reinsurance advisory board

Market access challenges: India

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The review of the Indian Reinsurance Regulations has produced some positive movement towards the further opening of the (re)insurance sector for international (re)insurance companies, which have long recognised the potential of the Indian market and transferred resources and experience to India accordingly. Nevertheless, the RAB remains concerned about discriminatory measures applied to foreign reinsurance branches and cross-border reinsurers.

Existing legislation and recent developments

Order of preference/offer of participation

The Reinsurance Regulations 2018, which came into force on 1 January 2019, amended the way in which the order of preference is applied to local cedants when placing reinsurance business. While the revised approach gives more business opportunities to international reinsurers, it still limits their ability to compete on equal terms with local reinsurers. The Regulations now envisage a two-step process for reinsurance placements (from which life (re)insurers are exempt):

- Obtaining the best terms for cessions:
  - Indian and foreign reinsurers can offer their terms to cedants on an equal basis.
- An offer of participation taking into account the order of preference:
  - Every cedant must offer the best terms obtained first to Indian reinsurers (currently only the General Insurance Corporation of India (GIC Re)) and then to foreign ones. Consequently, Indian foreign reinsurer branches (FRBs) are placed second in order of preference, while cross-border reinsurers are fourth (after International Financial Service Centre insurance offices that meet the required credit rating).

Compulsory cessions to GIC Re

The Insurance Regulatory and Development Authority of India (IRDAI) lowered the compulsory non-life reinsurance cession to GIC Re from 5% to 4% for the financial year 2022-23. While the RAB welcomes the decrease, it is still the case that compulsory cessions discriminate against foreign reinsurers.

Limits on cessions targeting foreign reinsurers in the context of cross-border reinsurance

Unless the Indian cedant has sought prior regulatory approval, the following overall limits on cessions to cross-border reinsurers apply, based on the reinsurer's rating (S&P or equivalent):

- to companies with ratings higher than A+: 20%
- to companies with ratings higher than BBB+ and up to and including A+: 15%
- to companies with ratings of BBB and BBB+: 10%

Registration of cross-border reinsurers (CBRs)

In order to conduct cross-border business in India, reinsurers without a physical presence in India are required to register with the IRDAI in accordance with the 2016 Guidelines on Cross-Border Reinsurers and apply for a Filing Reference Number (FRN). The IRDAI issued new guidelines on the registration process in January 2021, which confirmed that participation on risks and confirmation of the receipt of premiums is now linked to the issuing of the FRN. Failure to provide the necessary confirmations can result in either a delay to or a rejection of a reinsurer's future CBR registration.

Repatriation of capital

IRDAI regulations require FRBs to hold a certain amount of capital locally at the time of registration and thereafter to maintain adequate solvency. In addition, FRBs are required to provide a letter of comfort from their parent entities that the parent would always meet all the liabilities of the branch.

Even though this framework effectively guarantees that reinsurers have sufficient capital to meet their obligations at all times, there are currently no rules on how additional local capital can be repatriated freely. There is also no clear procedure for repatriating surplus/profits.

Taxation

For tax purposes, FRBs are treated as "non-residents", requiring them to pay a corporate tax of around 43% plus surcharge/education cess. This high tax rate has to be reflected in the reinsurance premiums charged, making FRBs less competitive than local players, which enjoy an effective tax rate of only 22% plus surcharge/education cess. This large difference in the effective tax rate cannot be absorbed by FRBs and so heavily constrains the viability of their business. This puts them at a significant disadvantage to local reinsurers.

Registration and operations of FRBs

A Committee made up of representatives of reinsurers, FRBs and Lloyd's India was set up in October 2019 to clarify the applicability of certain provisions of the regulations, guidelines and circulars issued by the IRDAI. A report was prepared by the Committee and reviewed and circulated by the IRDAI.

In January 2021, the IRDAI issued a consultation on the draft Regulations on Registration and Operations of FRBs. These draft Regulations include provisions that would

- require all activities to be localised in India;
- prohibit the provision of support services by group companies;
- require the recruitment of local underwriters to handle each class of business; and,
- require data to be stored in centres located and maintained in India.

In addition, restrictions on the outsourcing of functions exists. Although branches are committed to upskilling the local team, there are certain expert processes that should be permitted to be outsourced within the group (eg, the maintenance and negotiation of IT contracts, expert advice on certain risks, etc.).

With regards to data localisation, IRDAI regulations and other acts currently require data to be localised on servers in India. As branches operate under a group framework, branches rely on the group infrastructure to leverage governance and risk-mitigation standards applicable to data storage and processing. Data localisation requirements therefore lead to increased costs. This is not in line with other jurisdictions such as Singapore, Hong Kong and Australia.

Unearned Premium Reserve (UPR) methodology applicable to reinsurers

For the determination of the Unearned Premium Reserve (UPR), the IRDAI requires reinsurers to apply a methodology based on either

- a 1/365th fraction method applied on the unexpired risk period of the annual policies or
- a fixed percentile of the premium written during the preceding 12 months (100% for marine, and 50% for other lines of business). This method is not relevant in the context of the reinsurance industry, especially for proportional treaty contracts that cover multiple underlying policies and have a premium earning pattern usually spread over two years. It is also not aligned with usual market practices or guidelines issued in other jurisdictions.

As a result, the application of the IRDAI methodology appears to be in contradiction to the principle that the premiums earning pattern should be consistent with the remaining claims coverage period before the expiration or renewal of the policy.

Branch reporting requirements

FRBs are currently expected to adhere to the reporting and compliance requirements applicable to direct insurance companies. These are sometimes not in line with their business model, which can even lead to the need for manual intervention to be able to publish or submit reports.

Corporate reorganisation of branches of foreign reinsurers

Indian regulations currently prevent foreign reinsurers that do business in India through licensed branches from reorganising their corporate structure. Specifically, it is currently not possible to transfer the portfolio of an existing entity to a new branch of another wholly-owned affiliate in the same group. This is not in line with international best practices and imposes additional challenges for FRBs.

Foreign direct investment

The Finance Minister of India presented the Union Budget for the Financial Year 2021–22 on 1 February 2021. As part of the Budget, the Finance Minister proposed an increase in foreign investment limits for Indian insurance companies from 49% to 74% and indicated that foreign control may be permitted subject to certain safeguards, including that:

- a majority of directors and key management personnel are resident Indians;
- at least 50% of directors on the board are independent; and,
- not less than 50% of profits are retained as general reserves.

This is a positive move towards a further liberalisation of the Indian insurance market, increasing its attractiveness to foreign investors. On 13 April 2021, the government released draft rules amending the Indian Insurance Companies (Foreign Investment) Rules, 2015 for consultation. These rules entered into force on 19 May 2021 as the Indian Insurance Companies (Foreign Investment) Amendment Rules, 2021.

It would be in the interest of the further development of the Indian insurance market to keep the above-mentioned safeguards as light as possible, relaxing certain restrictions, such as the Indian owned and controlled requirement.

Impact on foreign reinsurers

Order of preference/offer of participation

The previous law granted full right of preference to national reinsurers. The two-step approach therefore constitutes a partial reopening of the Indian market to foreign players, since they are now able to compete on the same basis as Indian reinsurers while offering their best terms. However, the approach does not create equal treatment of GIC Re and FRBs, as there is still an order of preference that favours locals.

Compulsory cessions to GIC Re and other restrictions on cross-border reinsurance

All the restrictions described above discriminate against foreign reinsurers, whether cross-border reinsurers or FRBs.

Registration of CBRs

The IRDAI's new approach to the CBR registration process seems to discriminate against foreign reinsurers that have established an FRB in India compared to competitors who have not. It is opaque and restricts the ability of foreign reinsurers to conduct cross-border business.

The limitation to lines of business or retro placements for FRBs forces reinsurers to conduct business through branches rather than cross-border reinsurance, which means that more capital needs to be held at the level of the branch. Furthermore, disallowing or significantly limiting direct placements between cedants and cross-border reinsurers appears to conflict with the procedures for reinsurance placements as prescribed in the Reinsurance Regulations 2018.

This lack of legal certainty and transparency poses a challenge, not just to international companies wishing to do cross-border business in India, but also to the local cedants that rely on the continued availability of international risk capacity at competitive terms.

Repatriation of capital

If excess capital that goes beyond what is needed to meet local capital requirements cannot be repatriated, a parent undertaking's ability to make efficient use of its capital and react flexibly to changing market conditions is severely limited. Consequently, parent undertakings will be hesitant to bring in additional capital to increase the business written through Indian FRBs. This also undermines the prospect of future additional investment in India from the headquarters of Indian FRBs.

Registration and operation of FRBs

The RAB has stressed forcefully that the changes proposed by the IRDAI would significantly affect the business model of FRBs in India and undermine the provision of reinsurance in India.

Furthermore, the proposed restrictions on the outsourcing of functions severely affect the ability of a branch to benefit from systems and process support from other entities in its group or from best-in-class global service providers contracted by its group. Intragroup servicing arrangements also keep the cost of operations under control, which further contributes towards the profitability of the branch.

Examples of functions that should not be considered as core are accounting (including access to group reporting systems and processes), risk management and investment-related advisory and processing support, as these activities are of an advisory nature. The ability to tap into the experience of international advisors would only strengthen branch operations and make them more robust.

For data localisation, if branches are to carve out local data on separate servers, it will lead to operational costs that render the branch business model infeasible and require additional governance and risk mitigation leading to additional compliance requirements.

UPR methodology
The implementation of the IRDAI methodology on UPR requires reinsurers to set up specific manual or semi-manual procedures which create operational risks and bring additional costs.

Furthermore, since reinsurers are not able to opt for the fraction method (1/365th), especially for treaty/proportional contracts, and thus can only apply the fixed percentile method, the earning of premiums in the reinsurers' financial statements are not consistent with the exposure to potential claims. This brings a risk of volatility in technical results and thus has potential impacts on the solvency of reinsurance companies from year to year.

Branch reporting requirements
The requirements in place are burdensome for reinsurance companies. The cedants rely on the parent's financial standing when placing business with local branches, and imposing extensive, onerous reporting requirements such as those applied to direct insurance companies has a direct compliance cost impact on the branch.

An example of an onerous reporting requirement is publishing public disclosures on the company's website and in newspapers on an annual basis. Reinsurance is a B2B activity and disclosing confidential information such as the salaries of key managerial personnel is not warranted.

Corporate reorganisation of branches of foreign reinsurers
The lack of a regulatory framework that allows for the corporate reorganisation of FRBs restricts the ability of foreign reinsurers to make changes to their licensed entity in India and operate efficiently in a way that adapts as their corporate needs change.

Foreign direct investment
The limiting of foreign direct investment prevents foreign reinsurers and other international players from fully supporting the local market, which can slow the overall growth of the economy.

Recommendations and preferred outcomes

Remove the order of preference/offer of participation
The RAB calls on the Indian authorities to remove any form of order of preference completely and to strive for a level playing field between national and foreign reinsurers.

Abolish restrictions on cross-border reinsurers and create a level playing field for FRBs and local reinsurers
The RAB urges India to reconsider its current regime of restrictive practices in respect of the cross-border supply of insurance and reinsurance services, not least in light of its commitments under the World Trade Organization's General Agreement on Trade in Services (GATS).

Increase the transparency of the CBR registration process
The RAB calls on the Indian authorities to increase the transparency and legal clarity of the CBR registration process. Any restrictions and limiting conditions to cross-border reinsurance that are not in line with the procedures for reinsurance placements as prescribed in the IRDAI's Reinsurance Regulations, 2018 should be removed.

Provide clarity on the repatriation of capital
The RAB urges India to establish a clear procedure on repatriating excess capital and profits. The RAB recommends that FRBs should be allowed to freely repatriate capital in excess of the level to be maintained to meet the solvency requirements.

Create parity with local players on the direct tax rate

The RAB urges India to bring the direct tax rate applicable to FRBs (circa 43%) into line with that applicable to local reinsurers (25%). The current disparity stands out among countries that allow foreign reinsurers and it seriously affects the pricing and competitiveness of their offerings.

Registration and operation of FRBs

The RAB's key recommendations to the IRDAI are:

- Prohibited outsourcing activities should be limited to the core functions as defined in the 2015 regulations.
- The regulations should be amended to allow underwriters in FRBs to underwrite multiple lines of business with support from global experts.
- The requirement to hold data in centres located and maintained in India should be removed.

In addition, the RAB calls on India to allow the outsourcing/intragroup servicing arrangements of non-core functions to group entities or vendors within group companies. The RAB also urges India to lift its data localisation requirements.

UPR methodology

The RAB recommends that reinsurers be allowed to follow a well-recognised method for UPR computation adapted to the reinsurance industry, which consists in earning premium over the effective risk period (ie, 1/8th per quarter when the period of risk cover is two years). This would be in line with the spirit of IRDAI regulations and would help reduce operational and financial risks.

Implement regulations allowing transfer of portfolios between branches within same company

An approval process for allowing the transfer of portfolios through statutory novation should be implemented, in line with common practice in other jurisdictions. This would allow for the simultaneous licensing of a new branch, the transfer of all treaties from the old to the new branch and the cancelling of the old branch's licence. Additionally, the Indian authorities should consider allowing companies to maintain multiple licensed entities in the country so that (re)insurers can manage their corporate structures in the most efficient way.

Lift foreign direct investment cap

The need to retain foreign investment limits in the insurance sector should be reviewed, as has been done in other sectors, and the RAB welcomes the signalling by the current Indian government that it intends to do so.

Insurance Europe's Reinsurance Advisory Board (RAB) is a specialist representative body for the European reinsurance industry. It is represented at chairman or chief executive officer (CEO) level by the seven largest European reinsurance firms: Gen Re, Hannover Re, Lloyd's, Munich Re, PartnerRe, SCOR and Swiss Re, with Insurance Europe providing the secretariat. Through its member bodies, the RAB represents around 60% of total worldwide reinsurance premium income. The RAB promotes a stable, innovative and competitive market environment. It further promotes a regulatory and trading framework that facilitates global risk transfer through reinsurance and other insurance-linked capital solutions.