CORE TENANTS OF REINSURANCE STRATEGY

One of the most important risk management tools that can be used by an insurer is Reinsurance. The insurer can utilize reinsurance in order to reduce its insurance risks and the volatility of its financial results, stabilize its solvency, use its available capital more efficiently, improve its ability to withstand disasters, increase its underwriting capacity and draw on the reinsurer's expertise with respect to product development.

It should be recognized that reinsurance exposes the insurer to other risks, including residual insurance risks, legal risks, counterparty risks and liquidity risks. These risks are interrelated and can make reinsurance a complex matter. Consequently, the insurer should emphasize on adequate reinsurance management through robust systems and controls to protect its financial soundness and reputation.

The following are the core aims of a Reinsurance program:

1. To protect its Capital and its Shareholders,
2. To stabilize its results from year-to-year by leveling claims fluctuations,
3. To increase its capacity to handle larger and more complex risks of various classes,
4. To maintain any statutory minimum solvency requirements and provide security,
5. To spread risks throughout world markets, not just locally, to lessen financial impact on any single economy,
6. Limit concentration of risk,
7. Take advantage of risk expertise of reinsurers who have greater experience of business (territory and class),
8. Achieve consistent overall underwriting surplus through prudent underwriting controls,
9. Implement a Reinsurance program that is operationally sound and based on robust systems and controls,
10. To protect its net exposure.

The insurer should adopt the following principles in the oversight of its Reinsurance Risks.

- Principle 1: Roles and responsibilities of Board of Directors and Senior Management in Reinsurance.
- Principle 2: Incorporation of Reinsurance Risk Management in integrated risk management process on an enterprise wide and group wide basis including those of parent entity, if any.
- Principle 3: Reinsurance risk management policy.
- Principle 4: Reinsurance process management.

Furthermore, reinsurance strategy should take the following into consideration:

- Anticipated reinsurance needs and the nature and adequacy of the reinsurance offered.
- Reinsurance not only as a risk management tool, but also as an additional source of risk, in the scenarios used and stress tests performed when quantifying risks.

- The impact of reinsurance on capital management, such as decisions regarding the allocation of capital and analyses with respect to the issuance or repayment of capital.

Reinsurance arrangements should take the following issues into account when selecting and reviewing reinsurers' panel:

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

Main tenets regarding Communication, Monitoring and Controlling of the Reinsurance Program can be highlighted as follows:

1. *Reinsurance Program information to underwriters:* On conclusion of reinsurance contract, the reinsurance department should inform the underwriting department of any changes effected in the contract, wherein underwriting that has an impact and communicate the limits on the amount and type of insurance that is automatically covered by reinsurance.

2. *Monthly Review & Closings*: Every month at the time of financial-closings, the reinsurance accountant should run the reinsurance reports including but not limited to Premium Register, Claims Paid Register, and Claims Outstanding Register wherein the distribution is re-checked before submitting the same for Technical Accounts closure.

3. *Quarterly Review & Closings:* Every Quarter ceded values (inclusive of Premium & Commission and/or Claims Paid) by underwriting year by reinsurer should be drawn by the reinsurance accountant and reviewed for the ceded sum insured values included in the reports such as Premium Register, Claims Paid Register and Claims Outstanding Register wherein the distribution is re-checked before submitting the same for Technical Accounts closure.

4. *Excess of Loss Review:* The Reinsurance department should generate relevant Claims Paid and Outstanding Report and reviews the exposure to treaty based on the priority set for each Claims Year. In case of recovery which might arise due to the incurred position of the claims, it is notified to the reinsurer. The review should be done every month, quarter and at the time of financial closing and Submission of Statement of Account to the reinsurer. The specific loss year continues to be notified with the claim run-offs completely.

5. *Reinsurance Control*: As per the treaty arrangements, the reinsurance program is set up in the software system which automatically monitors the flow of data as entered by underwriting and claims. The reinsurance program should be then attached to the specific line of business and participation distribution is automated with minimum manual involvement.

6. *Claims Reporting:* Reinsurance department should ensure that claims are reported to the appropriate reinsurer and that reinsurance claims payments are being promptly collected. This assessment may also include a review of the reinsurance contracts. The Board of Directors receives reports on the effectiveness and performance of the reinsurance protection regularly.

Segregation of Duties between Reinsurance, Underwriting and Claims: All communications with reinsurers and reinsurance brokers is done by the Reinsurance Department. Claim processing related communications are made to the Claims Department with a copy being marked to the Reinsurance Department. However, necessary coordination is maintained between the Reinsurance Department, Underwriting Departments, Claims Departments and the Finance Department for Reinsurance related transactions and requirements.

The choice of reinsurance strategy is often a result of several factors, such as asset mix, product mix, the amount of equity capital, owner situation, and risk aversion, price of reinsurance and market conditions. The choice of reinsurance strategy by an insurer is made such that the return on equity is potentially maximized.

Reinsurance risk management policy can include procedures for selecting risk transfer methods and reinsurers as well as procedures for implementing, monitoring, reviewing, amending and documenting reinsurance contracts. Reinsurance strategy should also take into account the particular nature, size and complexity of an insurer's activities and its risk profile, the reinsurance risk management policy and related procedures.

The risk management policy for reinsurance can be explained as follows:

1. Retention Limits are defined in light of insurer's risk appetite and its risk tolerance levels set out in the reinsurance strategy. The types of reinsurance contracts that are most suitable for managing risks are specified in light of its risk tolerance levels.

2. The conditions for using Alternative Risk Transfer mechanisms are defined, including their intended use, their anticipated impact on profitability, solvency and capital requirements as well as the specific controls to which they are subjected.

3. The possible use of intermediaries is addressed, such as reinsurance brokers. The reinsurance risk management policy discusses the criteria for selecting intermediaries, such as experience and expertise, the tasks to be handled by intermediaries and the important contractual terms, such as the duration of intermediary contracts.

4. The reinsurers' selection process is determined, including selection criteria. The process generally considers diversification of reinsurance sources as well as the financial position of the reinsurers.

5. Limits are established on the amounts and types of insured risks that are automatically covered by reinsurance. The conditions and criteria for use of facultative reinsurance are also defined.

6. The conditions that must be included in reinsurance contracts are mentioned, such as insolvency clause (which defines the applicable terms and conditions in the event of the reinsurer bankruptcy) or an offset clause (pursuant to which the reciprocal debts of the insurer and the reinsurer cancel each other in certain circumstances) or a clause whereby the contract constitutes the final or entire understanding between the parties (the contract is not subject to collateral agreements).

7. The process for monitoring the application of this reinsurance risk management policy should also be outlined. The process is intended to see to it that the insurer complies with its own policy. It addresses the following, among other things:
   - assessing compliance with the established retention limits,
   - assessing the financial position of reinsurers,
   - monitoring concentration limits for single counterparty exposure per reinsurer,
   - monitoring reinsurance claims recoveries,
   - ensuring that actual risk transfers are as expected,
   - the availability, accuracy and adequacy of reinsurance documents to satisfy insurer's needs.