GIBRALTAR FINANCIAL SERVICES COMMISSION

Reinsurance

Supervisory Statement - July 2018

Introduction

This Supervisory Statement has been issued by the Gibraltar Financial Services Commission ("GFSC") in order to set out its expectations of Gibraltar based Insurance Companies with respect to Reinsurance and Reinsurance Counterparty Credit Risk.

The Supervisory Statement should be read in conjunction with the Insurance Regulatory Approach document also published by the GFSC on 12th February 2018.

General considerations

Reinsurance will usually be an important aspect of the risk mitigation and capital management plans of most Insurance Companies. As such, the GFSC expects firms to consider and document their considerations in the following areas when deciding on the reinsurance arrangements they wish to enter into:

1. Understanding and ensuring appropriate risk transfer is taking place;
2. Giving appropriate consideration as to how the reinsurance arrangements will impact business plans, capital forecasts and reserving;
3. Considering any risk concentration which will be created through the arrangements; and
4. Assessing how any risk concentration and exposures will be monitored and mitigated.

In understanding and ensuring appropriate risk transfer, Boards should consider the proposed detailed arrangements and ensure that they understand the various provisions of the contracts, that suitable economic value calculations have been undertaken where appropriate and that the proposed contract meets the risk mitigation objectives initially intended to be addressed.

Given the complexity of some of the reinsurance arrangements available in the market, it may sometimes be appropriate for the Board to engage suitable experts and advisors to assist with any analysis required. The GFSC will expect Boards and any relevant committees to be able to demonstrate that due consideration has been given to individual contracts as well as the firm's overall reinsurance strategy and that where appropriate the necessary risk modelling and stress testing has been performed.

The complexity of the reinsurance arrangements can also sometimes transfer to the business forecasts, reserving and SCR calculations required to be undertaken by firms under Solvency II. The GFSC expects firms' risk management systems to be sufficiently robust to ensure that the level of risk transfer is reflected appropriately within firms' business forecasts and SCR calculations. Furthermore, Boards should also consider whether there are aspects of the reinsurance arrangements which are not appropriately captured by the parameters of the Standard Formula or any Internal Models and should therefore be supplemented by further assessment as part of the Own Assessment of Economic Capital within the ORSA.

Firms are also required to consider whether they will or could become exposed to significant concentrations of counterparty default risk through the reinsurance arrangements they wish to enter. Section 20 of the Financial Services (Insurance Companies) (Solvency II Directive) Act 2015 ("Solvency II Act") requires firms to have suitable risk management processes and controls for managing counterparty default and concentration risk. This would also involve considering whether any other arrangements are required over and above the capital charges created by the counterparty default risk and concentration risk charges in the Solvency II Standard Formula provisions to appropriately mitigate the relevant risks. In these circumstances, suitable risk mitigation could include introducing funds withheld and collateral arrangements into reinsurance contracts.

Firms are expected to set out their risk tolerances in the areas of counterparty default and concentration risks, to monitor these on an ongoing basis, as well as having suitable contingency plans in place where monitoring identifies that the particular risk could be increasing beyond the firms stated risk appetite. In doing so firms should consider the proportion of reinsurance cessions and recoverables to their overall balance sheet and capital resources, any impact on liquidity and cash flow forecasts as well as any potential barriers these could create to the implementation of suitable recovery or resolution plans. Where possible firms should consider whether amendments, or additional clauses are required in reinsurance contracts to enable them to implement any formulated contingency plans.

The GFSC expects firms' risk management plans, processes and controls to be proportionate to the size of the firm and its overall reinsurance strategy in both percentage and absolute terms.

Where firms are considering to change their reinsurance strategies or exposures significantly this may constitute a significant change in business plan and should therefore be referred to the GFSC.

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