
Consultation Paper

**REGISTRATION AND
REGULATION OF REINSURERS
IN SRI LANKA**

November 2015



**Insurance Board of Sri Lanka
Level 11, East Tower
World Trade Centre
Colombo 1.**

CONSULTATION PAPER**REGISTRATION AND REGULATION OF REINSURERS IN SRI LANKA****Introduction:**

The Insurance Board of Sri Lanka has received requests from many interested parties to set up reinsurance company/companies in Sri Lanka. As per the current Insurance Law, there is no specific regulatory framework for establishing and regulating reinsurance companies in Sri Lanka.

Reinsurance is an important risk management tool used within the insurance industry, to spread the uncertain cost of risk exposure over a larger global capital base. The complexity of reinsurance products has evolved substantially in recent years and this remains an untapped market in Sri Lanka.

We are of the opinion that allowing the formation of local and foreign owned reinsurance companies in Sri Lanka will support and enhance the local insurance industry and the country's economy.

As such, we have attached herewith a consultation paper and proposed legislative changes and rules in relation to registration and regulation of reinsurers in Sri Lanka, for the views of the insurance industry and the general public on the same. IBSL in particular wishes to obtain the views of those intending carrying on business as reinsurers and those who use or rely on the work of reinsures.

Comments on Consultation Paper:

The comments received would be subject to consideration by IBSL and may be made publicly available and will not be treated as confidential unless a special request is made in this respect. We will not accept a standard confidentiality statement in an email message as a request for non-disclosure. Please send any clearly identified confidential submissions separately, if reasonably possible, so that we may more easily keep them apart from the non-confidential submissions. Please keep in mind that IBSL may have to disregard confidential submissions that in fairness should be made available to others for further comment. For that reason, please avoid confidential submissions if possible, or keep them short.

Copies of this consultation paper are available to download from our website – www.ibsl.gov.lk/public-consultations.html. Alternatively, you can request paper copies by calling IBSL on 2396184 - 9.

Please send in your comments under the title "REGISTRATION AND REGULATION OF REINSURERS IN SRI LANKA " on or before 31st December 2015 by registered post or e - mail or fax to:

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Table of Contents

1. Overview	4
2. Proposals related to the Regulation of Insurance Industry Act	4
3. Other proposals	8
4. Annexure	10

Overview

- 1.1 IBSL proposes to affect legislative changes to enable the registration of pure reinsurance companies in Sri Lanka in appropriate cases. (No insurers, except the National Insurance Trust Fund Board, have permission at present to carry on reinsurance business.)
- 1.2 This consultation paper sets out IBSL's proposed approach. All stakeholders and prospective stakeholders in Sri Lanka's insurance industry and the wider economy are invited to make submissions. **Please ensure that submissions arguing against any of the proposals in this paper are well supported by reasons and evidence.**
- 1.3 Broadly, in IBSL's view, reinsurance business should be regulated prudentially in Sri Lanka in much the same way as direct insurance (although, under risk based supervision, the regulatory result may not always be the same). This policy is consistent with the International Association of Insurance Supervisors (IAIS) Insurance Core Principles.
- 1.4 As the IAIS has stated, regulators should impose requirements and apply the degree of supervision reflecting the characteristics of the reinsurance business and the nature of the risks. Regulation should not stifle innovation that would improve the efficiency and stability of the insurance market, and overly strict regulation may unduly inhibit market entry.
- 1.5 In this paper, IBSL addresses the following issues:
 - Composites,
 - Establishment as a public company/ branches,
 - Paid up capital, deposits, and fees,
 - Lloyd's of London,
 - Listing,
 - Restricting business to insurance business,
 - Retrocession to the National Insurance Trust Fund Board,
 - Filing policy forms with IBSL,
 - Limits on assets kept outside Sri Lanka,
 - Risk based capital rules,
 - Principles for businesses.

Proposals related to the Regulation of Insurance Industry Act

2.1 In IBSL's view, the Regulation of Insurance Industry Act, No.43 of 2000 (as amended) ("the **Act**") does not require to be amended to specifically deal with reinsurance business. Section 12(1) states that "*no person shall carry on insurance business in Sri Lanka unless such person is for the time being registered ... under this Act*". Under the common law, both direct insurance and reinsurance business (including retrocession) can be defined as "*carrying on insurance business*". There is nothing in the Act that might affect this conclusion. For example, there is nothing in the definition of "*insurance business*" that excludes reinsurance business.

2.2 However, there are other provisions in the Act that need to be addressed.

Composites

2.3 Under section 12(2) of the Act, insurance companies may apply to carry on general or long term insurance business, but not both. Many pure reinsurance companies are composites. Some jurisdictions do not allow composites (limiting registered reinsurance companies to general or long term business), but many jurisdictions do not limit pure reinsurance companies in this way.

2.4 IBSL proposes that, at this stage of the market's development, IBSL should not permit pure reinsurers to operate as composites. This has the advantage of simplicity and greater safety.

Question: Accordingly, section 12(2) would continue to apply to pure reinsurers although it would be amended to enable exceptions for reinsurers [and micro-insurance] in future. What are your views?

Public company

2.5 Section 13(1)(a) requires insurers (defined to mean insurance companies registered under the Act) to be a public company incorporated and registered under the Sri Lanka Companies Act. Many jurisdictions permit pure reinsurance companies to operate through a branch, and some (eg, the United Kingdom) also allow insurance business on a services only basis (without a permanent establishment in the jurisdiction). The arguments for and against allowing branches are finely balanced. With a branch, you may bring the full capacity of the head office into the country, including expertise and financial resources. But this can also happen with a subsidiary. On the other hand, a branch may have little independence from head office and there may be no real management in the jurisdiction, and no board of directors. Perhaps the main benefit of a subsidiary is increased control by the regulator, especially if the firm runs into financial difficulty or becomes insolvent.

2.6 For reasons of simplicity and greater safety, IBSL proposes no change to section 13(1)(a) except to add a new section to enable exceptions for reinsurance companies in future.

Question: Although the Act would be amended to enable exceptions for reinsurance companies in future, (re)insurance companies established outside Sri Lanka would not at this time be permitted to set up branches in the jurisdiction, and services business would continue to be prohibited. What are your views?

Paid up capital, deposits, and fees

2.7 Under sections 13(1) and (2) and 16(2), IBSL may prescribe different amounts of paid up share capital, deposits, or fees for different "classes of insurance business" (defined in the Act as long term insurance business or general insurance business). IBSL proposes, in addition, that it should be able to prescribe different amounts for direct insurance and reinsurance business or to set amounts based on the number, size, or category or sub-class of insurance business carried on.

2.8 However, it is not clear that different amounts of paid up share capital, deposits, or fees for pure reinsurers would be appropriate at this time. The paid up capital and deposit requirements under the Act should not be a challenge for prospective reinsurers. And paid up share capital and deposits may be increased (although not reduced) under Sections 53 or 95A in appropriate cases. With experience, we may take a different view in due course, but at present IBSL does not propose to impose different levels of paid up capital, deposits, or fees for reinsurance.

Question: *IBSL proposes to treat direct insurance and reinsurance business the same under sections 13(1) and (2) and 16(2). It will, however, pursue legislative amendments to enable different levels of paid up capital, deposits, or fees in future, depending on whether the business is direct or reinsurance, by size, or by category or sub-class. What are your views?*

Lloyd's of London

2.9 Lloyd's should be able to apply for registration, whether as a direct insurer or reinsurer. It is a significant and well capitalized player in the global market. Although many of Lloyd's members are incorporated, they are essentially capital providers. Lloyd's insurance business is conducted through unincorporated syndicates (which form and re-form). Lloyd's insurance business in a jurisdiction will probably involve more than one syndicate, and different syndicates from time to time. It is not possible for a syndicate to incorporate.

2.10 IBSL proposes that it would be appropriate to enable Lloyd's to be registered, should it wish to apply to do so, to carry on (re)insurance business. This would of necessity be on somewhat different terms from other insurance entities due to its peculiar structure - <http://www.lloyds.com/lloyds/about-us/what-is-lloyds>.

Question: *IBSL proposes that the Act be amended to enable Lloyd's to be registered as a branch on terms acceptable to IBSL. See proposed new section 13A in the annex. What are your views?*

Listing

2.11 Under section 15A, insurers must be listed in Sri Lanka within three years of registration. The Act has been amended to exempt non-listed subsidiaries of companies that are listed on a recognized exchange. Reinsurers not held by a suitably listed company would be required to list in Sri Lanka.

Question: *For reasons of simplicity, IBSL proposes that section 15A (and the exemption) would apply to both direct insurers and pure reinsurers. What are your views?*

Only insurance business

2.12 Under section 12(4), (re)insurers may not carry on any business other than insurance business. There is an exception for ancillary financial services business. Many jurisdictions allow pure reinsurance companies to carry on certain related activities such as statistical or actuarial advice, risk analysis, and research, subject to adequate management by the reinsurer of conflicts of interest and the ring fencing of these activities from the insurance business. The downside risk of conflict of interest or an adverse effect on the financial position of the company should be monitored by IBSL, but the upside of the additional expertise in the market should more than make up for the additional costs of supervision.

Question: *IBSL proposes that section 12(4) be amended to enable pure reinsurers to provide non-insurance services in the areas of statistical and actuarial advice, risk analysis, and research. IBSL also proposes that the exemption apply to reinsurance brokers. What are your views?*

Onward reinsurance to NITFB

2.13 Although the Ministerial Order under section 31(1A) could be modified to reduce the obligation on a reinsurer to obtain a portion of its onward reinsurance from the National Insurance Trust Fund Board (NITFB), IBSL proposes that section 31(1A) be dis-applied to onward reinsurance/ retrocession.

Question: *What are your views?*

Filing policy forms

2.14 Section 37 requires (re)insurers to file their policy forms with the Board. This requirement is not risk based. In addition, conduct requirements of this sort are not usually appropriate for reinsurance business because the parties can usually be expected to take care of themselves. IBSL proposes that section 37 be amended so as not to require the automatic filing of reinsurance policy forms.

2.15 Taking a risk based approach, IBSL may in any event require reinsurance policies to be provided when this appears to be justified in any particular case, and may require the amendment of policies. IBSL also has the power to make rules in this area under section 13(1) to deal with any market problems that may become apparent in the future. (See also IBSL's proposed rules below which would be implemented as part of IBSL's Risk Based Supervision regime.)

Question: *What are your views on dis-applying section 37 to reinsurance policy forms?*

Filing onward reinsurance contracts

2.16 Similarly, section 50 requires all (re)insurers to file certified copies of their onward reinsurance contracts. This requirement is not risk based. IBSL proposes that section 50 be dis-applied to retrocession.

Question: *What are your views on dis-applying section 50(1) to retrocession?*

Other minor matters

2.17 Section 31(1) allows insurers to reinsure only with other "insurers" (ie, insurance companies registered under the Act). IBSL proposes that this section be amended to make clear that (re)insurers may reinsure with companies that are not registered under the Act (subject to regulatory requirements).

2.18 Section 101(1) allows (re)insurers to place reinsurance business with an insurance company that is not registered under the Act. In other words, insurers can reinsure (or retrocede) with a reinsurance company that is not carrying on business in Sri Lanka. However, section 114(2)(a) deems a person who issues etc a policy to a person in Sri Lanka (including a (re)insurer) to be carrying on insurance business in Sri Lanka. These provisions contradict one another. IBSL proposes that reinsurance be expressly excluded from section 114(2)(a), and that it be made clear that section 114(2)(a) is subject to section 101(1).

2.19 Section 34 imposes limits on the insurance business that (re)insurers may accept. Reinsurers will wish to be able to accept some business from overseas (re)insurance companies and should probably do so to diversify. We have concluded that section 34 would permit the acceptance of reinsurance from insurance and reinsurance companies outside Sri Lanka, whether or not the risks are situated in Sri Lanka.

Question: *Should IBSL be proposing any other legislative changes?*

Other proposals

Subordinate legislation

3.1 If reinsurers cover risks situated outside Sri Lanka or carry on business outside Sri Lanka, whether via a branch in another jurisdiction or not, they may be required to keep assets to cover liabilities in that jurisdiction. Reinsurers can apply for permission to keep assets outside Sri Lanka under section 25(3) of the Act, but it may be appropriate to dis-apply or reduce the prescribed limits in regulation 4 of the Insurance Board Regulations 2005.

Question: *What are your views?*

3.2 Regulations 29 – 31 of the Control of Insurance (Miscellaneous Provisions) Regulations 1987 will be repealed (and will no longer be an issue in this context).

RBC Rules

3.3 Under the proposed Risk Based Capital (RBC) Rules, newly licensed reinsurers will be required to comply immediately. Broadly there are 3 options here. Some jurisdictions do not impose capital adequacy requirements on pure reinsurance companies at all. (IBSL does not consider this to be acceptable in Sri Lanka.) Some impose only high level requirements for adequate financial resources, risk management, and so on (subject to regulatory supervision and additional requirements at the firm level). Others apply their more detailed solvency requirements equally to direct insurance companies and pure reinsurance companies (and to direct and reinsurance business), with some very limited exceptions.

3.4 As the IAIS notes, in setting solvency requirements, regulators should take into account the risk profiles of insurance companies, including the volume of business and degree of diversification. The higher a company's sensitivity to risk, the greater the need for it to have strong risk management practices and sufficient capital. Significant risks faced by reinsurance companies include underwriting (including accumulations and geographical concentration), retrocession, investment (including liquidity and currency matching), taxation and, for companies in a group, group risk. Since reinsurance companies' operating results are also potentially more volatile than those of direct insurance companies, especially if they are covering eg catastrophe or long-tail risks, they must hold capital adequate to cover the risks inherent in this type of business and sufficient to be able to withstand extreme but plausible loss scenarios.

3.5 Having said that, reinsurance companies are often very sophisticated and well able to use dynamic financial analysis tools to more reliably determine the amount of economic capital they need. Also, if the company is a subsidiary in an insurance group, IBSL may to a greater or lesser extent be able to take into account the oversight of the home state regulator of the group.

3.6 All of this supports an argument for high level capital adequacy requirements. Having said that, well managed reinsurers should have no difficulty complying with the detailed requirements of the RBC Rules. Full compliance with solvency requirements is also generally expected under the IAIS Insurance Core Principals, in part to maintain a level playing field with direct insurance companies that also carry on reinsurance business.

3.7 IBSL proposes to take the more prudent approach and does not intend to dis-apply the minimum requirements in the RBC Rules to reinsurance business. Proportional and non- proportional business should be reported separately. Initially, if reinsurers have some contracts that are not clearly attributable

to particular sub-classes or categories of business so that it is not clear which liability factor should be used, IBSL may accept a “best endeavours” effort from the actuaries. If the amount of liabilities subject to best endeavours is material, then IBSL will consider amending this aspect of the RBC Rules. (For assets etc, the application should be identical.)

Question: *What are your views on the application of the RBC Rules to reinsurers?*

Other rules

3.8 Individuals holding key positions should be demonstrably competent to perform the roles with integrity and, to the extent reasonably possible, not be in a conflict of interest position (or at least be able adequately to manage any potential conflicts).

3.9 In addition to a rule on “fit and proper”, IBSL proposes to make high level rules under section 13(1)(e) setting out principles based, outcomes focused requirements for effective governance, and adequate risk management and systems and controls **for both direct insurers and reinsurers**. Please see the proposed rules in the annex.

Question: *What are your views on the proposed rules?*

Investments – Determination #1

3.10 Reinsurers’ investment strategies are likely to be somewhat different from, and perhaps more complex than, those of direct insurers. IBSL will expect to receive and review reinsurers’ investment strategy and plan every year and will consider applications from reinsurers to invest in assets other than those listed in Determination #1.

3.11 IBSL does not propose to amend Determination #1, other than to make the amendments needed to bring the Determination into line with the RBC Framework/ Rules.

Accounts and reporting requirements

3.12 IBSL imposes requirements for accounts and reporting under sections 47 to 49 of the Act. IBSL may require additional reporting for reinsurance business.

Application form for registration

3.13 Subject to any changes to the Act mentioned above, the application form for insurance companies requires few changes for reinsurance business although additional questions will be asked and material requested in the Licensing Guide to be issued in due course. Regardless of what is in the form, IBSL will always wish to understand fully the prospective (re)insurer's business plan, how it is to be capitalised, who are its senior managers, other key personnel, controllers, officers and directors, and how it will be operated and governed (including risk management, internal and external audit, actuarial support, systems and controls, compliance, investment management, underwriting, claims, reinsurance, and so on). To the extent that information is not supplied or not fully supplied with the form, IBSL may ask for additional information under section 14(j) of the Act.

Annexure:**Proposed Legislative Changes and Rules**

- changes underlined, deletions marked ...

Regulation of Insurance Industry Act, No.43 of 2000 (as amended)

Section 12(2A)

Notwithstanding subsection (2), the Board may permit reinsurers [or providers of micro-insurance] to carry on both general insurance business and long term insurance business, or (on application) so determine in a specific case, subject to the terms and conditions the Board may specify.

Section 12(4)

A person registered under subsection (1) shall not carry on any form of business other than insurance business:

Provided that, a person may with the prior written approval of the Board, carry on any financial services business which is ancillary or associated with the insurance business for which a registration is obtained under this Act or, in the case of pure reinsurers and reinsurance brokers, carry on related activities such as statistical or actuarial advice, risk analysis, and research, subject to the terms and conditions the Board may specify.

Section 13(2)

For the purpose of paragraphs (b), (c) and (d) of subsection (1), different amounts may be prescribed for different classes of insurance business, for different categories or sub-classes of insurance business, for direct insurance business and reinsurance business, and for different sizes of insurance business.

Section 16(2)

The Board may prescribe different amounts as annual fee in respect of different classes of insurance business, of different categories or sub-classes of insurance business, of direct insurance business and reinsurance business, and of different sizes of insurance business.

Section 13A (branches)

(1) Notwithstanding sections 12(2), 13(1)(a), (b), and (bb), 15A, and [sections 52 and 53 incorporated by Act No 03 of 2011], subject to (3) and (4), the Board may register [Lloyd's of London] [an association of underwriters] or a reinsurance company to carry on insurance business in Sri Lanka through a branch office in Sri Lanka.

(2) Notwithstanding section 14(1), an application for registration by an association of underwriters shall be accompanied by evidence of payment of the prescribed fee and the following:

(a) a copy of its statute or deed of association;

(b) a certificate that:

(i) the law of the country in which it is constituted provides for the regulation of its insurance business, and

(ii) the association is operating in accordance with that law;

(c) the address of the principal office in Sri Lanka and the name of the principal officer;

(d) the name and address of the insurance agents and insurance brokers through which insurance may be placed in Sri Lanka;

(e) a business plan for a period of three years; and

(f) any further documents and information the Board may require.

(3) If the Board is satisfied that:

(a) the association or reinsurance company (as the case may be) is likely to be able to comply with the requirements of and under this Act;

(b) the insurance business is financially sound and will be managed in a prudent manner by persons who are fit and proper; and

(c) the association or company has made the deposit required by section 13(1)(c),

the Board may register the association or company, subject to the terms and conditions the Board may specify.

(4) The Board may exempt the association or company from any requirement in or under the Act that it considers cannot realistically be applied or that it considers would be unduly onerous, taking into account the unique features of the association or branch business, subject to the terms and conditions the Board may specify.

Section 31(1)

An insurer may, subject to such terms and conditions that may be specified by the Board in order to ensure that the interests of policy holders and the insurers are adequately safeguarded, reinsure with any other insurer or insurance company in or outside Sri Lanka, any liability arising out of any contract or policy of insurance, effected or issued by the first- mentioned insurer.

Section 31(1A)

Every insurer who reinsures shall be required to reinsure with the National Insurance Trust Fund Board established by the National Insurance Trust Fund Act, No. 28 of 2006, a percentage not exceeding fifty per-centum as shall be determined by the Minister by Order published in the Gazette, of the liability sought to be reinsured. This subsection does not apply to retrocession.

Section 37(1)

For the purpose of examining whether the interests of policy holders are being adequately safeguarded every insurer shall be required to file with the Board:-

- (a) all policy forms to be issued by such insurer, other than reinsurance policies, prior to ... issue;
- (b) any amendments to be made to any such policy forms already issued; and
- (c) where required to do so by a notice in writing, copies of any policy forms already issued.

Section 50

(1) Every insurer shall from time to time furnish the Board with certified copies of its reinsurance treaties ..., contracts and arrangements (except retrocession) relating to any class of insurance business transacted by such insurer in Sri Lanka:

Provided that certified copies of such reinsurance treaties, contracts and arrangements as are in force on the appointed date, shall be furnished not later than three months after the appointed date.

(2) The Board shall have the power to review all reinsurance treaties, contracts and arrangements furnished to it ..., for the purpose of determining whether such treaty, contract or arrangement is in any way detrimental, to the interest of the insurer, the insured or to the development of the insurance industry or to the national interest. Where the Board is of the view that the interests of the insurers and the public are not adequately safeguarded, the Board shall have the power to recommend any amendments that it considers necessary for the development of the insurance industry.

Section 101(1)

No person in Sri Lanka, shall without the prior written approval of the Board, directly or indirectly place any insurance business with an insurance company not registered under this Act, except in relation to reinsurance business.

Section 114(1)

“broker” means an insurance broker ... who functions as an intermediary for the placing of insurance business for or on behalf of an insurer, a policy holder or a proposer for insurance or reinsurance, with an insurer or insurance company, in expectation of a payment by way of brokerage or a commission;

[“micro-insurance” means insurance that is accessed by or accessible to the poor;]

Section 114(2)(a)

For the purposes of this Act, a person shall be deemed to carry on or transact insurance business of any class in Sri Lanka, if such person-

- (a) issues, or undertakes liability under, any policy or contract of insurance of that class, other than a contract of reinsurance or a policy approved under section 101(1), to or with a person for the time being in Sri Lanka; or

Proposed new Rules – Principles for Insurers

Made under section 13(1)(e)

1. An insurer must conduct its business with integrity.

2. An insurer must conduct its business with due skill, care, and diligence, and ensure that its senior managers, directors, officers, and other key employees and contractors are fit and proper.
3. An insurer must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management.
4. An insurer must maintain adequate financial resources.
5. An insurer must observe proper standards of market conduct.
6. An insurer must pay due regard to the interests of its customers, and treat customers fairly.
7. An insurer must manage conflicts of interest fairly, both between itself and its customers and between customers.
8. An insurer must deal with its regulators in an open and co-operative way and, as soon as reasonably practicable, must disclose to the Board anything relating to the insurer about which the Board would reasonably expect notice.