



IRA

Insurance Regulatory Authority

IRA/PG/12

**GUIDELINE TO THE INSURANCE INDUSTRY ON
REINSURANCE ARRANGEMENTS**

FEBRUARY 2013

**To Insurance Companies
Reinsurance Companies
Insurance Intermediaries**

**GUIDELINE ON REINSURANCE ARRANGEMENTS FOR INSURERS AND
INSURANCE INTERMEDIARIES**

This guideline on reinsurance arrangements is issued pursuant to section 3A of the Insurance Act for observance by Insurers and Insurance Intermediaries.

This guideline aims to ensure that insurers have reinsurance management framework with a documented Reinsurance Management Strategy, sound reinsurance management policies and procedures, and clearly defined managerial responsibilities and controls.

The guideline further aims to ensure a properly structured reinsurance programme that would assist insurers to limit wide fluctuations in underwriting results.

To this end, the Insurance Regulatory Authority issues this guideline on reinsurance arrangements to be effective from 1stApril, 2013.

Yours faithfully,



SAMMY M. MAKOVE
COMMISSIONER OF INSURANCE & CHIEF EXECUTIVE OFFICER

THE INSURANCE ACT (CAP 487)
IRA/PG/12
GUIDELINE TO THE INSURANCE INDUSTRY
ON REINSURANCE ARRANGEMENTS

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1.0 AUTHORIZATION

IN EXERCISE of the powers conferred by sections 3A (a), (b) and (g) of the Insurance Act, the Insurance Regulatory Authority (herein referred to as Authority) issues the Guideline set out here below, for observance by all insurance companies, reinsurance companies and intermediaries registered under the Insurance Act Cap 487, in order to offer guidance on principles to be adhered to in respect of reinsurance arrangements.

2.0 INTRODUCTION

- 2.1 A reinsurance contract is a contract of indemnity between the reinsurer and an insurer and does not constitute a legal transfer of part of the underlying risk.
- 2.2 This guideline is of equal relevance to life insurers, general insurers and reinsurers. Where appropriate, this guideline is also relevant to intermediaries.
- 2.3 Reinsurance forms a vital part of an insurer's risk transfer strategy. It provides for protection against the potential large accumulations of individual losses that can result from catastrophic events.
- 2.4 Reinsurance also functions as an alternative means of capital access in order to finance risk and business acquisition costs.
- 2.5 Reinsurance provides flexibility for insurers in the size and types of risk and the volume of business they can reasonably underwrite.
- 2.6 Use of reinsurance by insurers should be looked at as part of an overall risk assessment of the insurer and not merely with reference to a single type of risk and whether that risk has increased or decreased.

2.7 A reinsurance contract is by nature a business-to-business transaction, made between professional counterparties as part of a wider risk and capital management approach.

2.8 Reinsurance arrangements should take the following issues into account:

- i. The relative financial strength and claims payment record of the reinsurers in question (both in normal and stressed conditions);
- ii. The soundness of the risk and capital management strategy;
- iii. The appropriateness of the reinsurance strategy given the underlying insurance portfolios;
- iv. The structure of the reinsurance programme;
- v. The extent to which relevant functions are outsourced, either externally or within the same group of companies;
- vi. The levels of aggregate exposure to a single reinsurer or different reinsurers being part of the same group;
- vii. The proportion of business ceded so that the net risks retained are commensurate with the insurer's financial resources;
- viii. The level of effective risk transfer;
- ix. The resilience of the reinsurance programme in stressed claims situations; and
- x. The extent of any credit risk mitigation in place.

3.0 DEFINITIONS

The following key definitions apply:

- 3.1 **Authority** – The Insurance Regulatory Authority;
- 3.2 **Cedant** – an insurer who enters into a reinsurance arrangement with a reinsurer. The term “the cedant” is synonymous with the term “the reinsured”;
- 3.3 **Coinsurance** – the sharing of risk, on the same terms, between two or more insurance companies;
- 3.4 **Facultative** - Facultative reinsurance means reinsurance of individual risks by offer and acceptance wherein the reinsurer retains the right to accept or reject each risk offered;
- 3.5 **Fronting Arrangements** - the issuance of a policy by licensed Kenyan insurer or intermediary on behalf of a second insurer because the second insurer is not licensed or admitted in Kenya. The licensed Kenyan insurer issues the policy to the insured and retains legal responsibility for meeting claim payments under it, but has reinsured 100% of its exposure to the second insurer;
- 3.6 **Insurer** – A registered insurance or reinsurance company authorised to conduct insurance business in Kenya;
- 3.7 **Investment Grade** - a rating on claims payment ability and financial strength of the reinsurer provided by ratings agency;
- 3.8 **Maximum Event Retention (MER)** – the maximum amount retained, calculated separately by class of business, by the insurer in respect of the accumulation of all losses arising from a defined event;

- 3.9 **Pool** - An organization of insurers or reinsurers through which particular types of risks are underwritten with premiums, losses, and expenses shared in agreed ratios;
- 3.10 **Reinsurance** –a financial transaction by which risk is transferred (ceded) from an insurance company (cedant) to a reinsurance company (reinsurer) in exchange of reinsurance premium;
- 3.11 **Reinsurer** - An insurer assuming the risk of another insurer under an insurance contract;
- 3.12 **Retention** - The net amount of risk which the ceding company or the reinsurer keeps for its own account;
- 3.13 **Retrocession** - means the reinsurance of reinsurance business accepted by a reinsurer.
- 3.14 **Treaty** - A reinsurance agreement which is obligatory between the ceding company and the reinsurer containing the contractual terms applying to the reinsurance of some class or classes of business.

4.0 OBJECTIVES

- 4.1 The objectives of this guideline is to ensure that insurers:
- 4.1.1 Set standards for the use of reinsurance and other forms of risk transfer;
- 4.1.2 Have a framework to manage the selection, implementation, monitoring, review, control and documentation of reinsurance arrangements that are used to contribute to the insurer’s ability to meet its obligations to policyholders; and
- 4.1.3 Adequately control and transparently report their risk transfer programmes.

5.0 GENERAL PRINCIPLES

- 5.1 Insurer's reinsurance strategy shall be part of the risk and capital management strategy.
- 5.2 The reinsurance strategy shall take into account the insurers' business model, levels of capital and business mix.
- 5.3 Responsibility for developing and agreeing upon the strategy shall rest with the Board and Management of the insurer,
- 5.4 Board and Management shall be responsible for establishing appropriate monitoring mechanisms to ensure that the strategy is being delivered and complied with by the insurer.
- 5.5 The Board and Management shall commission regular reviews of the performance of the reinsurance programme, to ensure that it functions as intended and continues to meet its strategic objectives;
- 5.6 The Board and Management shall put in place appropriate written terms of reference for the individuals or departments involved in the day-to-day management of the reinsurance programme, including scope of authority and specification of matters reserved for the Board and Management;
- 5.7 The insurer shall be required to put in place controls of reinsurance arrangements suitable in the context of the nature, scale and complexity of the business and the extent of their reinsurance exposures. These controls shall be part of the insurer's overall internal control and governance structure.
- 5.8 The insurer shall be required to consider the following features while conducting traditional reinsurance transactions;

- 5.8.1 The characteristics of its reinsurance programme, including associated counterparty risk, are adequately reflected in any assessment of risk-based solvency capital.
- 5.8.2 Procedures for identifying reinsurers that provide security which it finds acceptable and for keeping this under review. There should also be processes for dealing with situations where there is a need to assess reinsurers outside the minimum investment grade.
- 5.8.3 Set prudent limits or guidelines reflecting security and size of the reinsurer, in relation to its maximum aggregate exposure to any one reinsurer or to a group of related reinsurers.
- 5.8.4 Procedures for monitoring this aggregate exposure to ensure that these limits or guidelines are not breached, including procedures to see that excess concentrations are brought back within limits or guidelines, or otherwise managed, going forward.
- 5.8.5 Processes to ensure that all reporting due to and from reinsurers is timely and complete and that settlements are made as required by the contract.
- 5.8.6 The cedant shall give due consideration to the risk posed by a mismatch, unintended or not, in terms and conditions between reinsurance contracts and the underlying policies, meaning that the cedant may bear a greater net exposure than it intended because of this gap.
- 5.8.7 The insurer should have a specific process in place to approve, monitor and confirm the placement of each facultative risk. The facultative reinsurance shall be secured before the commencement date of the policy for the risk that exceeds its treaty capacity and/or its risk appetite. The insurer should

further ensure that reporting of balances due to and from facultative reinsurers is timely and complete and that settlements are made as required by the contract/within a specific duration.

5.8.8 Monitor the performance and potential exhaustion of its reinsurance programme, to ensure compliance with the reinsurance strategy and to make decisions about the ongoing suitability of the programme.

5.9 An insurer shall be required to have processes in place to ensure that it has accurate and complete reinsurance documentation at, or shortly after, the inception date of its reinsurance arrangements. Reinsurance documentation ensures clarity in the contract terms and conditions and reducing the possibility of dispute between the parties when called upon to fulfil their contractual obligations.

5.10 The insurer shall be required to control its liquidity position taking into account the structure of the risk transfer contracts and their likely payment patterns. These can include clauses which allow for accelerated payment of amounts due from reinsurers in the event of a large claim and/or the use of collateral or deposit accounts, giving cedants access to funds as needed.

5.11 The insurer shall be required to transact insurance business with reinsurers having minimum investment grade rating of BBB provided by international ratings agency Standard and Poors, or the equivalent

6.0 SPECIFIC REQUIREMENTS

6.1 Board and Management Responsibilities

6.1.1 The Board of Directors shall set limits on:

- i. The net risk to be retained per class of business and aggregate for the company; and

- ii. The maximum foreseeable amount of reinsurance protection to be obtained from approved reinsurers.

6.1.2 Management shall document clear policies and procedures for implementing the reinsurance strategy set by the Board of Directors, including:

- i. Setting underwriting guidelines that specify the types of insurance to be underwritten, policy terms and conditions, and aggregate exposure by class of business;
- ii. Establishing and documenting limits on the amount and type of insurance that will be automatically covered by treaty reinsurance; and
- iii. Establishing and documenting criteria for acquiring facultative cover.

6.1.3 The Board of Directors shall review the reinsurance strategy at least biennially and whenever there have been material changes in the company's circumstances.

6.1.4 An insurer shall seek the advice of Appointed Actuary on the soundness of risk and capital management strategy before entering into, modifying or terminating a reinsurance arrangement.

6.2 Reinsurance Management Strategy (RMS)

6.2.1 Every insurer shall have a written reinsurance management strategy (RMS), approved by the company's Board of Directors that is appropriate to the insurer's overall risk profile.

6.2.2 An insurer shall be required to review and submit its RMS to the Authority biennially and whenever there have been material changes in the company's circumstances prompting revision of the RMS, within 20 working days of the insurer's Board approving the RMS.

6.2.3 At a minimum, the RMS of an insurer shall:

- i. Identify the insurer's tolerance for risk;
- ii. Identify the level of cessions appropriate for the insurer's tolerance for risk;
- iii. Identify, and clearly articulate, any other reasons for seeking reinsurance cover, such as risk diversification, financing of new business or expertise transfer;
- iv. Determine what types of reinsurance arrangements are most appropriate to limit risks to the insurer's level of tolerance;
- v. Set out how liquidity will be managed where there is a timing mismatch between the payment of claims and the receipt of reinsurance recoveries;
- vi. Peak exposures and seasonality in the insurance book;
and
- vii. Appetite for credit risk.

6.2.4 The RMS shall be part of the insurer's overall underwriting strategy which in turn is a subset of the company's risk management strategy.

6.2.5 The RMS shall define and document the insurer's approach for reinsurance management framework, identifying the procedures for:

- i. The reinsurance cover(s) to be purchased;
- ii. The selection process of reinsurers;
- iii. What collateral, if any, is required from the reinsurer at any given time; and
- iv. How the reinsurance program will be monitored, including reporting and internal control systems.

6.3 Reinsurance Arrangements

6.3.1 An insurer shall be required to submit to the Authority a Reinsurance Arrangements Statement that details the insurer's reinsurance arrangements on an annual basis with the renewal of application.

6.3.2 Insurers may enter into reinsurance arrangements whereby insurance risk is transferred from the direct insurer to the reinsurer. Reinsurance contracts may be:

- i. Traditional contracts, such as "treaty" and "facultative" reinsurance; and
- ii. Within treaty reinsurance, reinsurance cover may be proportional or non-proportional, and contracts such as surplus reinsurance, excess of loss reinsurance, stop loss reinsurance and catastrophic excess of loss reinsurance may be entered into.

6.3.3 Insurers may enter into coinsurance arrangements, provided that any such arrangements are clearly identified and fully taken into account in the insurer's reinsurance strategy.

6.3.4 Insurers may enter into inward reinsurance arrangements, provided that:

- i. Any such arrangements are clearly identified and fully taken into account in the insurer's reinsurance strategy;
- ii. Adequate retrocession arrangements are in place, so that the insurer entering into such arrangements only retains the levels of risk in accordance with its risk management and reinsurance strategies;
- iii. The insurer has provided for adequate reserving for any inwards reinsurance business; and
- iv. The terms and conditions of the reinsurance cover must be compatible with those of the underlying insurance business, in order to avoid uncovered risk.

6.3.5 Limits on the net risk to be retained need to be set both by line of business and for the whole company. The insurer will also need to set limits per risk or per event, or a combination thereof. The limits must be based on an evaluation of the insurer's risk profile and the cost of reinsurance. The limits, or retentions, must be based on calculations by line of business.

6.3.6 In calculating the quantum of reinsurance cover required, insurers shall apply the following methodology:

- i. A calculation of the quantum of maximum loss arising from the catastrophic event determined by the Board to be the most financially damaging to the insurer;
- ii. In calculating the maximum loss, the Board shall include the impact of this catastrophic event on all classes of business underwritten by the insurer;

- iii. Establishing the Maximum Event Retention (MER).
- iv. Effect reinsurance cover between the maximum loss and the MER.

6.3.7 The insurer must put in place adequate internal control systems to ensure that:

- i. All underwriting is carried out in accordance with company policy;
- ii. Planned reinsurance cover is in place at all times;
- iii. Claims are reported to the reinsurer in a timely manner and in accordance with the reinsurance agreement;
- iv. Reinsurance claims payments are being promptly recovered; and
- v. Material deviations from items (i) to (iv) above are identified and reported to Management and the Board of Directors.

6.3.8 The insurer must have in place written procedures in respect of:

- i. Timely payments of reinsurance premiums to reinsurers; and
- ii. Timely recovery of reinsurance claims.

6.3.9 Insurers may establish reinsurance pools, provided that such pools have been authorized by the Authority in writing. In providing such authorization, the Authority will take into account that:

- i. Any such arrangements are clearly identified and fully taken into account in the cedant's reinsurance strategy;

- ii. Adequate retrocession arrangements are in place, so that each cedant participating in the pool only retains the levels of risk in accordance with its risk management and reinsurance strategies;
- iii. The business within the reinsurance pool is accounted for separately; and
- iv. The reinsurance pool has provided for adequate reserving for any inwards reinsurance business.

6.3.10 Approval to participate in an international reinsurance pool managed and administered outside Kenya must be obtained from the Authority in writing.

6.3.11 The Authority reserves the right to request further details of reinsurance arrangements and copies of reinsurance slips and reinsurance treaties from time to time. Such a request must be complied with within the reasonable time limit set by the Authority

7.0 PROHIBITED PRACTICES

7.1 Insurers are prohibited from entering into reinsurance arrangements whereby no insurance risk is transferred from the direct insurer to the reinsurer. Reinsurance arrangements must involve transfer of risks from the direct insurers to reinsurers.

7.2 Insurers are prohibited from transferring the entire risk to a reinsurer. Approval from the Authority must be sought in writing in respect of any exceptions.

- 7.3 Fronting Arrangements are prohibited, unless approved by the Authority in writing.
- 7.4 In requesting for approval, each fronting arrangement must be submitted to the Authority in writing and the insurer shall ensure that it has adequately reserved for the risk or collateral in place.

8.0 ENFORCEMENT

8.1 Remedial Measures

8.1.1 When the Authority determines non-compliance with the provisions of this guideline, it may take any intervention prescribed in the Insurance Act.

8.1.2 When the Authority determines that the insurer's non-compliance with the provisions of this reinsurance directive impact the company's ability to meet claims as and when they fall due, the Authority may issue such orders which it considers necessary to protect policyholders in accordance with the Insurance Act.

8.2 Administrative Sanctions

8.2.1 Where the Authority determines that an insurer has not met the requirements of this directive, the Authority may impose any or all of the administrative sanctions to correct the situation in accordance with the provisions of the Insurance Act, including but not limited to:

- i. Prohibition from declaring and/or paying dividends;
- ii. In the case of insurers and/or intermediaries carrying out unauthorized fronting arrangements, suspension of licence;
- iii. Suspension or closure of the insurer to new business;
- iv. Suspension of acquisition of fixed assets; and
- v. Monetary penalties.

9.0 EFFECTIVE DATE

The effective date of this Regulation is 1st April 2013.

10.0 TRANSITIONAL ARRANGEMENTS

10.1 All applicants for a licence to conduct business as an insurer must comply with the minimum requirements of this regulation with immediate effect.

10.2 All existing registered insurers who are currently not compliant with the requirements of the new directive shall be required to regularise their status by 30th June 2013.

11.0 ENQUIRY

Enquiries on any aspect of this guideline shall be referred to;

Address: The Technical Manager,
Insurance Regulatory Authority,
P.O. Box 43505-00100,
Nairobi

Telephone: +254 20 4996000

Facsimile: +254 20 2710126

E-mail: commins@ira.go.ke



Bima Bora Kwa Taifa
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