India is serious and with far reaching domestic and international consequences.

Setting up of Branches by Foreign Reinsurers in India

The order in which cessions are to be made by Indian insurance companies is stated in the regulations notified on 23rd October 2015. The exposure draft issued in respect of Lloyd's market operation includes Lloyd's Syndicates to follow suit. (As of December 2015 the exposure draft in respect of Lloyd's Syndicates are under the Authority's consideration.)

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The notification includes the following:

1) Applicant for setting up a branch to make requisition for registration in one of the following two categories :

    a. Category – I – those with order of preference at par with Indian Reinsurer(s). These would be reinsurers who subscribe to retaining 50% of accepted reinsurance premiums in India.

    b. Category – II – others. These would be reinsurers who subscribe to retaining 30% of accepted reinsurance premiums in India.

2) Assigned capital being Rs 100 crore to be invested as per guidelines in this regard.

3) Orderly growth of insurance and reinsurance would be one of the reasons for IRDAI to decide on the number of registrations of branch offices in a year. (As of December 2015, there are four applicants in non-life Category 1 and one applicant in life Category 1. There are no other applicants for Category 2 and SEZ.)

4) Outsourcing: The branch office of foreign reinsurer shall retain the core activities such as underwriting, claims settlement and regulatory compliances and may outsource functions such as back-office servicing, investment, IT, accounts, marketing, human resources, administration and publicity. No other function can be outsourced without the prior approval of the Authority.

5) Margin of solvency computed in accordance with the solvency regulations issued by the Authority. In respect of Lloyd's it is proposed to mandate access to its Central Fund of Lloyd's.

6) Order of preference for cessions by Indian insurers.

Order of Preference for Cessions

Order of preference for cessions by Indian insurers – Every Indian insurer, in order of preference, shall offer for participation in its facultative and treaty surpluses:

> **First** - to at least three of the Indian Reinsurers including GIC Re and to those granted certificate of registration as Category 1 Branch. A proposed amendment

to the notification places GIC Re with the first right of refusal within this category. This is being reviewed. In order to uphold competitiveness amongst reinsurers in Category 1 a view is to mandate that all cessions be shown to GIC Re and to two other reinsurers. This would ensure competition amongst reinsurers and an opportunity to GIC Re to be shown all cessions instead of being selectively shown certain cessions.

Second - to those granted certificate of registration as Category 2 Branch, only after having offered to at least three of the entities in (a) above, including one to GIC Re.

Third - to the offices of insurers set-up in Special Economic Zone, only after having offered to at least three of the entities in (a) and (b) above.

Fourth - the balance may then be offered to overseas reinsurers and to Indian insurers. The concern for cedants would be to show their treaties to Indian insurers who compete for direct business. It would be more appropriate to allow an option to Indian insurers to cede treaties to Indian insurers.

Maximizing retention within the country continues to be a key objective. In view of the mandatory order of preference in cessions it would be a useful to amend regulation 3 (11) of IRDA (General Insurance – Reinsurance) Regulations, 2013, by deleting the caps on overseas cessions. This would add clarity to branch offices of foreign reinsurers and Lloyd's Syndicates to make use of their parental capacity and solvency.

The impact of the above upon practice would be –

1. GIC Re will continue to be a priority reinsurer to the Indian insurance market but will be in competition with Category 1 and 2 Branches of Foreign Reinsurers. In view of the high levels of capacity being offered by GIC Re and expected to be offered by Foreign Reinsurers through their Branches it is highly unlikely any Indian Reinsurer will set shop. Such Reinsurer will be constrained for capacity based upon net worth from Rs. 200 crores required to be invested as share capital. In this space GIC Re and Branches of Foreign Reinsurers are expected to be dominant.

2. Foreign Reinsurers are expected to be encouraged by an option to retain lower premium at 30% as Category 2 Branch and yet enjoy the order of preference, given that only three reinsurers amongst Indian Reinsurers and Category 1 Branch require to be shown the reinsurance offer. As noted earlier as at present there is no indication of interest from foreign reinsurers for investing in this category of branch office.

3. Foreign Reinsurers' Branches once established can lead quote reinsurance programmes of Indian insurers and take as high a share as is feasible. It is to be noted that there is no cap on cessions within India.

4. The spill over of facultative surplus after showing the proposed cession to at least three amongst GIC Re and Category 1 Branches will then be shown to Category 2 Branches. In all, for all domestic reinsurers, three of them need to be shown prior to making an offer to insurers in SEZ (Special Economic Zone).

   In a significant move GIC Re permitted retrocession of Inward Reinsurance to treaties led by them from this year. This resulted in increased domestic capacity for facultative reinsurance. The extent to which Indian insurers would undertake Inward Reinsurance business is a matter of their Risk Appetite and Underwriting Philosophy.

5. The spill over of treaty surplus after showing the proposed cession to at least three amongst GIC Re and Category 1 Branches will then be shown to Category 2 Branches. In all, for all domestic reinsurers, three of them need to be shown the reinsurance offer prior to making it an offer to insurers in SEZ.

6. What spills over after being shown to insurers within SEZ will then be placed overseas reinsurers and Indian insurers. What is ceded overseas will continue to be subject to caps on cessions as made to any one single reinsurer. With increased reinsurance cessions expected within India these caps for overseas cessions will cease to be relavant. It would assist the spirit of order of preference in cessions and the parental capacity support to the branch office to have no caps.

In the process delineated from 1 to 6 above much will be absorbed in India. In 2013-14 the reinsurance cessions from India to overseas reinsurers is USD 1 billion. In the course of next two years when the Foreign Reinsurers' Branch Offices, including Lloyd's, come into full play 90% of these premiums is estimated to be retained in India. This will be almost Rs. 5500 crores in reinsurance premium circulating within the Indian market instead of going out of India. This will lead to spurt in domestic reinsurance broking and conservation of foreign exchange for India. There will be the associated issue of dearth in skilled manpower.

Obligatory cessions are the subject of industry review as their cumulative results are a concern to the designated reinsurer, GIC Re. With the possibility to voluntarily cede Quota Share treaty within the Indian market to GIC Re, Foreign Reinsurers' Branch offices and to any new Indian Reinsurer, it is expected that obligatory cessions would be completely phased out.

Role of JV Partners

Entry into Indian insurance market to foreign reinsurers was liberalized from 24% to 26% in 1999. This gave a blocking majority to the foreign JV Partner. Now there is increase in FDI from 26% to 49% which however does not change the foreign JV Partner's status to freely pass ordinary resolutions.

Within the Joint Ventures, the foreign partners have taken up positions of operational authority to determine the course of business. To this extent they have absolute power over the business. In some instances this control is 100%. The percentage of shareholding is of little relevance to such control.

If the JV Partner were to set up a Branch it would enable and assist the JV Partner to receive all of their JV's reinsurance cessions. They will need to retain at least 30% of these premiums in India and can retrocede the balance 70%. This is a new opportunity for JV Partners of Indian Insurance Companies to increase their involvement.

Status of Broking Companies with foreign JV Partner

The roll out of branches by foreign reinsurers in India and the increased domestic reinsurance capacity will result in increased domestic reinsurance broking activity. With an estimated Rs. 5500 crores in reinsurance premium held back and circulating within India and a much reduced reinsurance premium going overseas, the equations between the Indian and Foreign broking partners in JV will be drastically changed. Focus, including those of the reinsurance brokers, will shift to tying up the Indian insurers to the domestically available reinsurance capacity. Reliance upon overseas reinsurers will be significantly reduced.

Realignments between the broking JV partners can be expected in the matter of their business conduct within India.

We hear about paradigm shift. Now we witness its happening literally before our eyes.

References :

- Insurance Regulatory and Development Authority of India (Lloyd's India) Regulations, 2015.
- Insurance Regulatory and Development Authority of India (Registration and Operations of Branch Offices of Foreign Reinsurers other than Lloyd's) Regulations, 2015.
- Insurance Regulatory and Development Authority of India, Explosure Draft dated 02.12.2015.