GUIDELINES NO. TIU/G-3/2020/13

GUIDELINES ON REINSURANCE/RETAKAFUL MANAGEMENT FOR INSURANCE COMPANIES AND TAKAFUL OPERATORS

1. INTRODUCTION

1.1 These Guidelines are issued pursuant to Section 88 of the Insurance Order, 2006 and Section 90 of the Takaful Order, 2008 to provide guidance on Section 29 of the Insurance Order, 2006 and Section 30 of the Takaful Order, 2008 on the use of reinsurance to ensure that registered insurance companies and takaful operators adequately control and transparently report their reinsurance activities.

1.2. These Guidelines should also be read together with:

1.2.1 Section 29 of the Insurance Order, 2006 or Section 30 of the Takaful Order, 2008;

1.2.2 Notice on Corporate Governance for Insurance Companies and Takaful Operators [Notice No. TIU/N-3/2017/7];

1.2.3 Guidelines on Risk Management and Internal Controls for Insurance Companies and Takaful Operators [Guideline No. TIU/G-3/2018/8]; and

1.2.3 any other Guidelines, circulars or notices, which the Authority may issue from time to time.

1.3. These Guidelines are not exhaustive and are subject to revision from time to time as deemed necessary by the Authority.

1.4. These Guidelines take effect on 1 June 2021.

2. DEFINITION

For the purpose of these Guidelines:

2.1. “ceding insurer” means an insurer who has a portion of the risks ceded to another insurer;

2.2. “insurer” means a registered insurance company under the Insurance Order, 2006 and a registered takaful operator under the Takaful Order, 2008, unless otherwise specified; and

2.3. "reinsurance" includes retakaful.

3. CLASSIFICATION AS REINSURANCE CONTRACT

3.1. An insurer should not classify a contract as a reinsurance contract if such a classification will misrepresent or is designed to disguise a material risk to the insurer's current or continuing profitability or capital position. There should not be any unconditional obligation on the part of the ceding insurer to indemnify the assuming insurer for any negative balances that may arise out of the contract or any separate agreement or understanding between the contracting parties that would serve to reduce, offset or eliminate the assuming insurer's obligations.

3.2. The contract should also not contain any unfair terms and conditions nor possess characteristics that may jeopardise the ability of the ceding insurer to meet its policy liabilities, such as giving the assuming insurer an option to unilaterally alter the terms and conditions of the contract, or, terminate the contract due to an increased likelihood of the assuming insurer experiencing losses under the contract.

4. REINSURANCE MANAGEMENT STRATEGY

4.1. Reinsurance management refers to the oversight and control of outwards reinsurance arrangements, where a portion of the risks assumed by an insurer is ceded to another insurer. Insurers may purchase reinsurance to provide security and liquidity, and to increase their capacity to underwrite more business.

4.2. Reinsurance management plays an important role in ensuring the insurer's ability to meet the statutory obligations under Section 29 of the Insurance Order, 2006 and Section 30 of the Takaful Order, 2008. If an insurer places significant reliance on reinsurance as a risk mitigant, weaknesses in its reinsurance arrangements may impair its liquidity or capital position and possibly affect its ability to meet its obligations to policyholders and claimants.

4.3. The Reinsurance Management Strategy ("RMS") should form part of the insurer's overall underwriting strategy and risk management framework and should be properly documented. The RMS should lay down clear methodologies for determining all aspects of reinsurance arrangements, as well as management responsibilities and controls, including but not limited to:

4.3.1. identification of the insurer's tolerance to risk;

4.3.2. identification of the risk retention levels appropriate to the insurer's tolerance to risk;

4.3.3. determination of the types of reinsurance arrangements most appropriate to manage the insurer's risk exposure in relation to its risk tolerance;

4.3.4. selection of the panel of reinsurers used, including consideration of diversification and credit worthiness of the reinsurers;

4.3.5. management of any known concentration risks with respect to a particular industry, geographical region, product type, and/or single insured in the insurer's underwriting books;

4.3.6. involvement of reinsurance brokers, if any, including their role in structuring the insurer's reinsurance arrangements and the selection criteria for reinsurance brokers;

4.3.7. the process for monitoring, reviewing and updating the RMS in response to changes in the market and the insurer's risk profile;

4.3.8. management of credit risk which will affect the collectability and timely receipt of its reinsurance recoverables;

4.3.9. management of liquidity risk arising from a timing mismatch between the payment of claims and the receipt of reinsurance recoverables; and

4.3.10. management of legal risk arising from the reinsurance contract wordings not accurately reflecting the intent for the purchase of the reinsurance cover or the reinsurance contract being not legally enforceable.

5. ROLE OF THE BOARD OF DIRECTORS AND SENIOR MANAGEMENT

5.1. The primary responsibility for the sound and prudent management of an insurer rests with the Board of Directors ("the board") and senior management. The board and senior management should develop, implement and maintain a RMS appropriate to the operations of the insurer to ensure that the insurer has sufficient resources to meet obligations as they fall due.

5.2. The board should review the RMS at least once a year, or when there are material changes to the insurer's circumstances, its underwriting policy or the status of its panel or reinsurers.

5.3. Senior management should define and document clear operational policies and procedures for implementing the RMS approved by the board. Adequate internal control systems should be in place to ensure that all business activities are carried out with the RMS in mind and that the planned reinsurance cover is in place.

5.4. Senior management should ensure proper and effective reporting systems which satisfy all requirements of the board with respect to reporting frequency, level of detail and recommendations for change are in place.

5.5. Senior management of the ceding insurer should regularly review the performance of its reinsurance programme to ensure that it functions as intended and continues to meet its strategic objectives.

6. **REINSURANCE PROGRAMME**

6.1. A ceding insurer should have a reinsurance programme that is appropriate to their business and part of their overall risk and capital management strategies.

These strategies should include:

6.1.1. objectives pursued by using reinsurance;

6.1.2. risk concentration levels and ceding limits as defined by their risk appetite; and

6.1.3. mechanisms to manage/control reinsurance risks.

6.2. Reinsurance programmes should consist of the following:

6.2.1. detailed implementation of the reinsurance-related elements (of the risk and capital management strategies);

6.2.2. the ceding insurer's overall risk appetite;

6.2.3. comparative costs of capital; and

6.2.4. liquidity positions of the ceding insurer.

6.3. The ceding insurer should have in place proper management controls suitable for the insurer's business which include the following:

6.3.1. set prudent limits or guidelines that reflects the security and size of the reinsurer. These should be in relation to their maximum aggregate exposure to any one reinsurer or a group of related reinsurers;

6.3.2. set sufficient capital to cope with the exposures that it assumes to events of low frequency and high severity;

6.3.3. have procedures for monitoring this aggregate exposure to ensure that the limits or guidelines are not breached. The ceding insurer should also have procedures to manage excess concentrations going forward, such as bringing them back within limits or guidelines;

6.3.4. give due consideration to the risk posed by a mismatch in terms and conditions between reinsurance contracts and the underlying policies;

6.3.5. have appropriate criteria for purchasing facultative coverage, as well as, a specific process to approve, monitor and confirm placement of each facultative risk;

6.3.6. have processes and adequate controls to document principal economic and coverage terms and conditions of reinsurance contracts clearly and promptly;

6.3.7. impact that the ceding insurer's reinsurance contracts have on the capital requirements;

6.3.8. finalise the formal reinsurance contract without undue delay (ideally prior to the inception date of reinsurance contract); and

6.3.9. consider how its reinsurance contracts will operate in the event of an insolvency of itself or its reinsurer.

6.4. The ceding insurer should also assess the impact of the reinsurance programme on liquidity management. The following have to be taken into account when assessing the liquidity:

6.4.1. the ceding insurer should remain liable to fund all valid claims under contracts of insurance that it has written (regardless of whether reinsured or not);

6.4.2. the ceding insurer should take appropriate measures when managing its liquidity risk(s), including funding requirements in adverse circumstances; and

6.4.3. the ceding insurer should respond to different levels of risk it could face.

7. SUPERVISORY REVIEW OF REINSURANCE ARRANGEMENTS

7.1. When assessing the reinsurance programme, the Authority may consider the following factors:

7.1.1. structure of the programme, including any alternative risk transfer mechanisms;

7.1.2. proportion of business ceded so that the net risks retained are commensurate with the ceding insurer's financial resources and risk appetite;

7.1.3. financial strength and claims payment record of the reinsurer in question (in normal and stressed conditions);

7.1.4. levels of exposure to a single reinsurer or different reinsurers being part of the same group;

7.1.5. extent of any credit risk mitigation in place;

7.1.6. expected resilience of the reinsurance programme in stressed claims situations, including stress related to the occurrence of multiple and/or catastrophic events; and

7.1.7. extent to which relevant functions are outsourced by the ceding insurer, including the criteria for the selection of reinsurance brokers.

MANAGING DIRECTOR

AUTORITI MONETARI BRUNEI DARUSSALAM

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