



PRIVATE SECTOR CONSULTATION

Rule and Statement of Guidance: Reinsurance Arrangements

**Private Sector Consultation
Rules and Statement of Guidance on Reinsurance Arrangements**

A. Introduction

1. Section 34(1)(a) of the Monetary Authority Act (2020 Revision) (“MAA”) states that:

After private sector consultation and consultation with the Minister charged with responsibility for Financial Services, the Authority may -

(a) issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;

2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAA as follows:

When this Act requires private sector consultation in relation to a proposed measure-

(a) the Authority shall give to each private sector association a draft of the proposed measure, together with -

- i. an explanation of the purpose of the proposed measure;*
- ii. an explanation of the Authority’s reasons for believing that the proposed measure is compatible with the Authority’s functions and duties under section 6;*
- iii. an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
- iv. an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
- v. notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3));and*

(b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations.

3. The Cayman Islands Monetary Authority (“the Authority” or “CIMA”) seeks consultation and comment from the private sector associations concerning the *Rule and Statement of Guidance on Reinsurance Arrangements* (attached as **Appendix 1**).

B. Background

4. The Authority, in 2003, issued a Statement of Guidance (“SOG”) on Reinsurance Arrangements – Class A Insurers. This has evolved over time. Additionally, in 2017 the International Association of Insurance Supervisors

("IAIS") revised and updated its insurance core principle ("ICP") on Reinsurance and Other Forms of Risk Transfer.

5. The Authority has flagged several challenges with some insurers and reinsurers which require the measure to be updated in part to a rule to ensure enforceable means. In some cases, reinsurance strategies are deficient, lacking identification, implementation, and monitoring of main risks and considerations. Furthermore, some risk transfer arrangements are inadequate, exposing the insurer/reinsurer to money laundering, terrorist financing, and/or proliferation financing ("ML/TF/PF") issues. Given that the jurisdiction's National Risk Assessment ("NRA") assessed the Cayman Islands' insurance sector as having "Low-Medium" level of vulnerability to ML/TF/PF, a robust regulatory measure is required to help mitigate the risks to the sector.
6. Therefore, the revision of the SOG is necessary to bring it up to date with the legislative changes, updates to the international standards, and evolving insurance industry trends that have occurred in the sector since the 2008 revision of the SOG.

C. International Standards

7. The IAIS ICPs are the global framework for the supervision of the insurance sector and is applicable to insurers and reinsurers. Amendments were made to ICP 13 in November 2017; the standards along with a briefing of the guidance material of ICP 13 are laid out in **Table 1**.

Table 1: Summary of ICP 13

ICP 13: Reinsurance and Other Forms of Risk Transfer
The supervisor requires the insurer to manage effectively its use of reinsurance and other forms of risk transfer. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.
13.1 The supervisor requires ceding insurers to have a reinsurance programme that is appropriate to their business and part of their overall risk and capital management strategies.
The ceding insurer's risk and capital management strategies should clearly articulate the part played by reinsurance and also taking into account its (the ceding insurer's) business objectives and levels of capital and business mix. The role of senior management team and the Board of Directors is summarized with their responsibilities encompassing the development, implementation, monitoring, and review of the reinsurance programme and reinsurance strategy. The supervisor's role is to understand and assess the ceding insurer's business objectives and strategies and how reinsurance fit.
13.2 The supervisor requires ceding insurers to establish effective internal controls over the implementation of their reinsurance programme.
Control of the reinsurance programme should be part of the ceding insurers overall system of risk management and internal controls. Ceding insurers should consider their appetite for reinsurer credit risk; have in place procedures for identifying reinsurers that meets its security requirements; set prudent aggregate exposure limits or guidelines to any reinsurer or group of related reinsurers; consider the risk posed by mismatch in terms and conditions between reinsurance

ICP 13: Reinsurance and Other Forms of Risk Transfer
contracts and the underlying policies; have appropriate criteria in place for the purchase of facultative coverage; and consider the operational risk related to contract documentation.
13.3 The supervisor requires ceding insurers to demonstrate the economic impact of the risk transfer originating from their reinsurance contracts.
In general, a contract should be considered as a loan or deposit if, during its development, the ceding insurer has the unconditional obligation to indemnify the reinsurer for any negative balances that may arise out of the contractual relationship. This characteristic does not result in risk transfer. All liabilities of the ceding insurer should be contingent on the proceeds of the underlying insurance business. Ceding insurers should provide the supervisor with sufficient information about its reinsurance contracts to enable the supervisor to make informed judgements about the substance of the risk transfer.
13.4 When supervising ceding insurers purchasing reinsurance across borders, the supervisor takes into account the supervision performed in the jurisdiction of the reinsurer.
Taking into account the supervision performed in the jurisdiction of the reinsurer may help the supervisor to assess the overall risk profile of the ceding insurer. Supervisory recognition should take place through formal agreements and can be conducted through unilateral, bilateral and multilateral approaches to recognition.
13.5 The supervisor requires the ceding insurer to consider the impact of its reinsurance programme in its liquidity management.
Liquidity issues could arise from the ceding insurer's reinsurance programme as the ceding insurer remains liable for all valid claims. The supervisor should require ceding insurers to take appropriate measures to manage their liquidity risk and the supervisor should assess these responses. External triggers can give rise to liquidity issues, especially where reinsurers have retroceded significant amounts of business. Therefore, the supervisor should be aware of the potential consequences of such triggers for the overall efficiency and stability of the market.
13.6 In jurisdictions that permit risk transfer to the capital markets, the supervisor understands and assesses the structure and operation of such risk transfer arrangements, and addresses any issues that may arise.
A wide range of techniques has been developed to allow the transfer of insurance risk to the capital markets. In general, arrangements used to enable risk transfer to the capital markets operate like mainstream reinsurance. For example, risk is transferred via a reinsurance contract with similar terms and conditions to any other reinsurance contract. Insurance risk transfer to the capital markets can occur by making use of a wide variety of arrangements. Insurance risk transfer to the capital markets usually entails the creation of a dedicated entity, which for the purpose of the ICPS, is referred to as special purpose entities (SPEs). Supervisors should be able to understand and assess, initially and on an ongoing basis, a SPE structure and the underlying risks.

D. Purpose of Proposed Measure and Consistency with the Authority's Functions

8. Section 6(1) of the MAA outlines the principal responsibilities of the Authority, which includes its regulatory functions, *inter alia*, "to regulate and

supervise financial services business carried on in or from within the Islands”.

9. Section 6(3) of the MAA provides that in performing its regulatory functions, the Authority shall, *inter alia*:
 - (a) *endeavour to promote and enhance market confidence and the reputation of the Islands as a financial centre;*
(...)
 - (b) *recognise the international character of financial services and markets and the necessity of maintaining the competitive position of the Islands, vis a vis both consumers and suppliers of financial services, while conforming to internationally applied standards insofar as they are relevant and appropriate to the circumstances of the Islands;*
 - (c) *recognise the principle that a burden or restriction which is imposed on a person or activity should be proportionate to the benefits, considered in general terms;*
(...)
 - (d) *recognise the need for transparency and fairness on the part of the Authority.*

10. The regulatory measure was revised to make it consistent with more recently issued regulatory measures with the addition of Section 3: Statutory Authority; Section 4: Scope of Application; and Section 5: Definitions.

11. New sections were inserted in the regulatory measure, specifically Section 8: Risk Transfer; Section 9: Counterparty/Credit Risk; Section 11: Group-wide reinsurance programmes; Section 12: Internal Controls; and Section 13 Catastrophe Reinsurance. **Table 2** provides a summary of changes.

Table 2: Summary of Proposed Changes

	Section	Proposed Changes
1.	Introduction	Expanded to include the applicable regulations, rules, and statements of guidance.
2.	Statement of Objectives	Expanded to clarify broadly, the Authority’s expectations that reinsurance arrangements be adequate, taking into account the size, nature, and complexity of the insurer.
3.	Statutory Authority	This section was inserted to be in line with the template used for other regulatory measures and sets out that the regulatory measure is in line with the MAA.
4.	Scope of Application	This section was inserted to be in line with the template used for other regulatory measures.
5.	Definitions	This section was inserted as a reference tool for the meaning of key terms used in the measure.

	Section	Proposed Changes
6.	General	This section captures a broad overview regarding the reinsurance programme and the importance that it captures key elements.
7.	Reinsurance Strategy	<p>This section was revised to include new subsections aimed at expanding the content of the reinsurance strategy such as: the reinsurance strategy forms a key element of the capital and risk management framework (subsection 7.4); must consider concentration risk and other risks assumed by the ceding insurer (subsection 7.5); and must consider risk transfer to capital markets (subsection 7.6).</p> <p>In addition, this section now establishes the requirement for the ceding insurer to develop and document for the selection of reinsurance brokers or reinsurers (subsections 7.7 and 7.8 respectively).</p> <p>Lastly, the new subsection 7.9 calls for the ceding insurer to demonstrate the impact of reinsurance on liquidity management.</p>
8.	Risk Transfer	This new addition to the regulatory measure captures considerations for the reinsurance contract and risk transfer arrangements. Ceding insurers must be able to demonstrate the economic impact of risk transfer (subsection 8.1); certain arrangements for reinsurance are not deemed to be reinsurance contracts (subsections 8.3 and 8.4 respectively); and reinsurers not retaining any risks are required to provide rationale (subsection 8.5).
9.	Counterparty/Credit Risk	This new section expands on some of the main counterparty risk and credit risk the ceding insurer should take into account such as establishing a minimum criteria for the selection of reinsurers; that reinsurance brokers should be regulated entities; and that an initial and ongoing assessment of the reinsurer should take place.
10.	Documentation of reinsurance contracts	This section is new and includes forms of documentation that should be kept by the ceding insurer.
11.	Group-wide reinsurance programmes	This new section establishes that ceding insurers should be able to identify its exposers in the case where exposures are covered by the group reinsurance programme.

	Section	Proposed Changes
12.	Internal Controls	This new section establishes the arrangements for internal controls such as regular review of the reinsurance strategy; a documentation of the person(s) responsible for developing the reinsurance strategy; and regular monitoring of the reinsurance contracts.
13.	Catastrophe Reinsurance	This new section discusses what should be documented with regards to catastrophe exposure management such as all policies and procedures; persons responsible for conducting catastrophe modelling, and documentation of the risk appetite.
14.	Enforcement	This section states the Authority's response when there is a breach of this regulatory measure.
15.	Effective Date	This states when the measure will come into effect.

E. Jurisdictional Comparison

12. A review of the reinsurance arrangements composing of the requirements of supervisors and the obligations of ceding insurers, was undertaken. Eight (8) jurisdictions were analysed. **Table 3** provides a summary of the main components from each jurisdiction and includes the Cayman Islands and whether the proposed measure will address the requirements and obligations.

Australia

13. The Australian Prudential Regulation Authority ("APRA") *Prudential Standard GPS 230 on Reinsurance Management*¹ sets out the requirements for reinsurance arrangements as it pertains to the reinsurance management framework, the reinsurance management strategy, and the reinsurance arrangements statement.
14. The reinsurance management framework must provide assurance that the reinsurance arrangements are well managed based on the size, nature, and complexity of the regulated institution's operations. To ensure the reinsurance framework is effective, the Standard states that a review process must be conducted frequently, and the scope of the review must include a review of the reinsurance management strategy and a review of the internal control system. Furthermore, persons or groups having the responsibility to manage the reinsurance management framework must be identified and documented.
15. The reinsurance management strategy must be reviewed annually or as close to annually as possible and where there are material changes, must be approved by the Board of Directors and submitted to APRA within 10 business days. Regulated institutions must put in place the necessary

controls to document and monitor reinsurance strategy to assess the appetite for risk and identify if there are processes or controls that are not effective.

16. APRA requires that processes be put in place for the selection, implementation, monitoring, and reviewing of reinsurance arrangements - for instance, methodologies for the selection of reinsurance participants; how the processing of reinsurance premiums and the collection of reinsurance assets; expected cession ratios for reinsurance arrangements.
17. The Standard requires the documentation of reinsurance arrangements. Within a set timeframe after the inception date(s), regulated institutions must have legally binding contracts between themselves and all participating reinsurers.
18. The reinsurance statement must substantiate the implementation of the reinsurance management strategy and must contain, inter alia, details on any Limited Risk Transfer Arrangements; details of the Insurance Concentration Risk Charge ("ICRC") calculation including details of modelling for catastrophe events; and details on how the reinsurance arrangement would reduce the overall gross exposure by class of business, which would result in the net retention per risk.
19. A regulated institution must inform APRA immediately if it anticipates that a problem is likely to arise out of its reinsurance arrangements that may materially and adversely affect its current or future capacity to meet its obligations. The regulated institution must put in place plans to redress any such problem and advise APRA accordingly.
20. APRA has requirements for insurers to engage in a Limited Risk Transfer Arrangement for reinsurance. APRA will consider a Limited Transfer Risk as a reinsurance arrangement only if it reflects a legitimate transfer of the cedant's risk to the reinsurer. For the arrangement to be approved by APRA, the regulated institution should ensure to document the following criteria: purpose and effect, cost and benefits of arrangement, appropriate process and controls are in place, and there would be no adverse effect on capital position of insurer. A Limited Risk Transfer Arrangement may only be considered reinsurance for the purpose of calculating a regulated institution's net exposure and its ICRC where it has been approved by APRA as a reinsurance arrangement.

Bermuda

21. The Insurance Act of 1978 is the primary statute providing for the regulation of reinsurance-related activities carried on in or from within Bermuda.
22. The Bermuda Monetary Authority's ("BMA") guidance note on *Insurance Activity*² applies to all insurance licensees that are registered under the Insurance Act and states that it is the responsibility of the board to ensure that the control system encompassing internal processes and procedures are effective and compliant with regulations. They should also regularly monitor and oversee the risk management in place for the underwriting policy as well as for reinsurance arrangements. The Authority will also evaluate the operations to discover if the internal control system is adequate for the size, complexity, and risk profile of the insurance activities.
23. The guidance note also addresses that ceding insurers have in place a reinsurance program that will assist in "the selection, monitoring, review

and control of reinsurance arrangements.” It is also important to understand the level of risks for reinsurance arrangements as this will allow the insurer to calculate how much capital will be needed. The insurer should also have in place criteria for the selection of reinsurers, they should consider assessing their security as well as what collateral is involved.

24. BMA’s 2020 Handbook on *The Bermuda Capital and Solvency Return*² address the details in which ceding insurers should provide regarding intra-group reinsurance and retrocession arrangements. The insurer should account for intra-group exposures such as: counterparties involved along with where they are domiciled, aggregate values of exposure limits (gross and net), and proportion of the group’s insurance business exposure covered by internal reinsurance retrocession and other risk transfer arrangements. The handbook also covered how the group-specific catastrophe risk should be calculated.
25. BMA’s 2020 Year End Long Term Instructions Handbook for Class E, Class D, and Class C insurers and reinsurers, requires that when calculating the Enhanced Capital Requirement (ECR), insurers should only take into account risk-mitigation where certain qualitative criteria are met: a) The contractual arrangements and transfer of risk are legally effective and enforceable in all relevant jurisdictions and there is an effective transfer of risk to a third party; b) The contractual arrangement ensures that the risk transfer is clearly defined; c) all appropriate steps are taken to ensure the effectiveness of the arrangement and to address the related risks; d) the effectiveness of the arrangement and the related risks are monitored on an ongoing basis; e) providers of risk mitigation should have credit quality to guarantee that the insurer will receive the protection in the as specified by the contracting parties; f) there is no double counting of risk-mitigation effects in technical provisions and in the calculation of the ECR.
26. In addition, BMA’s 2020 Year-End Long-Term Instructions Handbook for Class E, Class D, and Class C insurers and reinsurers, require completion of Schedules of the BCSR. For instance, the Schedule of Particulars of Ceded Reinsurance, requires that for funds held by ceding companies, where specific assets have been allocated for the benefit of the reinsurer, such that the reinsurer bears market risk on those assets, the BMA requires insurers to look through to the underlying assets and report those balances. Where there are no specific identified assets, the reinsurer is effectively in a similar position to a typical cedant with reinsurer exposure and the amount will be treated similar to reinsurance recoveries and are reported on a different Schedule than the previous scenario. Also, the Schedule of Concentration Risk required the identification of the largest 10 independent exposures relating to instruments such as equity holdings, real estate, loans, and bonds.
27. The BMA’s The Insurance Code of Conduct¹, applicable to all insurers and establishing the duties, requirements, and standards of insurers, sets out the overall responsibilities for the Board of Directors such as review and approval of risk management framework policies and procedures. It requires that the components of the risk management framework such as liquidity risk, concentration risk, strategic risk, underwriting risk, and credit risk be approved by the Board of Director and that the board is responsible for setting appropriate strategies and for oversight of implementation of these strategies and is responsible for oversight of the risk management and

¹ <https://cdn.bma.bm/documents/2019-01-10-07-16-47-Insurance-Code-of-Conduct-revised-2014.pdf>

internal controls framework. Additionally, underwriting risk mitigation techniques should be part of the underwriting strategies and should be approved, evaluated, and assessed for effectiveness. The risk management framework includes addressing concentration risk and developing strategies and policies to identify, respond, mitigate, and monitor the credit risk arriving from risk exposures. The risk management framework should include regular reviews to ensure all material risks are identified, responded to, reported, and monitored and be supported by systems that capture appropriate data and provide the information to the board, senior management, and support business functions. The risk management framework should include regular reviews to ensure material risks are continuously assessed, monitored, and actioned.

28. The BMA's Insurance Code of Conduct discusses the strategic risk component of the insurer's risk management framework wherein it should include that processes and procedures be developed to ensure execution of the overall organizational strategy and techniques developed to mitigate against risks arising while implementing strategies. The Insurance Code of Conduct discusses that insurers should have clearly documented policies and procedures for its functions with operating and oversight responsibilities clearly defined. Such policies should be reviewed at least annually while the design and effectiveness of the risk management and internal controls framework should be regularly assessed.
29. The Insurance Act provides a wide definition of "insurance business" to mean "the business of effecting and carrying out contracts either a) protecting persons against loss or liability to loss in relation to risks to which these persons may be exposed; or b) to pay a sum of money or render money's worth on the occurrence of an event, and includes re-insurance business".
30. The BMA has a wide range of enforcement and disciplinary powers created by the Insurance Act.

Canada

31. The Office of the Superintendent of Financial Institutions ("OSFI") is the federal insurance regulator of Canada. The Guideline on *Sound Reinsurance Practices and Procedures*³ addresses OSFI's practices and procedures that are deemed effective for the business of reinsurance.
32. Federal Regulated Insurers ("FRIs") should implement a Reinsurance Risk Management Policy ("RRMP") as the framework for the reinsurance arrangements. The policy should be part of the FRI's overall enterprise-wide risk management plan and should be approved and overseen by senior management. The policy and procedures that are necessary for efficient and accurate operation of the internal controls should be reviewed, at least, annually by senior management. The RRMP should document the role and responsibilities of personnel in charge of implementing the RRMP as well as to have a process in place to update the policy should there be any changes in market conditions. The Insurer should also document the list of reinsurers that are registered or pre-approved and those that are unregistered. OSFI expects that enhanced due diligence be performed on reinsurers that are not registered or cedant insurers that are not regulated by OSFI. It is also recommended that reinsurance arrangements should undergo various stress testing to observe exposure to large and catastrophic losses. These scenarios will give insight to the adequacy of the FRI's risk appetite and risk tolerance.

33. Additionally, the Guideline mentions that when selecting a reinsurance counterparty, FRI's should conduct due diligence to determine if the reinsurer is credible. The insurer should investigate; claims payment record, expected future claims obligations, balance sheet strength, access to capital and sources of liquidity, quality of its governance practices and procedures and retrocession arrangements. Also, should the FRI be a reinsurer, they should also conduct its own due diligence on the risk associated with the potential cedant. If a cedant insurer is aware that there is heavy reliance on retrocessions, the cedant should seek more information on the identities and financials of the other party.
34. Once a reinsurer is chosen the reinsurance contract should be evaluated throughout the period of the contract terms. It is recommended that management should also evaluate after expiration of contract should there be material exposures incurred resulting in potential future reinsurance recoverables.
35. Reinsurance contracts should be clear and represent accurate information pertaining to the arrangement; preferably completed by all parties before the effective date. If it is not possible to have the executed contract before the effective date, a formal document such as a slip, cover note, or binding letter of intent should be provided in the interim. Ceding FRI's are to ensure that they are not adversely affected by the terms and conditions of reinsurance contracts. This will be important should there be any issues with the cedant's or reinsurer's insolvency status, an insolvency clause should be included in the contract to ensure the receivables from reinsurers are not withheld.
36. In June 2019, OSFI published a draft revision of *Guideline B-3: Sound Reinsurance Practices and Procedures* and inserted a section on "Managing risks arising from the use of reinsurance" wherein OSFI clarifies that the RRMP should identify risk these risks and approaches for managing such risks. The RRMP should establish appropriate counterparty concentration limits both to individual counterparties and to groups of affiliated counterparties. When assessing counterparty risk, an FRI should consider all elements of risk associated with counterparties, including the implications of the legal and insolvency framework of a counterparty's home jurisdiction, and the terms and conditions of reinsurance contracts. Counterparty risk should be considered at an aggregate level (e.g., group of affiliated counterparties) for stress testing.

Guernsey

37. The Guernsey Financial Services Commission's *Guidance Note for Licensed Insurers on Reinsurance and other Forms of Risk Transfer* provides guidance to licensed insurers by covering the appropriate measures a ceding insurer should have in place with regards to reinsurance.
38. Ceding insurers should have a reinsurance programme that is part of their wider management strategies. The management strategies such as the risk and capital management strategies should consider the objectives, risk concentration and ceding limits and well as controls to manage reinsurance risk. The reinsurance strategy should capture the insurance risk appetite, liquidity positions and levels of exposure in the insurance book. The Board and 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.

39. Ceding insurers should also have in place procedures that will assist in selecting reinsurers that are credible and suitable for the reinsurance arrangement. There should also be implemented a process for assessing reinsurers that are not on the pre-approved list. Additionally, the ceding insurer should consider the maximum aggregate exposure for a reinsurer or group.
40. The ceding insurer should ensure that during the underwriting process, the criteria for terms and conditions are met for each reinsurance arrangement. This is to prevent any mismatch arrangements that can cause greater net exposure to the ceding insurer.
41. The guidance note also recommends criteria and procedures for purchasing facultative coverage, i.e. "*any facultative reinsurance coverage bought should be linked to the procedures for aggregations and recovery management.*" The necessary controls to monitor these purchases should be in place for this type of coverage.
42. The ceding insurer and the reinsurer should have the proper controls in place to produce contracts accurately and in a timely manner, with such contracts being documented ideally before the inception date.

Hong Kong

43. The Insurance Authority ("IA-Hong Kong") developed and issued *Guideline on Reinsurance*⁵ and a *Guideline on Reinsurance with Related Companies*⁵. The Insurance Authority address the need for insurers to implement a reinsurance management strategy based on the size, risk profile and financial condition of the company.
44. The reinsurance management strategy should be approved by the Board of the Directors and should be reviewed on an annual basis or when there are material changes to the "*insurer's circumstances, its underwriting and risk management strategies or credentials of reinsurers.*" The governing body of an insurer is responsible for formulating and reviewing the system and controls to monitor a reinsurance strategy. Any deviations from the established controls are to be approved by the governing body.
45. The ceding insurer should also document certain aspects of the reinsurance management strategy such as: objectives; identify those responsible for approval and monitoring; documenting the observations of key factor controls; choosing the appropriate reinsurance arrangement; describe the criteria for evaluating the creditworthiness and diversification of reinsurers; credit risk exposure; process for monitoring liquidity risks and aggregation of risks; internal controls for managing arrangements; describe involvement of reinsurance brokers; and criteria for the use of facultative reinsurance.
46. The control system should be aligned with the policies in place that govern reinsurance, this is so that any deviations from those controls can be identified and reported in a timely manner. The information system should be efficient to identify and discrepancies and report these in a timely manner. The guideline also recommends that insurers should conduct stress tests for various risk assessments.
47. There should be proper protocols for the due diligence and selection of reinsurers and there should be in place a pre-approved list of reinsurers available. If there is need for an assessment of a reinsurance arrangement

that is not on the list, there should be procedures in place regarding the approval process. In terms of the reinsurance contract, it is important for controls to be in place to ensure that reinsurance contract documents are provided in a timely manner and they are clearly and accurately prepared. The finalization of the reinsurance terms should be completed before the inception of coverage. There should be processes in place for timely exchange of communication to and from reinsurers and there should proper controls to manage the prompt collection of reinsurance claims.

48. A ceding insurer may decide to use Alternative Risk Transfer (ART), as opposed to a reinsurance arrangement. The IA-Hong Kong requires the insurer to have in place the framework to control and monitor the ART arrangements. Insurers may also transfer risk to the capital market through a Special Purpose Entity (SPE). Section 6.2 -6.7 of the *Guideline on Reinsurance* explains the type of system and controls that should be put in place as well as the criteria IA expects to be implemented for approval of the arrangement.
49. The *Guideline on Reinsurance with Related Companies* focuses on grouping of companies and the adequacy of these arrangements. The IA-Hong Kong will assess the application and decide on the amount of the net reinsurance that would be recovered of the net asset amount.

Ireland

50. The Solvency II Directive was transposed into Irish Law as the European Union (Insurance and Reinsurance) Regulations 2015. The legislation entered into force on 1 January 2016. The Solvency II framework sets out requirements around capital, governance and risk management. Solvency II also introduces increased regulatory reporting requirements and public disclosure requirements. Part 4 of the legislation, Chapter 1, Chapter 2, and Chapter 3, details the responsibilities of the board of directors of the reinsurer; system of governance; and public disclosure requirements respectively. Chapter 1 requires that the board of directors has the ultimate responsibility for compliance to the legislation. Additionally, Chapter 1 requires that there must be written policies covering at least risk management, internal control, internal audit and any outsourcing arrangements and that the board of directors shall ensure such polices are implemented and reviewed at least annually.
51. The legislation also sets out that there should be an effective risk management system comprising of "*strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis, the risks, on an individual and aggregated level, to which the undertaking is or could be exposed, and any interdependencies.*" The risk management system should cover asset-liability management; underwriting and reserving; liquidity and concentration risk management; operational risk management; and reinsurance and other risk-mitigation techniques. The risk management system should comprise of written policies relating to these matters.
52. The Central Bank of Ireland has issued the *Guidelines on Completing and Submitting Life Insurance, Non-Life Insurance and Reinsurance Applications* and relevant checklists for insurers and reinsurers submitting an application for authorization under the legislation.
53. Each insurer and reinsurer must conduct their Own Risk and Solvency Assessment (ORSA) which also forms part of the Central Banks's licensing

requirements. Applicants are required to demonstrate in the ORSA how the risk management system will cover reinsurance and other risk-mitigation techniques. In addition, applicants seeking authorization as a life or non-life insurance provider must provide details of their reinsurance and other risk mitigation techniques including a) providing the reinsurance policy including settling reinsurance programs, level of risk transfer, selection of type of reinsurance, principles for the selection of reinsurance counterparties; b) providing details on the procedures for assessing the effective risk transfer; c) providing the concentration limits for credit risk exposure to reinsurance counterparties, and appropriate systems for monitoring these exposures; d) giving details on the liquidity management to deal with any timing mismatch between claims' payments and reinsurance recoveries; and e) giving details on the structure of any reinsurance/retrocession programme, including excesses, limits, currencies and reinsurer. Additionally, as part of the information on the scheme of operations, the applicant must submit the guiding principles as to reinsurance and to retrocession.

54. For applicants who are seeking authorization as a reinsurance provider, they are also required to set out the types of reinsurance activity; provide details on proposed reinsurance business and products; provide a copy of the ORSA report which demonstrates, amongst other things, reinsurance and other risk-mitigation techniques; provide confirmation that the reinsurance agreements are consistent with legal requirements and details of the new product approval process; and provide details on the kind of reinsurance arrangements to be made with ceding insurers.

Switzerland

55. The Swiss regulatory body for insurance and reinsurance is *the Swiss Financial Market Supervisory Authority* ("FINMA"). The framework for reinsurance is regulated by the *Insurance Supervisory Act* ("ISA")⁷ and the corresponding *Insurance Supervisory Ordinance* ("ISO"). Under the ISA, reinsurers domiciled in Switzerland must be licensed to conduct reinsurance business. An application and business plan should be sent to FINMA for approval. Should there be any re-insurance activities for insurance classes – if approval is granted, it will also cover those arrangements. Additionally, every year, insurance companies are required to produce a management report consisting of the annual accounts, annual report and if required by law, the consolidated accounts. If an insurance company is part of an insurance group or an insurance conglomerate, the submission of consolidated accounts is required.
56. According to the Guideline on *Conditions for Permission to Conduct Business*⁷, the insurer's business plan should include details of its internal controls that monitor and manages their operations; an organigram should also be provided in the report. The plan should also provide the designated list of persons responsible for supervision and the company's management; including the names of those persons who sit on the board of directors.
57. The Guideline also proposes that the insurer should give details regarding the various insurance categories they will implement as well as the risks associated with these. It is noted that when managing risks, the size of the company should also be factored in. When the ceding insurer is selecting a reinsurer, they should ensure that the reinsurer is able to take on the risk associated with the arrangement. "*Retention on its total business should amount to no less than 20%. The supervisory authority may allow justified exceptions.*"

58. In addition, the guideline encourages an insurance company to ensure that they have adequate capital to cover all their business activities. Solvency margin requirements are place and calculated by two methods; one on the volume of business, based on *Solvency I* and the other based on risks the insurance company is exposed to, based on the *Swiss Solvency Test (SST)*.
59. Based on FINMA's 2017/2 circular on *Corporate governance – insurers*⁷, the board of directors are responsible for implementing and monitoring the effectiveness of the internal controls that govern major outsourcing arrangement such as reinsurance. The internal control system should be adequate for the complexity and risks of the insurance company. There should also be in place proper compliance and reporting parameters that will monitor for any discrepancies in processes and procedures. The insurance company should document the key components of the internal control system and the head of the risk management function regularly observes and prepares report on the suitability of the risk management, to the board of directors.
60. FINMA's has mandated in the 2008/29 circular on *Internal business transactions – insurance groups*⁶ that a minimum criterion should be implement for reporting reinsurance transactions, this includes: names of involved parties, equity capital of involved parties, domicile of involved parties, amount of gross premium revenue, currency and nominal amount of risk, type of reinsurance, direct insurance line, purpose of reinsurance, terms, and deductible of the involved parties.
61. Under FINMA's circular 2017/3 insurers can follow the guidelines on the treatment of natural catastrophe risk (nat cat risks) in the SST model. When modeling nat cat risks, the insurer should specifically base the modelling on the insurance company's risk profile. An application to use a nat cat model should be submitted to FINMA for review and approval.

United Kingdom

62. Reinsurance arrangements in the UK have operated under the *Directive 2009/138/EC of The European Parliament and of the Council*⁷ since January 2016. The Prudential Regulation Authority's ("PRA") requirements as it relates to the management of reinsurance counterparty credit risk is provided in the supervisory statement *Solvency II Directive: reinsurance – counterparty credit*⁸.
63. According to the Directive, it is ultimately management's responsibility to ensure the reinsurance undertakings are compliant with the law and regulations pursuant to the Directive. Member States should have implemented an effective governance system, proportionate to the size, nature, and complexity of the insurance company, to oversee the effectiveness of the reinsurance undertakings. Insurers should have policies and procedures documented for the management of internal controls and risk management of reinsurance undertakings. These written policies and procedures should be reviewed for adequacy and approval of any changes by management, at least annually.
64. The supervisory statement addresses the notion that reinsurance undertakings should be integrated in the overall risk management of the company. The PRA expects for the Board to: "*understand the risk transfer taking place, ensure that the economic impact is adequately reflected in business planning, capital setting and reserving, and appreciate the wider associated risks to which the reinsurance placements can give rise.* In the

case where risk is transferred to several counterparties, the insurer should assess the counterparty default risk which will include the appetite for risk. The Directive also addresses the risk management system and some of the areas that must be covered are liquidity and concentration risk management, as well as operational risk management.

65. The PRA's supervisory statement states that for reinsurance contracts the Board should review and ensure that the appropriate risks are documented in reinsurance contracts. The more complex the arrangement, the more risks will exist and treatments such as the effective transfer of risk and appropriate solvency capital requirement (SCR) should be approved.
66. The Directive instructs Member States to report on their reinsurance undertakings to the supervisor on an annual basis. The reports prepared by management should include the nature of the arrangements, volume of premiums, technical provisions, volatility of claims, benefits covered by the undertaking and if appropriate systems are in place to monitor the risk inherent to the reinsurance undertakings. Should there be any major changes to the model, this should be documented and presented to the supervisory authority for approval.
67. There should be written documentation of the reinsurance undertaking which will include the design and the operational details of their internal model.
68. Member States must assess the reinsurer as a requirement of the supervisory authority. The financial soundness, suitability, reputation, and experience of any person directly involved in the reinsurance should be taken into consideration. As well as to ensure the reinsurance undertaking would be able to comply with the prudential requirements of the Directive.
69. For reinsurance undertakings at group-level the insurer should calculate the solvency capital requirement for the group. This will take into consideration global diversification risk that will reflect the risk exposures of the group.
70. When calculating the SCR, insurance companies must also include the risk loss under adverse events (catastrophe risk). The risk model must reflect risk that arise from exposures to these extreme events.

Table 3: Summary of Jurisdictional Comparison on Reinsurance Arrangements

		Australia	Bermuda²	Canada	Cayman Islands	Guernsey	Hong Kong	Ireland	Switzerland	UK
1.	The Board of Directors provides oversight of the reinsurance programme.	X	X	X	X	X	X	X	X	X
2.	Reinsurance strategy is included in capital and/or risk management framework.	X	X	X	X	X	X	X	X	X
3.	Reinsurance strategy covers concentration risk management.	X	X	X	X	X	X	X		X
4.	Risk transfer to capital markets forms part of the reinsurance strategy.		X	X	X	X	X	X	n/a	
5.	The reinsurance strategy establishes a minimum criteria for the selection of reinsurers and reinsurance brokers.	X	X	X	X	X	X	X	X	X
6.	The reinsurance strategy includes the impact of reinsurance on liquidity management.	n/a	X	X	X	X	X	X	X	X
7.	The reinsurance strategy includes requirement for regular reviews of the reinsurance contracts.	X	X	X	X	X	X	X		

² Most of the BMA's regulatory measures is mentioned in the context of the reinsurance management framework, not in the context of a reinsurance management strategy.

		Australia	Bermuda²	Canada	Cayman Islands	Guernsey	Hong Kong	Ireland	Switzerland	UK
8.	Reinsurance strategy contains key details to allow for the selection, monitoring and maintenance of reinsurance contracts.	X	X	X	X	X	X	X	X	
9.	There are clear policies and procedures for the implementation of the reinsurance strategy.	X	X	X	X	X	X	X	X	X
10.	Ceding insurers employ a method of selection and retention of reinsurers to ensure only reinsurers with proven track records are selected.	n/a	X	X	X	X	X	X	X	X
11.	Ceding insurers possess documentation for business purposes of the reinsurance arrangements.	X		X	X	X	X	X	X	X
12.	Ceding insurer employ limits on net risk to be retained.	n/a	X	X	X	n/a	n/a		X	
13.	The ceding insurer's internal control systems facilitate timely reporting of claims and prompt collection of reinsurance claims payments.	X		X	X	X	X	X	X	X
14.	Contracts meet the characteristic of what is deemed to be a reinsurance contract.			X	X		X	X		
15.	Reinsurers not retaining any risk provide documented rationale for the use of such structures.	n/a		n/a	X		n/a	X	n/a	
16.	Ceding insurer assesses the financial soundness of the reinsurer.	X		X	X	X	X	X	X	X

		Australia	Bermuda²	Canada	Cayman Islands	Guernsey	Hong Kong	Ireland	Switzerland	UK
17.	Ceding insurer documents risk appetite for aggregate exposure to reinsurer.	x		x	x	x	x	x		x
18.	Ceding insurers identify exposures covered by group-wide reinsurance programmes.	n/a	x	n/a	x					x
19.	Risk management and internal controls are reviewed annually by the Board of Directors.	x		x	x	x	x	x	x	x
20.	Material reporting due to and from reinsurers are thorough, timely and in accordance with other conditions of the reinsurance contract.	n/a		x	x	x	x	x		
21.	Catastrophe reinsurance arrangements have policies and procedures for catastrophe exposure management	x		x	x		n/a		x	
22.	The risk appetite of catastrophe reinsurance arrangement is documented and approved by the Board of Directors.	n/a		x	x		n/a			x

F. Cost and Benefit Analysis

71. The Authority assessed the costs and benefits of the revision of the regulatory measure. The costs and benefits associated with the revision of the proposed regulatory measure are presented in **Table 4**.

Table 4: Costs and Benefits of Issuing the Rule and SOG on Reinsurance Arrangements

	Costs	Benefits
<i>CIMA</i>	<ol style="list-style-type: none"> 1. The Authority will incur administrative costs associated with the amendment of the Reinsurance Arrangements measure. This consists of private sector consultation; gazettal and publishing the measure; amendment of internal supervisory manuals and procedures; training staff on the amended measure. 2. Resource allocation for implementation of the measure such as enhancements to the onsite and offsite inspection process and enhancement or development of reporting forms and/or processes. 	<ol style="list-style-type: none"> 1. Implementation of the amended measure will enhance the reinsurance regulatory framework of the jurisdiction. 2. Implementation of this measure further assists the Authority in regulating and supervising financial services business by for instance promoting and enhancing market confidence, consumer protection and the reputation of the Islands as a financial centre
<i>Cayman Islands</i>	<ol style="list-style-type: none"> 1. Potential for some of the insurance licensees to exit or not consider the jurisdiction instead of complying with the amended regulatory measure. 	<ol style="list-style-type: none"> 1. Implementation of the amended measure will enhance the reinsurance regulatory framework of the jurisdiction thus improving the reputation of the jurisdiction. 2. Potential increased business from insurers and reinsurers seeking jurisdictions with enhanced reinsurance regulatory frameworks. 3. The potential of improved ratings in international assessments on the insurance and reinsurance sector and/or the jurisdiction's financial services sector.

	Costs	Benefits
<i>Insurance Licensees</i>	<ol style="list-style-type: none"> 1. May incur cost of implementing and monitoring new policies and procedures to comply with enhancements to, amongst other things, the reinsurance strategy and internal controls. 2. Potential for increased operational expenses associated with for instance training or hiring employees; engaging consultants or other specialists; enhancing or replacing equipment or systems. 	<ol style="list-style-type: none"> 1. Insurance licensees will benefit from clarity regarding the Authority's expectations resulting in reduced delays to license applications, reporting requirements, or inspections. 2. Attraction of new business to insurers and reinsurers given the enhancement to the jurisdiction's reinsurance framework.
<i>Summary</i>	Consequent to the above, it is determined that for licensees, the benefits derived from the amendments to the regulatory measure outweigh the costs to licensees of adjusting their reinsurance framework.	

G. Consultation Feedback and Comments

72. Before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations only. Feedback submitted by individuals, entities, or other bodies, unless acting on behalf of private sector associations, will not be accepted by the Authority. Representations from private sector associations must be submitted as a consolidated document, and a listing of the entities which provided feedback should be included. Private sector associations should ensure that conflicting positions are resolved prior to submission to the Authority. Where positions conflict within or across associations, the Authority will consider all available information in taking a decision, which will be at its sole discretion.
73. To ensure that all responses are given due consideration, it is important that private sector associations make clear reference to the sections of the measure being commented on, and that responses are unambiguous, clearly articulated and based on fact. The consultation process is not designed to address complaints or grievances. Feedback of this nature should be submitted through the established complaints process.
74. In cases where the feedback proposes to change a policy position of the Authority or substantially amend any requirement of the draft measure, information to support the position of the association must be provided. The table below provides an example of the Authority's expectation with regard to feedback for the proposed measure.

Reference	Example of a Helpful Comment	Examples of Comments needing more Support
Rule 4.2 ³	<p>In Rule 4.2 the current text omits the fair value measurement of liabilities. Also, as defined it is not asymmetrical with the Market Price definition and thus scenarios exists that fall into neither category.</p> <p>Suggested wording: <i>Hard-to-Value Securities means an asset or liability for which there is no Market Price which is required to be measured at fair value pursuant to 5.2</i></p>	<ul style="list-style-type: none"> × This is not what is done in other jurisdictions. × I don't think we should do this. × CIMA is not considering the position of the experts.

75. All feedback submitted by private sector associations will be given due consideration, nevertheless, the decision to adopt any feedback provided into a proposed measure will be at the sole discretion of the Authority.

H. **Notice of Representations**

76. The Authority seeks consultation through written comments and representations from the private sector associations concerning the:

Rules and Statement of Guidance on Reinsurance Arrangements

77. The Authority must receive representations by 1700hrs on **Friday, November 5, 2021**. Representations received after this deadline may not be considered and will not form part of the collated written response provided to private sector associations.
78. Comments and representations must be addressed to:

The Managing Director
 Cayman Islands Monetary Authority
 P.O. Box 10052
 SIX, Cricket Square
 Grand Cayman KY1-1001
 Cayman Islands
 Tel: 345-949-7089
 Fax: 345-946-5611
 Email:
consultation@cimoney.com.ky
 and copied to ShannonFrancis@cima.ky.

79. The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.

³ This example is not reflective of the content of the proposed measure.



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