INSURANCE - INDIA

Reinsurance industry: recent developments and way forward

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New reinsurance players

Until recently, the General Insurance Corporation of India (GIC) was India's sole reinsurer. The GIC was established in 1972 under a statute as a wholly owned company of the government of India, along with four subsidiaries, which together operated the general insurance market in India. Pursuant to the liberalisation of the Indian insurance sector in 2000, the GIC was made India's sole reinsurer in order to better address the reinsurance requirements of the growing number of insurance risks in India.

In this regard, notably, every Indian insurer must cede a certain percentage of the sum assured on each policy for different classes of insurance written in India to the GIC, as per Section 101A of the Insurance Act 1938. Although Indian insurers must cede at least the mandatory percentage as prescribed, in practice, an offer must be made to the GIC and the GIC may accept the offer in whole or in part.

The Insurance Laws (Amendment) Act 2015, which brought about extensive amendments to the Insurance Act, also permits the establishment of branch offices in India by foreign companies engaged in reinsurance business (foreign reinsurer branches). Pursuant to the Amendment Act, between 2015 and 2016 the Insurance Regulatory and Development Authority of India (IRDAI) issued the IRDAI (Registration and Operations of Branch Offices of Foreign Reinsurers other than Lloyd's) Regulations 2015 (Branch Office Regulations) and the IRDAI (Lloyd's India) Regulations 2016 (Lloyd's India Regulations), paving the way for foreign reinsurers to set up branches in India and for Lloyd's to establish a presence in India.

In December 2016 the IRDAI granted certificates of registration to five foreign reinsurer branches under the Branch Office Regulations. The IRDAI also granted a certificate of registration to ITI Reinsurance Limited (ITI) so that it could function as an Indian reinsurer alongside the GIC. Further, Lloyd's is in the process of forming an India branch, along with various other foreign reinsurers which are looking to underwrite reinsurance business through service companies set up in India under the Lloyd's India Regulations. In other words, the coming months will see the emergence of several new types of player in this sector.

Reinsurance regulatory framework

The regulatory framework governing the reinsurance of general insurance risks in India was initially governed by the IRDA (General Insurance-Reinsurance) Regulations 2000, which were superseded by the IRDA (General Insurance-Reinsurance) Regulations 2013. The passage of the amendment act set the stage for the amendment of these regulations, and in 2016 the IRDAI published the IRDAI (General Insurance-Reinsurance) Regulations 2016, which superseded the earlier reinsurance regulations. Similarly, the reinsurance of life insurance risks in India was governed by the IRDA (Life

Insurance-Reinsurance) Regulations 2000, which were subsequently superseded by the IRDAI (Life Insurance-Reinsurance) Regulations 2013.

The guiding principle behind the Reinsurance Regulations 2016 and the Life Reinsurance Regulations 2013 is to maximise retention by Indian insurers within India. As such, Indian insurers are strictly prohibited from fronting for a foreign reinsurer. While certain specifications regarding retention limits by life insurers are provided under the Life Reinsurance Regulations 2013, the IRDAI has not issued specific guidance on the appropriate minimum amount to be retained by general insurers.

Further, Indian insurers, Indian reinsurers and foreign reinsurer branches can carry out reinsurance business outside India only with foreign insurers and reinsurers (cross-border reinsurers) that satisfy the eligibility criteria (ie, have a minimum credit rating of 'BBB' from Standard & Poor's or equivalent and are registered in India in accordance with the applicable laws, among other things). Generally, the maximum limit on cessions to cross-border reinsurers under an insurance segment has been prescribed and is based on the cross-border reinsurer's rating.

In addition, subject to its retention limit and the mandatory cession to the GIC to reinsure the remaining insurance risks, with effect from January 16 2017, every Indian insurer must comply with the order of preference for cessions by Indian insurers prescribed by Regulation 28(9) of the Branch Office Regulations.

Order of preference

The order of preference contained in Regulation 28(9) sets out the hierarchy between the various entities with which an Indian insurer can place its reinsurance business. However, by way of a February 29 2016 circular, the IRDAI deferred the enforcement date of Regulation 28(9) until further orders, as at that time no foreign reinsurer branches had been registered to operate in India under the Branch Office Regulations. When the IRDAI began registering foreign reinsurer branches, it brought Regulation 28(9) of the Branch Office Regulations into immediate effect through a January 16 2017 circular.

In accordance with Regulation 28(9), as amended, Indian insurers must obtain the best terms for their facultative and treaty surpluses from:

- Indian reinsurers with the minimum credit rating (ie, good financial security characteristics) from any of the internationally renowned credit rating agencies for the previous three years; and
- at least three foreign reinsurer branches which have been registered under Regulation 4(a) of the Branch Office Regulations (ie, Category 1, wherein the foreign reinsurer branch must maintain a minimum retention of 50% of the Indian reinsurance business).

The Indian insurer must then offer the best terms for participation in the following order of preference:

- Indian reinsurers which have the minimum credit rating (currently, the GIC) and thereafter to those foreign reinsurer branches registered under Regulation 4(a) of the Branch Office Regulations (ie, Category I – 50% retention);
- other Indian reinsurers or to those foreign reinsurer branches registered under Regulation 4 (b) of the Branch Office Regulations (ie, Category II, wherein the foreign reinsurer branch must maintain a minimum retention of 30% of the Indian reinsurance business);
- foreign reinsurer branches set up in special economic zones, only after having offered terms to all the entities listed above; and
- if any balance is left, Indian insurers and overseas reinsurers/cross-border reinsurers.

Comment

Under Regulation 28(9) of the Branch Office Regulations, at present, the GIC has the right of first offer over any entity to which an Indian insurer can offer its reinsurance business.

Notably, the IRDAI granted registration to ITI so that it could function as an Indian reinsurer.

However, at this stage, it is unclear where ITI will fall in the order of preference, although it is expected to fall within the category of 'other Indian reinsurers', as set out in Section 2 of the order of preference described above. Further, while it is unclear whether the mandatory cession under Section 101A of the Insurance Act must be made to ITI and the GIC, from a plain reading of the provision, it may be argued that the mandatory cession may be required to be made to both entities. However, the mechanism and procedure for implementing this remains unclear.

Further, neither Regulation 28(9) nor the IRDAI itself have clarified the number of Category I or Category II foreign reinsurer branches with which an Indian insurer can place reinsurance business. No clarity has been provided on whether Indian insurers must offer their surplus to some or all foreign reinsurer branches at the same time or create an order of preference among the branches. Moreover, even assuming that Indian insurers must offer the surplus to all foreign reinsurer branches at once, the criteria for determining the allocation of reinsurance business between such branches remains unclear.

On November 23 2016 the IRDAI set up a committee to make recommendations for the efficient implementation and operation of the order of preference for cessions specified in Regulation 28(9) of the Branch Office Regulations. The committee, which was expected to come out with a report and guidelines by December 9 2016, must set out:

- the procedure for establishing the order of preference for cessions; and
- the manner of seeking quotes on best terms and establishing timelines for accepting the best offer.

The committee report is eagerly awaited by the insurance industry, as it is expected to clarify the implementation of Regulation 28(9) of the Branch Office Regulations and is likely to affect Indian insurers' reinsurance programmes in future. For now, Indian insurers are in the process of preparing and submitting their reinsurance programmes for the coming financial year, in accordance with the extant reinsurance regulatory framework.

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