Prudential Practice Guide

GPG 245 Reinsurance Management Strategy

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Australian Prudential Regulation Authority

About this guide

Prudential Standard GPS 230 Reinsurance Management (GPS 230) sets out APRA's requirements of **insurers** in relation to reinsurance management. This prudential practice guide aims to assist insurers in complying with those requirements and, more generally, to outline prudent practices in relation to reinsurance management.

Unless otherwise defined in this prudential practice guide, expressions in bold are as defined in *Prudential Standard GPS 001 Definitions.*

Subject to the requirements of GPS 230, insurers have the flexibility to configure their reinsurance management strategy in the way most suited to achieving their business objectives.

Not all the practices outlined in this prudential practice guide will be relevant for every insurer and some aspects may vary depending upon the size, complexity and risk profile of the insurer.

Reinsurance management

1. Reinsurance management is the process of selecting, monitoring, reviewing, controlling and documenting an insurer's reinsurance arrangements. Such arrangements may be used by insurers for security and liquidity purposes, and to increase an insurer's capacity to underwrite insurance business.

2. While the insurer retains the responsibility for reinsurance management, it is generally useful for the insurer to seek the advice of appropriate experts in relation to the appropriateness, adequacy and effectiveness of its reinsurance management framework.

Systems for selecting reinsurance arrangements

3. GPS 230 requires an insurer's reinsurance management framework to include sound policies and procedures to manage the selection of **reinsurance arrangements**.

4. An insurer's systems for the selection of its reinsurance arrangements form part of the insurer's reinsurance management framework. APRA envisages that the systems would cater for the particular circumstances of the insurer, and the systems would typically consist of policies and procedures that:

   (a) identify the level of risk transfer appropriate to the insurer's tolerance for risk;

   (b) determine the most appropriate type(s) of reinsurance arrangements to limit risks to the insurer's level of tolerance (separately documenting traditional reinsurance contracts and Limited Risk Transfer Arrangements referred to in GPS 230);

   (c) set out principles for the selection of reinsurance counterparties, including formal evaluation procedures to assess the diversification and creditworthiness of reinsurance counterparties;

   (d) describe the process for liquidity management to cover any timing mismatch between the payment of claims and the receipt of **reinsurance recoverables**;

   (e) describe, and set, concentration limits for credit risk exposures to reinsurance counterparties and appropriate systems for monitoring these exposures;

   (f) provide for identification and management of aggregations of risk;

   (g) provide for identification and management of upper bounds of programs;

   (h) allow for analysis of trends within the business and stress scenario testing in relation to the adequacy of the reinsurance arrangements over the previous 12 months; and

   (i) set out any assumptions made about the likely continuation of the availability of similar cover in future years.

5. In relation to paragraph 4(a), APRA envisages that:

   (a) for **Category A**, **Category B** and **Category C insurers**, an insurer would have a target of ceding no more than 60 per cent of its total written premium in any 12-month period; and

   (b) for **Category D** and **Category E insurers**, an insurer would have a target of ceding no more than 90 per cent of its total written premium in any 12-month period;

(c) while an **insurance group captive** of a local insurance group would have a target of ceding no more than 90 per cent of its total written premium in any 12-month period, the local insurance group as a whole would typically have a target of ceding no more than 60 per cent of its total written premium in any 12-month period; and

(d) an insurer would have in place policies and procedures to ensure that its reinsurance arrangements meet the target cession ratio[1] based on the estimated total written premium specified in the insurer's Business Plan (required under *Prudential Standard GPS 220 Risk Management*).

Review and REMS

6. GPS 230 requires an insurer's reinsurance management framework to include sound policies and procedures to review reinsurance arrangements and to submit to APRA a written Reinsurance Management Strategy (REMS).

7. An insurer's regular review of its reinsurance management framework and REMS would typically cover the following issues, where relevant:

   (a) the identification and recording of policies underwritten to which reinsurance is attached;

   (b) the identification of dates when an obligation to pay reinsurance premiums arises;

   (c) the identification of cases where a company has suffered a loss under a policy against which a reinsurance recoverable can be made;

   (d) the management of the timing of payments to, and collection from, reinsurance counterparties;

   (e) the selection and credit standing of reinsurance counterparties and their capacity to meet obligations;

   (f) any concentration of reinsurance programs with reinsurance counterparties which could create large exposures or detract from diversification benefits;

   (g) the accessibility of intra-group funding and reinsurance under a range of conditions; and

   (h) the impact of adverse trends in estimated insurance liabilities on reinsurance and implications for the capacity of the insurer to meet its future policyholder obligations.

8. The insurer's REMS would typically not contain detailed policies or procedures that underpin the reinsurance management strategy but may refer to them for illustration purposes.

Reinsurance documentation

9. APRA envisages that any reinsurance contract an insurer enters into with a **non-APRA-authorised reinsurer** would provide for the following:

   (a) the non-APRA-authorised reinsurer certifies that it and its corporate group meet capital adequacy requirements established by its home regulator;

   (b) in the event that the home capital adequacy requirements are no longer met, the non-APRA-authorised reinsurer notifies the insurer immediately;

   (c) the non-APRA-authorised reinsurer certifies that it is authorised by its home regulator to offer the type of reinsurance covered by the contract or is at least able to certify that it is not restricted from offering the type of reinsurance cover offered; and

[1] The calculation of the cession ratio does not take into account exchange commissions.

(d) the non-APRA-authorised reinsurer immediately notifies the insurer of any material change in the status of its authority to carry on insurance or reinsurance business in its home market or any other market around the world.

10. In respect of the requirements in paragraph 31 of GPS 230, where an insurer enters into any reinsurance contract with any reinsurer, APRA envisages that the contract would provide that the reinsurer pays reinsurance recoverables to the insurer on the same basis, if the insurer becomes insolvent, as when the insurer is solvent.

Trust fund as collateral against reinsurance recoverables

11. Where an insurer possesses recognised collateral in the form of a trust fund against reinsurance recoverables due from a non-APRA-authorised reinsurer to reduce the Investment Capital Factor applicable to the reinsurance recoverables as provided for under *Prudential Standard GPS 114 Capital Adequacy: Investment Risk Capital Charge*, APRA envisages that the trust fund would satisfy the following criteria:

(a) the trust fund is maintained by a custodian resident in Australia;

(b) the custodian deals with the assets in the trust fund allocated to the insurer solely upon the direction of the insurer;

(c) the assets in the trust fund allocated as collateral for the insurer are clearly identifiable and segregated from other assets in the trust fund;

(d) the assets in the trust fund allocated as collateral for the insurer do not also serve as collateral against other assets of the insurer or assets of other persons;

(e) the assets in the trust fund allocated as collateral for the insurer are assets in Australia within the meaning of the *Insurance Act 1973* and *Prudential Standard GPS 120 Assets in Australia*;

(f) the assets in the trust fund allocated as collateral for the insurer are not instruments (including debt and equity instruments) issued by the non-APRA-authorised reinsurer or a related counterparty of the non-APRA-authorised reinsurer within the meaning of paragraph 29 of GPS 114

(g) the assets in the trust fund allocated as collateral for the insurer are liquid and of high quality;

(h) the trust fund documentation specifies trigger events for the transfer to the insurer of assets in the trust fund allocated as collateral for the insurer;

(i) there is periodic revaluation of the assets in the trust fund allocated as collateral for the insurer to ensure that there is sufficient collateral; and

(j) the trust fund documentation specifies the period within which the assets in the trust fund allocated as collateral for the insurer are to be topped up by the reinsurer to ensure that there is sufficient collateral.

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