

**INTERNATIONAL ASSOCIATION OF  
INSURANCE SUPERVISORS**



**TASK FORCE RE**

**ENHANCING TRANSPARENCY AND  
DISCLOSURE IN THE REINSURANCE  
SECTOR**

**March 2004**

**TASK FORCE ON ENHANCING TRANSPARENCY AND DISCLOSURE  
IN THE REINSURANCE SECTOR**

**Enhancing Transparency and Disclosure in the Reinsurance Sector**

**Report presented to the Financial Stability Forum, March 2004**

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**Executive summary**

The objective of this report is to set out the full process and product of the IAIS Task Force (Task Force Re)'s work in response to the request from the Financial Stability Forum (FSF) to improve the transparency of the global reinsurance market and risk-oriented disclosures of individual reinsurers. This work has been undertaken having regard to potential sources of vulnerabilities in the global reinsurance market and the industry's linkages with other financial sectors.

Task Force Re is comprised of senior representatives of the regulatory authorities of jurisdictions in which major reinsurers are incorporated and the organisation of the Task Force is described in more detail in Chapter 1. The process has been a collaborative effort between the participating authorities and industry representatives. Their participation in, and commitment to, the work of Task Force Re has been a key element in achieving fruition of this work.

The process has been a very challenging one and involved many discussions and negotiations to achieve consensus, given the wide divergences between different jurisdictions in the regulatory and reporting requirements imposed on reinsurers between different jurisdictions, as well as large differences in the accounting standards, different risk management practices of individual reinsurers and differing market dynamics. To address the particular issue of publication of aggregate and national data, a pragmatic approach has prevailed to take into account both the meaningfulness of the aggregation and the potential confidentiality concerns.

In carrying out its work, Task Force Re took stock of existing data and analyses of reinsurers in order to improve the understanding of aggregate reinsurance risks. This is elaborated in Chapter 1. To enhance the transparency of the global reinsurance industry, Task Force Re has developed a framework for collecting, processing and publishing global reinsurance market statistics covering a significant sample of the reinsurance activity worldwide in the following seven key reinsurance jurisdictions: Bermuda, France, Germany, Japan, Switzerland, the United Kingdom and the United States. A total of 40 reinsurers, including direct insurers assuming reinsurance business, and 3 monoline bond reinsurers were selected and asked to participate in this exercise on a voluntary basis. The framework includes templates that are organised in a way that may make the statistics collected through these templates relevant to evaluating both reinsurers' financial health and related systemic stability considerations and may provide a basis for an assessment of the linkages with counterparties from other sectors. The statistics cover the following key aspects:

- Size and structure of the global reinsurance market
- Structure and profile of reinsurance risk assumed
- Derivative financial instruments and credit risk transfer activity

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- Counterparty risk and linkages to other sectors
- Investments, profitability and capital adequacy

This aspect of the work is elaborated in Chapters 2 and 3 of this report.

Task Force Re is currently collecting 2001 and 2002 data and compiling prototype statistics. The first global reinsurance market report analysing 2003 data will be published in the fourth quarter of 2004.

With respect to the point in the Terms of Reference relating to the improvement of risk-oriented disclosures of individual reinsurers, Task Force Re took into account a number of recently completed studies and other current work having been conducted by groups such as the IAIS Enhanced Disclosure Subcommittee, IASB, BCBS Transparency Group, and the Joint Forum Multidisciplinary Working Group on Enhanced Disclosure. The way forward in this area is elaborated in Chapter 4, focusing on the work being done by other committees of IAIS.

- a) Concerning technical performance and risks, a *Standard on Disclosures Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers* was approved by the Technical Committee in December 2003 and is expected to be adopted at the Annual General Meeting in October 2004. The standard addresses the analysis of technical performance, key assumptions and sources of measurement uncertainty as well as sensitivity, stress testing and scenario analysis.
- b) The Enhanced Disclosure Subcommittee is currently working on a Standard on Disclosure concerning Investment Performance and Risks for Insurers.

Task Force Re finds this progress encouraging and urges reinsurers and supervisors to make efforts in line with the above-mentioned work.

Following the development of the global reinsurance market statistics framework and its review of the existing standards and practices and ongoing work on risk-oriented disclosures, Task Force Re will disband in March 2004 and be succeeded by a Steering Group on Transparency in the Reinsurance Sector. The Steering Group will, in the first place, take charge of the production of global reinsurance market statistics and the preparation of global reinsurance market reports, on an annual basis. It will also address further development of global reinsurance market statistics including assessment of resilience. Furthermore, as the process of enhancing transparency has to evolve with market developments, the framework developed by Task Force Re will have to be reviewed and adapted on a regular basis by the Steering Group to ensure its continuing relevance and usefulness. The Steering Group will also need periodically to assess the need to continue to produce global reinsurance market statistics and to prepare global reinsurance market reports, given on-going progress by the IAIS and other groups, which may lead to improvements in both transparency of the global reinsurance market and in disclosure. The Steering Group should also monitor closely progress by other Committees of the IAIS, notably the Enhanced Disclosure Subcommittee, and work in other fora in the field of risk-oriented disclosures of internationally active reinsurers. The areas for further work are addressed in Chapter 5.

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**Chapter 1: Background and existing data and analyses on reinsurers**

**Background**

By providing coverage against economic losses to policyholders and other beneficiaries, the insurance industry is indispensable to economies at large. Reinsurers, like insurers, serve as financial intermediaries. They finance risk of loss, helping to disperse it geographically. This spreading of the risk of financial loss contributes to financial stability and to economic growth, nationally and internationally. The reinsurance industry plays a fundamental role in further spreading risk exposure and providing liquidity post catastrophic events, thus maintaining stable conditions in the primary insurance market. The spreading of risks to reinsurers reduces the fluctuation in the business performance of primary insurers. In addition, it has a stabilising effect upon the market through its function as the insurer of insurers. Due to their global nature and the few barriers to entry, reinsurance markets tend to be competitive. Reinsurance premiums should cover at least expected losses and other costs – including the costs of the necessary financial strength to avoid default due to unexpected losses. In the short run, prices may be substantially above expected losses and other costs, due to capacity constraints – i.e. a hard market.

Reinsurance is thus a key component in the insurance marketplace. However, there are different views on their systemic importance. (See Box 1 for examples of different views on reinsurers and their importance.)

The work of Task Force Re originated from the FSF meeting in September 2002 in which the FSF discussed a number of concerns related to the reinsurance industry. It noted that “the reinsurance industry had performed well in the face of past shocks”. However, the opaqueness of the reinsurance market and of public disclosures made it difficult, if problems in the reinsurance industry were to arise, to assess the potential impact on the insurance sector as a whole and on the stability of other elements of the financial services sector more generally.

The FSF called for efforts at the national and the international level to produce data and reports on the global reinsurance market. At the same time individual reinsurance and insurance firms should expand the frequency, and enhance the quantitative and qualitative content, of their public disclosures. These efforts should begin speedily. The FSF would lend its full support to the work of the IAIS and others to improve industry disclosures and to develop an efficient global framework for reinsurance supervision, which could benefit reinsurers, primary insurers and policyholders, and therefore economies at large.

This work would involve a number of challenges, in particular in respect of the production of global reinsurance market data and reports. Currently there are significant divergences in regulatory, supervisory and reporting requirements applied to reinsurers across jurisdictions, as well as significant differences in accounting conventions and practices, which it would not be possible to resolve as part of this work. In view of these differences a pragmatic approach would need to be adopted in the setting up of a framework which could be used to produce global reinsurance market data. The setting up of such a framework is described in Chapter 2. Great care would need to be taken in making analysis and interpretation of such data in global market reports, in view of the different reporting and accounting bases adopted in different

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jurisdictions. Further comments on the basis of reporting financial data for these purposes are made in Chapter 3. This framework would need to be one which evolved to take into account the progress of various fora which are addressing some of these issues, as well as any resolutions achieved within the context of the development of the framework itself.

In the meantime, the fact that such divergences exist indicates that a cautionary approach should be applied in the interpretation of existing data and analysis of the global reinsurance market. This might also explain the fact that in general regulators have little data themselves on the reinsurance industry, at least in a format that can be used beyond individual firm supervision, and hence the need for reliance upon industry reports for information on the global reinsurance market

**Reinsurance and recent policy initiatives**

An important regulatory initiative adopted by the IAIS was a set of principles<sup>1</sup> and a standard<sup>2</sup> on the supervision of reinsurers. Both the principles and the standard were introduced to address concerns that reinsurers are supervised differently from jurisdiction to jurisdiction. These initiatives represent an important step towards internationally recognised supervisory practices for the global reinsurance industry. The underlying premise for the principles and the standard is that all reinsurers should be subject to supervision and they anticipate a global approach to the supervision of reinsurers anchored in the home jurisdiction. The principles identify elements of a supervisory framework that are common for primary insurers and reinsurers, such as licensing, fit and proper testing and on-site inspection, and those elements that need to be adapted to reflect reinsurers' unique risks. The standard elaborates on those elements that need to be adapted – in particular the so called supervisory review requirements. It applies to internationally active reinsurers that are pure reinsurers or insurers, whose main activity includes the issuance of reinsurance coverage, having cedants in at least one jurisdiction outside their own. The standard notes that “as [it] becomes widely adopted and implemented, it may become one of the building blocks in the eventual development of a system of accreditation of home supervisors”. Currently, an IAIS survey is underway to assess the state of implementation by various jurisdictions of this standard, the results of which may be used for the future development of guidance papers.

Along with the IAIS standard an EU Directive currently being developed will include both general and unique approaches for the supervision of reinsurers in the European Union. For instance, Germany, as an important reinsurance market, is currently taking early steps to fulfil the future EU Directive.

Separately, work on CRT is now progressing in a number of groups<sup>3</sup>. Notably, the Joint Forum is undertaking work on a cross-sectoral basis to facilitate a better understanding of the

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<sup>1</sup> IAIS *Principles on minimum requirements for supervision of reinsurers*, October 2002

<sup>2</sup> IAIS *Supervisory standard on supervision of reinsurers*, October 2003

<sup>3</sup> See for example: IAIS *Paper on credit risk transfer between insurance and banking sectors*, presented to the FSF, March 2003; Committee on the Global Financial System (CGFS), *Credit Risk Transfer*, Basle, January 2003

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CRT market. This work could result in concrete recommendations regarding risk management, supervision and disclosure of credit derivatives. The Committee on the Global Financial System is also working on collecting more comprehensive data on credit default swaps which constitute a significant portion of the CRT market.

**Box 1: Reinsurers and their importance: two views**

The IMF<sup>4</sup> has observed that "reinsurers are systemically important to insurers, they provide protection by covering peak exposures, and are often parts (or even the dominant business) of conglomerates. In addition to the same risks faced by primary insurers, reinsurers face two additional risks. First, reinsurers protect the peak exposures of the primary market and consequently experience greater volatility in results and therefore need greater capitalisation. Second, reinsurers are often the top trading company in a group structure and hold the group's capital. In such a position, they may be called upon to support ailing insurance or non-insurance subsidiaries, and thus may transmit systemic shocks within or between sectors".

A recent Sigma study<sup>5</sup>, *Sigma* 5/2003 "Reinsurance – a systemic risk?", on the other hand, emphasises that the evidence showing reinsurance as a source of systemic risk is not that compelling. Reinsurer bankruptcies are rare and have minor effects on primary insurers. Sigma has counted only 25 bankruptcies worldwide since 1980 and concluded that the danger of contagion within the reinsurance sector is slight. According to Sigma, "a collapse of the entire reinsurance system is thus only conceivable in the case of very large exogenous shocks of which the reinsurance industry has taken no account. Sigma calculated that reinsurance premiums amount to 6% of direct insurance premiums. Within the financial markets, the share of reinsurers – both in terms of investments and of borrowed capital is about 1% of the entire stock of equities and securities of US\$58,000 billion which is too little to generate turbulence.

**Review of 2002 and Outlook for 2003-2004**

The Global Overview of Standard and Poor's 2003 Global Reinsurance Highlights<sup>6</sup> comments that, following a number of poor years, 2002 was expected to be the year in which the global reinsurance market recovered. However this did not materialise and the year was characterised by rating downgrades<sup>7</sup> and poorer than anticipated returns. S&P have estimated a global combined ratio and rate of return for 2002 as 105% and negative 1.2% respectively.

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<sup>4</sup> See International Monetary Fund. 2003. Appendix on "Regulatory and Supervisory Challenges" in: *Global Financial Stability Report* (Chapter 2), September 2003. For more information, see also the June 2002 issue of the *Global Financial Stability Report*.

<sup>5</sup> Swiss Re: "Reinsurance – a systemic risk?" in *Sigma* No. 5/2003, available at [www.swissre.com/sigma](http://www.swissre.com/sigma), argues that the stable supply of reinsurance is a benefit to society as a whole and that the supply of reinsurance is subject to erratic price movement. *Sigma* also notes that other industries show large price fluctuations without harm to society and without intervention from government.

<sup>6</sup> Standard & Poor's: *Global Reinsurance Highlights*, 2003 edition

<sup>7</sup> Including as a result of investment losses and equity market downturns.

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A later special report by Fitch Ratings<sup>8</sup>, which is based upon estimated data, anticipates rating downgrades to outnumber rating upgrades in the near term. The report indicates a primary concern over reserve adequacy, particularly in respect of US liability business, although believing that much of the reserve deficiency has now been recognised. The Fitch Ratings report maintains a negative outlook for the reinsurance sector but notes that conditions are closer to those warranting a stable outlook than a year previously.

For the US, signs that conditions are improving is demonstrated by the combined ratios of the U.S. reinsurance industry for the 3rd quarter of 2003. While U.S. companies do not report 4th quarter results until March 1 and those results had not been reported or compiled at the time of this report, the 3rd quarter results for the industry showed continued improvement with the U.S. reinsurance industry combined ratio at 99.8%. Excluding companies in run-off, U.S. reinsurers' 3rd quarter combined ratio was 98.3%. These results show the first time that the industry has made an underwriting profit in at least a decade. U.S. regulators expect that the 4th quarter results will show continued improvement.

A report by the Benfield group<sup>9</sup>, anticipates continued stability for the reinsurance market, at least for 2004, barring a major catastrophe loss, and cites a number of factors. Underwriting discipline was maintained during the 2003/04 renewal season, and terms and conditions remained more stringent than before September 11. The report notes that property catastrophe rates weakened, but that this related to areas where rates had risen sharply in previous years, and the process was gradual and orderly. Casualty rates increased further, albeit at a slower rate. Capacity also increased, notably through 'new' capacity in Bermuda and London.

Despite the recent interest rate increases, investment returns are unlikely to be as high as they have in the past. Maintaining underwriting discipline will be necessary to generate acceptable overall returns. The report concludes its outlook for 2004 by suggesting that "the only factor likely to cause a major change in market conditions during 2004 appears to be a major catastrophe loss". Should such an event occur, the Benfield Group's view is that the incipient weakness of the market is likely to be sharply reversed. The Task Force notes, however, that the catastrophe losses arising would at the same time need to be borne.

Task Force Re also notes the significant increase in the equity markets during 2003 that has continued into 2004.

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<sup>8</sup> Fitch Ratings Special Report: *Review and Outlook: Global Reinsurance*, September 2003

<sup>9</sup> Benfield Group: *Holding the line – Reinsurance market and renewals review*, January 2004 – Industry Analysis and Research. Benfield Group, listed on the London Stock Exchange, is a reinsurance intermediary and risk advisory business. It has 30 offices and 1700 reinsurance and insurance professionals worldwide.



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**Box 2: Issues affecting reinsurers and recent developments**

Some of the problems so far faced by reinsurers have been due to multiple triggers, such as:

- Impact of September 11, 2001;
- Continued deterioration of asbestos related disease reserves due to changes in liability law;
- Operating losses due, in part, to the inadequate premiums charged;
- Credit risk losses due to large and unexpected corporate failures; and
- Equity market decline and volatility of bond markets

These problems have led to credit rating agencies downgrading the credit ratings of reinsurers. A credit downgrade of a reinsurer can itself lead to circumstances (for example: loss of business, liquidity issues arising from collateral requirements, rating trigger situations, increase in the cost of borrowing) whereby further downgrades arise as a consequence. Task Force Re carried out a basic study to assess the average extent of deterioration in reinsurer ratings between 2001 and 2003. This study looked at group ratings for those groups which include a reinsurance entity within the scope covered by the global reinsurance market statistics (see Chapter 2) and are within the top 40 of S&P's "Global Reinsurance Highlights (2003)", weighting ratings according to net reinsurance premiums. Using a scale of 1-9 to represent basis points above minimum 'investment grade' of BBB- (AAA therefore with the highest rating of '9'), the analysis enabled a review of the movement in the "notches" above BBB- over the period. This study reveals that an average of between AA+ and AA (or 7.5 points above BBB-) at the end of 2001 deteriorated to an average AA- (or 6 points above BBB-) by the end of 2003. The down-grading of some major companies has had a substantial impact on the average rating of reporting reinsurers. Notwithstanding the downgrades, however, the average rating of reinsurers appears still to be above that of primary insurers.

The stress faced by the reinsurance sector also exposed mild incidences of contagion. For instance, the losses sustained by a reinsurer not only forced a re-structuring of that particular group, but also caused a major shareholding bank to withdraw from the major part of its investment. Conversely, the troubles experienced by a bank caused its parent, an insurer, to provide a great deal of financial support while it was, itself, dealing with some of the factors mentioned above. While some would view it as a potential source of systemic concern when a reinsurer is part of a financial group, this particular example shows that access to financial support from a reinsurer within a financial group can have a stabilising impact upon the group.

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**Box 2: Issues affecting reinsurers and recent developments (continued)**

In terms of positive developments, during the upward and hard market stage of the cycle in the last 2 years, there was an increase in premium rates which benefitted reinsurers' operating results. Some reinsurers have taken steps such as raising new capital to strengthen their balance sheets. According to the Benfield report<sup>10</sup>, worldwide approximately US\$27 billion (net) of new capital was raised in 2003. The report notes that most of this new capital has been used as replacement capital.

Reinsurer groups represented by a 'reporting reinsurer' (see Chapter 2), raising amounts in excess of US\$500m in 2003 are listed below:

<u>Company</u>	<u>Location</u>	<u>US\$m</u>	<u>Type of Capital</u>
Munich Re	Germany	8,421	US\$4.6 billion rights issue, US\$3.9 billion subordinated bonds
Hartford Financial	USA	1,994	US\$1.7 billion equity, balance debt
SCOR	France	819	Rights issue
ACE Ltd	Bermuda	575	Hybrid- Redeemable cumulative preferred
Hannover Re	Germany	561	Equity – cash and contribution in kind
XL Capital	Bermuda	500	Equity
		<b>12,870</b>	

**Task Force Re**

The Technical Committee of the IAIS created Task Force Re in November 2002 under the chairmanship of Henrik Bjerre-Nielsen, Director-General of the Danish Financial Supervisory Authority and then Chair of IAIS Reinsurance Subcommittee.

The Task Force comprised of senior representatives of the regulatory authorities of the jurisdictions in which the major reinsurers are incorporated and actively engaged reinsurance industry representatives of major market participants within those jurisdictions, appointed by Task Force members, as well as a representative from a FSF Ministry of Finance (France) and the chairs of the Basel Committee Transparency Group and the Joint Forum Multidisciplinary Working Group on Enhanced Disclosure. Industry participation in, and commitment to, the work of the Task Force Re was a key element. A Technical Subgroup of the Task Force was also established, chaired by Jochen Metzger of the FSF Secretariat followed by Catherine Lezon, Deputy Secretary General of the IAIS, and comprising representatives of Task Force members and industry, to deal with the more technical aspects of the global statistics. The

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<sup>10</sup> Benfield Group:  *Holding the line – Reinsurance market and renewals review*, January 2004 – Industry Analysis and Research”

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Task Force was supported by a ‘virtual’ Secretariat comprising the IAIS and FSF Secretariats, as well as staff of the IMF and World Bank. (See Annex 1 and 2 for detailed terms of reference and the Task Force Members.)

The Task Force Re reported to the Technical Committee of the IAIS. Since the establishment of the Task Force Re, the Chairman has presented progress reports to the FSF in March and September 2003, prior to this final report.

### **Existing data and analyses on reinsurers**

#### **Reinsurers’ significance in the financial services industry**

Reinsurers are linked to the financial services industry via the various roles they take on. To assess reinsurers’ significance in the financial services industry, we look at the following roles they play.

- Role as the (re)insurer of primary insurers
- Investments and borrowing activities in the capital markets
- Participation in the credit risk transfer market, particularly as seller of credit risk protection

Other than as indicated the Task Force concurs with the findings of the different studies referred to in looking at these roles.

We also consider the impact of consolidation of the reinsurance industry.

#### **Role as the (re)insurer of primary insurers**

For the non-life sector in particular, reinsurance is one of the sources of credit risk for primary insurers. Sigma points out in its publication *Reinsurance – a systemic risk?*<sup>11</sup> points out that if a reinsurer really does go bankrupt, the primary insurers have to meet higher obligations than expected in the event of a claim. The additional financial burden can cause primary insurers problems.

However, the report quotes three studies<sup>12</sup>, all of which find that reinsurance risk was the trigger of problems for primary insurers in only about 5% of cases.

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<sup>11</sup> Sigma No. 5/2002: *Reinsurance – a systemic risk?* Available at [www.swissre.com/sigma](http://www.swissre.com/sigma)

<sup>12</sup> See:

McDonnell, William, *Managing Risk: Practical lessons from recent ‘failures’ of EU insurers*, FSA Occasional Papers No. 20, London, December 2002

Sharma, P et al, *Prudential supervision of insurance undertakings: Report of the London Working Group on Solvency II*, Conference of the Insurance Supervisory Services of the Member States of the European Union, Paris, 2002

Matthews, Patrick, *Insolvency: will historic trends return?* In Best’s Review P/C Insurance Edition, 1999, pp 59-67

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In this report Sigma has carried out its own analysis, comparing technical reserves held by reinsurers (i.e. recoverables from reinsurers) with three categories of investments held by primary insurers (investments in equities, bonds and real estate)<sup>13</sup>, looking at the four items in relation to each other, as a way of estimating reinsurance credit risk.

It finds that, on average, claims on reinsurers are the third largest balance sheet item of primary insurers. For non-life business the analysis (based on 2001 figures) shows that the share of technical reserves held by reinsurers, as a proportion of these combined assets, lay between 10.3% for Japan and 36% for the US. For life business, the analysis shows 'technical reserves held by reinsurers' are comparatively much lower. The reason for this is the lower cession rate, as in life insurance it is generally only the risk component (rather than the savings component) that is reinsured. The report comments that equities are far more important for life insurers than the technical reserves of reinsurers.

The report notes that, in the past, reinsurance insolvencies have been limited to individual reinsurers. Credit risk can be greatly reduced by an astute diversification of reinsurance programmes. It concludes that with such diversification, even in classes where session rates are high, the risk of default for primary insurers can reduce to a manageable level, and reinsurance is hence not a destabilising element.

**Reinsurers' investments and borrowing activities in the capital markets**

Sigma's<sup>14</sup> view is that reinsurers' significance in the capital market is marginal. Reinsurers invest part of their assets in the capital market. The study notes that "in doing so they make capital available for growth of an economy, whereby they generally pursue a long-term investment policy. In 2001, the worldwide investments of reinsurers in the capital market came up to USD 622 billion. This corresponds to a share of 1.1% of the entire equities and domestic securities of USD 58,000 billion (as at end of 2001). This proportion is too small for its disappearance to cause turbulence in the financial markets or to constitute a source of systemic risk".

Reinsurers also borrow capital in the financial markets. The report states that in 2001, the outstanding share capital of the reinsurers analysed came to USD 245 billion or 0.9% of the entire stockholdings of USD 27, 344 billion (which does not take into account external capital in the form of bonds), and concludes that "this is not enough to generate systemic risk either".

Sigma's overall conclusion is that investment and raising of capital by reinsurers in capital markets do not constitute systemic risk.

However, the Task Force notes that a failure of one key actor in one market (geographically, or for certain types of instruments) can be sufficient to have systemic consequences, at least in that market.

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<sup>13</sup> Taking market values for all jurisdictions included in this analysis, except for Japan and Italy, where book values are used.

<sup>14</sup> *Sigma* No. 5/2003: "Reinsurance – a systemic risk?" available at [www.swissre.com/sigma](http://www.swissre.com/sigma)

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**Participation in the credit risk transfer market, particularly as seller of credit risk protection**

A recent survey from Fitch Ratings<sup>15</sup> gives some insight into the amount of credit exposure that participants such as insurers and reinsurers take on in the CRT market. Fitch identified the following credit risk transfer via credit derivatives (net notional amounts in USD billions) as at the end of September 2002:

	<b>Net protection sold</b>	<b>Net protection bought</b>
Financial guarantors	166	
North American insurers	104	
European and Asian banks that use CRT markets to sell credit protection (see page 6 of Fitch)	67	
Reinsurers (see page 10 of Fitch)	32	
North American banks that use CRT markets to sell credit protection	27	
European and Asian banks that use CRT markets to buy credit protection		200
North American banks that use CRT markets to buy credit protection		123
Firms not responding to the Fitch survey (computed as a residual)		73

A few points can be emphasised from the above table:

- The financial guarantors (monolines) have the largest notional exposure taken on in CRT markets. Much of their activity in CRT markets involves taking on the least risky exposures (for example, “wrapping” senior tranches of cash and synthetic CDOs). Fitch found that over 95 percent of their exposure was rated single-A or better. However, there are some legacy exposures, particularly related to earlier vintages of high yield CDOs, which have undergone significant credit deterioration and could result in losses. In general, Fitch views these legacy credit losses to be highly manageable in the context of the financial guarantors’ capital and earnings capacity.
- Insurance companies are large sellers of protection. European and Asian banks have also taken on a fair amount of credit risk exposure via CRT. Reinsurers have participated in US\$32 billion of net protection sold.

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<sup>15</sup> Fitch Ratings Special Report: *Global Credit Derivatives: A Qualified Success*, 24 September 2003.

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Fitch also surveyed firms' investments in cash collateralised debt obligations (CDOs) – these instruments assemble a pool of bonds or loans and transfer the credit risk to investors. Fitch identified the following investment in cash CDOs as of September 2002.

	Investment in cash CDOs <sup>16</sup> (notional amounts in US\$ billions)
Financial guarantors	56
European banks	42
North American insurers	19
North American banks	12
European insurers	3
Asian insurers	3
Asian banks	2

Aggregating the figures, the report calculates that insurers and reinsurers had taken on US\$383 billion in nominal amount of credit exposure in the CRT market. Excluding financial guarantors the nominal amount is US\$151 billion of which US\$136 billion is credit derivatives. This amount, which includes net positions of insurers as well as reinsurers, is substantially lower than the outstanding share capital of reinsurers, which in 2001 came to US\$245 billion.

Fitch also highlighted the role played by larger banks as intermediaries and providers of liquidity in the global credit derivatives market. While the larger, globally-oriented institutions were net buyers of protection after giving consideration to matched and offsetting positions, these same institutions also reported sizeable gross protection sold positions. Indeed, of the \$1.7 trillion gross protection sold identified by Fitch, approximately \$1.3 trillion arose from banks and broker dealers, of which 63% was attributable to the top 10 institutions, ranked by notional outstandings. Fitch does not provide information on the extent to which the net positions with each counterparty of these institutions are covered by collateral.

The Fitch report referred to lists the top 25 counterparties involved in the selling of credit risk protection, of which only AIG, the last group in the list, has significant reinsurance operations. (AIG's reinsurance subsidiary, Transatlantic Re, is included within the scope of the work of the Task Force – see Box 3 in Chapter 2.)

S&P<sup>17</sup> has stressed that the reinsurance industry is increasingly "banking on the banking system" when it comes to providing collateralisation to cedants. S&P highlighted that about

<sup>16</sup> The study covers cash CDOs as they represent direct outlay, i.e. exposure.

<sup>17</sup> Standard & Poor's: *Global Reinsurance Highlights*, 2003 edition

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half of the collateralisation provided by reinsurers comes from letters of credit (LOCs) issued by banks or through various kinds of trust arrangements. According to S&P, LOCs are popular with cedants because banks far outshine (re)insurers in their reputation for timely payment. Further, the probability of both the reinsurer and the bank failing simultaneously is quite low. S&P however questioned the wisdom of relying on banks to provide collateral as an LOC is only as good as the bank behind it, and many of the institutions providing them are rated lower than the reinsurers they are backing. This trend indicates that some reinsurance risk is being transferred to the banking sector. However, it is not known to what extent LOCs are covered by collateral or the extent to which the wordings of LOCs limit effective risk transfer.

Task Force Re industry representatives disagreed that the use of LOCs is a risk transfer to the banking sector as banks normally protect their position by requiring 100% collateralisation in liquid assets from reinsurers for issuing the LOCs. Contrary to the position taken by S&P, the reinsurer might be running a counterparty credit risk in that the bank might not be able to support the LOC in the future. Industry representatives also refuted the view that "LOCs are popular with cedants because banks far outshine reinsurers in their reputation for timely payment" and indicated that reinsurance payments on a funded cover or on a securitisation would be similar to the speed of payment on an LOC.

**The consolidation of the reinsurance industry**

The Sigma report<sup>18</sup> notes that the top 5 reinsurance groups had a market share of 57% and that the acquisition wave in the 1990's increased the degree of concentration in the industry, which has improved rather than diminished diversification.

The Task Force accepts this view, but notes too that improved diversification due to concentration is not only likely to reduce the probability of default of the merged companies; it is also likely to create larger losses due to default as the exposure of each cedant to the merged companies is initially higher, i.e. the cedant has less diversification of the credit risk on its reinsurance recoverables. As a response the cedant may improve diversification by purchasing covers from other reinsurers.

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<sup>18</sup> *Sigma* No. 5/2003: "Reinsurance – a systemic risk?" available at [www.swissre.com/sigma](http://www.swissre.com/sigma)

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**Chapter 2: Setting up of global market statistics to enhance the transparency of the reinsurance industry**

The concept of 'global reinsurance market statistics' was premised on the view that analysis and publication of global reinsurance market data would increase transparency and promote a better understanding of aggregate reinsurance risks and the relationship of the reinsurance market with other sectors. The objective of the global reinsurance market statistics was therefore to develop a framework for the generation and publication of meaningful and timely data on the global reinsurance market.

**Participants in the Global Reinsurance Market Statistics**

The Task Force agreed that the global reinsurance market statistics should have individual entities, rather than groups, as their basis primarily to be consistent with the fact that prudential supervision occurs at entity level and that risks pass between entities rather than groups. To obtain a significant coverage of the global reinsurance market, criteria were agreed upon for the selection of globally significant reinsurers ('reporting reinsurers') to be included in the global reinsurance market statistics ('the statistics'). The reinsurers have initially been selected from seven jurisdictions (Bermuda, France, Germany, Japan, Switzerland, UK and US) in which the major reinsurance market participants are incorporated, and participate in the statistics on a voluntary basis to the extent that data required to produce the statistics is not publicly available.

The agreed selection criteria are based upon unaffiliated business only, to avoid the inclusion in the statistics of those reinsurers whose significant reinsurance transactions are intra-group only. By setting up subsidiaries to assume affiliate business (re)insurance groups may reduce their cost of capital, if such entities are domiciled in jurisdictions with a more favourable tax and supervisory regime than the home jurisdiction of the parent (re)insurer. To the extent that (re)insurance groups are operating with adequate group solvency requirements, or with economic capital models, which are at least as stringent, the setting up of reinsurance subsidiaries should have no impact on the probability of insolvency of the parent (re)insurer. The same applies if the parent is assuming business from "core" subsidiaries in order to avoid formally injecting capital into these companies, when needed.

The agreed selection criteria are as follows:

- Gross unaffiliated reinsurance premiums of US\$800 million (US\$20 million for monolines); or
- Gross unaffiliated technical reserves of US\$2 billion (not applied to monolines); with
- Discretion of the national authority to recommend certain entities to be excluded, with a final decision by Task Force Re or subsequent Steering Group.



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These criteria have been applied to the 2002 reinsurance data and have resulted in the selection of 40 reinsurers, including direct insurers assuming reinsurance business, and 3 monoline bond reinsurers<sup>19</sup>. A list of these reporting reinsurers is given in Box 3:

<b>Box 3: Reporting reinsurers</b>	<u>Pure</u>	<u>Mixed<sup>20</sup></u>	<u>Life</u>	<u>Non-life</u>	<u>Mono-line</u>
<b>Bermuda</b>					
Partner Reinsurance Company Ltd	✓		✓	✓	
XL Re Ltd <sup>(6)</sup>	✓		✓	✓	
<b>France</b>					
Axa France Collectives <sup>(2)</sup>		✓	✓	✓	
Axa Re <sup>(2)</sup>	✓		✓	✓	
Axa Re Finance (S.A.) <sup>(2)</sup>		✓		✓	✓
Caisse Centrale de Reassurance		✓		✓	
Scor	✓		✓	✓	
<b>Germany</b>					
GE Frankona Rückversicherung AG <sup>(4)</sup>	✓		✓	✓	
Hannover Rückversicherungs-AG	✓		✓	✓	
Kölnische Rückversicherungs-Gesellschaft-AG <sup>(3)</sup>	✓		✓	✓	
Münchener Rückversicherungs-Gesellschaft-AG <sup>(7)</sup>	✓		✓	✓	
Swiss Re Germany AG <sup>(1)</sup>	✓			✓	
<b>Japan</b>					
Toa Reinsurance Company	✓		✓	✓	
Tokio Marine & Fire Insurance Company Ltd		✓		✓	
<b>Switzerland</b>					
Converium AG <sup>(5)</sup>	✓		✓	✓	
European Reinsurance Company of Zurich <sup>(1)</sup>	✓		✓	✓	
Swiss Reinsurance Company <sup>(1)</sup>	✓		✓	✓	
<b>UK</b>					
Lloyd's		✓	✓	✓	

<sup>19</sup> A further monoline bond reinsurer may be included, subject to confirmation.

<sup>20</sup> Refers to reinsurers which carry on primary insurance as well as reinsurance business.

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<b>Box 3: Reporting reinsurers (continued)</b>	<u>Pure</u>	<u>Mixed</u>	<u>Life</u>	<u>Non- life</u>	<u>Mono- line</u>
<b>US</b>					
Ace Guaranty Corporation					✓
American Re Corporation <sup>(7)</sup>		✓		✓	
Converium Reinsurance (North America) Inc. <sup>(5)</sup>	✓			✓	
Employers Reinsurance Corporation <sup>(4)</sup>		✓		✓	
Employers Reassurance Corporation <sup>(4)</sup>	✓		✓		
Equitrust Life insurance Company		✓	✓		
Everest Reinsurance Company		✓		✓	
Federal Insurance Company		✓		✓	
Folksamerica Reinsurance Company		✓		✓	
GE Reinsurance Corporation <sup>(4)</sup>		✓		✓	
General Reinsurance Corporation <sup>(3)</sup>		✓		✓	
Hartford Fire Insurance Company		✓		✓	
Lincoln National Life Insurance Company		✓	✓		
National Indemnity Company <sup>(3)</sup>		✓		✓	
Odyssey American Reinsurance Corporation	✓			✓	
Radian Reinsurance Inc					✓
Reassure America Life Insurance Company		✓	✓		
RGA Reinsurance Company		✓	✓		
Security Life of Denver Insurance Company		✓	✓		
St Paul Fire & Marine Insurance Company		✓		✓	
Swiss Reinsurance America Corporation <sup>(1)</sup>	✓			✓	
Swiss Re Life & Health America Inc <sup>(1)</sup>		✓	✓		
Transamerica Occidental Life Insurance Company		✓	✓		
Transatlantic Reinsurance Company		✓		✓	
XL Reinsurance America Inc <sup>(6)</sup>		✓		✓	

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Significant groups represented by more than one reporting reinsurer

- (1) Swiss Re group
- (2) Axa group
- (3) Berkshire Hathaway group
- (4) Employers Re group
- (5) Converium group
- (6) XL Capital group
- (7) Munich Re group

Significant groups listed by S&P<sup>21</sup> (with a quoted net reinsurance premiums written in excess of US\$1bn) which are not represented by a reporting reinsurer, because their business is largely affiliate business, because they are not within participating jurisdictions, or for other reasons, include:

- Allianz Re Group
- Gerling Global Re Group
- Everest Re Group (Barbados)
- London Re Group (Canada)
- Reinsurance Group of America
- Sompo Japan Insurance Group
- Mitsui Sumitomo Insurance Group
- Aioi Insurance Group
- Korean Re Group (Korea)

**Content of the Global Reinsurance Market Statistics**

The statistics cover the following key aspects of the global reinsurance market:

- Size and structure of the global reinsurance market
- Structure and profile of reinsurance risk assumed
- Derivative financial instruments and credit risk transfer activity
- Counterparty risk and linkages to other sectors
- Investments, profitability and capital adequacy

Unless otherwise stated, the data covered by the statistics includes both affiliated and unaffiliated business.

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<sup>21</sup> Standard & Poor's: *Global Reinsurance Highlights*, 2003 edition

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**Gathering, processing and releasing the data**

The method of gathering, processing and releasing the data submitted by reporting reinsurers will be based on a three-level approach, with each level of data requiring different treatment and confidentiality rules:

- A-level data (reinsurer-specific information);
- B-level data (nationally aggregated data); and
- C-level data (global data).

The global reinsurance market statistics compiled from participating supervisors' data shall only contain aggregate information, and will be analysed and made available to the general public. Generally, the statistics will contain C-level data. However, subject to confidentiality requirements, B-level data received from each participating supervisor will be made available by the IAIS, or directly by the relevant supervisor, to financial stability organisations<sup>22</sup> and to participating supervisors. For further details see the note on the "Organisational set up of the global reinsurance market statistics", included in Appendix 3. Part of the future work of the Steering Group will be to determine which data may be published at B-level by the IAIS, in accordance with the arrangements described in this note.

The Task Force anticipates that all participating jurisdictions will be willing to make available their B-level data to the IAIS Secretariat, subject to the confidentiality safeguards included in the "Organisational set up of the global reinsurance market statistics". To the extent that this is not the case, the work of the Steering Group would be restricted. Since at the moment only two Bermudian reinsurers have been identified as reporting reinsurers, this gives rise to potential confidentiality concerns. Consequently, at the date of this report the Bermudian supervisor has indicated that it has not obtained the legally required consent from reporting Bermudian reinsurers to submit B-level data directly to the IAIS, with the exception of Table 5.4.

Prototype statistics, using data for 2001 and 2002, is being obtained for purposes of testing the global reinsurance market statistics process, to enable preliminary analysis to be carried out, and to indicate any potential areas for further development. It is intended that the first global reinsurance market report, analysing 2003 data and using results from the 2001 and 2002 prototype statistics where meaningful, will be published in the fourth quarter of 2004. The following chapter explains the different aspects covered in the global reinsurance market statistics.

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<sup>22</sup> Relevant financial stability organisations are listed in annex 1 of Appendix 3.

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**Chapter 3: Content of global reinsurance market statistics**

**Basis of reporting financial data**

For purposes of producing the Global Reinsurance Market Statistics, financial information included in the statistics will be consistent with the Generally Accepted Accounting Principles (“GAAP”) of the reporting jurisdictions or entities concerned or, in the case of US reporting reinsurers, consistent with regulatory reporting practice. The information submitted at the jurisdiction level will include a note on the high-level differences between the local GAAP (or, in the case of the US, US SAP) used for the preparation of information and US GAAP, supplemented by explanatory notes, where necessary.

The major differences between national GAAP (or US SAP) and US GAAP are identified in Appendix 4<sup>23</sup>. To enhance understanding of the statistics, narrative descriptions of key assumptions have been requested from each reporting jurisdiction. Comparison and interpretation should be approached with caution.

Data recorded in different currencies will be converted into US dollars at the exchange rates prevailing at the end of the financial year. Currency fluctuations will also need to be taken into account in the interpretation of the data.

A more detailed description of the contents of the reporting templates (“Tables”) to record this information, together with the purpose for each table, is given below. (See also proforma Tables in Appendix 5.)

**1. Global reinsurance market (tables 1.1 and 1.2)**

The purpose of this section is to gain a better understanding of the size and type of risks ceded to reinsurers globally. Premiums have been used to measure the expected value of risks currently underwritten – i.e. expected losses and other costs. Both Tables show gross reinsurance premiums assumed.

Table 1.1 analyses gross reinsurance premiums by class of business (life/non-life, with non-life analysed into property, liability and financial lines). The Table also shows how much of these premiums are retained and how much is retroceded both to other reporting reinsurers and to non-reporting reinsurers.

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<sup>23</sup> These differences present significant limitations to analysis by the Task Force or future Steering Group. Comparison and interpretation should be approached with caution. It is expected that such differences will narrow as International Financial Reporting Standards (the financial reporting standards produced by the International Accounting Standards Board) are further developed and the IAIS *Standard on Supervision of Reinsurers* is implemented. The Task Force welcomes the fact that other on-going work in different regional fora may help in this respect. For the time being, Task Force Re has taken measures such as asking reporting jurisdictions to provide clear explanations with respect to key assumptions and sources of measurement uncertainty which will have to be taken into account in any future analysis of the global reinsurance market statistics.

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From the global data it may be possible to analyse the levels of risk retention generally, and how much is retained within the group of larger players in the market (the reporting reinsurers).

Table 1.2 analyses gross reinsurance premiums assumed according to the following regions of ceding insurer:

- Europe
- North America
- Asia and Australia
- Africa, Near and Middle East
- Latin America

Aggregated results should show the origination of ceded risks at a global level. More importantly, further analysis of jurisdiction level information may also enable information on net cross-regional transfer of reinsurance risk to be produced.

Further comparisons with corresponding available information relating to direct business may produce analysis of cession ratios to reporting reinsurers, by class of business and by region.

Multi-year comparison of the above data produces information on changing patterns in global underwriting and risk management.

## **2. Structure and profile of reinsured risk (tables 2.1, 2.2 and 2.3)**

The purpose of this section is to obtain further information on the profile of reinsurance risks assumed by the global reinsurance market, to summarise technical performance and to quantify claims exposure in respect of retained reinsurance risk.

Table 2.1 shows gross reinsurance premiums assumed by class of business, and according to whether the business relates to proportional or non-proportional contracts.

Analysis may be carried out, given the different characteristics of risk and the different risk management techniques required for the two different types of contract, particularly from multi-year comparison.

Table 2.2 is a high level overview of technical performance, showing 'net premiums earned' and 'net claims incurred' by class of business.

Table 2.3 gives a profile of claims exposures in respect of retained reinsurance risk ('net claims incurred') by class of business and, where possible, making a distinction between reported claims and incurred claims which have not yet been reported to the reinsurer, for which the degree of uncertainty may be higher.

## **3. Derivative financial instruments and credit risk transfer activity (tables 3.1 and 3.2)**

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The purpose of this section is to obtain a profile of reinsurers' use of, and exposure arising from the use of, derivative instruments and their participation in credit risk transfer.

Table 3.1 analyses derivative financial instruments held by reinsurers, by type of contract:

- Interest rate contracts
- Equity and index contracts
- Foreign currency contracts
- Credit derivatives
- Others

Additional analysis indicates whether the contracts relate to hedging activity or not. The information includes both notional amounts and fair values.

As well as profiling notional and fair value exposures, it may be possible to analyse the purposes underlying reinsurers' activity in derivative markets (i.e. to what extent this activity represents risk mitigation and to what extent a separate business activity).

Table 3.2 records information on credit default swaps and collateralised debt obligation (CDO) investments, in respect of both bought positions and sold positions, including both notional amounts and fair values.

As well as providing an indication of the level of credit risk transfer activity engaged in by reinsurers, the results of the information in tables 3.1 and 3.2 will notably be compared with the estimates made by the different quantitative studies available.

#### **4. Counterparty risk and linkages to other sectors (tables 4.1, 4.2, 4.3 and 4.4)**

The purpose of this section is to give a profile of counterparty exposures both to and from the reinsurance sector, and hence to reveal if and where concentrations of cross-sectoral exposures occur, which involve the reinsurance sector.

Tables 4.1 and 4.2 deal with exposures of reinsurers to counterparties, the former by sector of counterparty (insurers, financial institutions, split where possible between banks and investment institutions, sovereigns and others) and the latter according to whether the counterparty is affiliated. These tables record information on selected assets covering the major asset categories:

- Recoverables from ceded reinsurance and retrocessions
- Debt securities
- Cash and cash equivalents
- Shares and other equity investments
- Derivative financial instruments
- Receivables arising from insurance operations

as well as the extent to which recoverables from ceded reinsurance and retrocessions, as well as derivatives, are covered by collateral.

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Tables 4.3 and 4.4 deal with exposures of counterparties to reinsurers, the former by sector of counterparty and the latter according to whether the counterparty is affiliated. The tables record information on selected liabilities and capital items covering the following major categories:

- Gross claims provisions (primary and reinsurance business)
- Derivative financial instruments
- Debt issued
- Paid up capital issued

as well as the extent to which reinsurers have provided collateral in respect of liabilities.

It is to be noted that, where cross-sectoral risk transfer occurs through the use of a special purpose vehicle (SPV), the sector of the counterparty will be shown according to the legal status of the SPV, which is likely to be 'insurer'. Further, 'gross claims provisions' relating to direct business undertaken by reinsurers will be given in total only, and not analysed according to counterparty for the reasons that a) there is no requirement for direct insurers currently to provide any such analysis, and b) this project is concerned primarily with reinsurance rather than direct business.

The aggregated data included in these tables will provide a profile of the sectoral structure of counterparty exposures by and to reinsurers, including by affiliation of counterparty.

The results should reveal sectoral concentrations of counterparty risk, both by and to the reinsurance sector, as well as to what extent exposures involve affiliates.

**5. Investments, profitability and capital adequacy (tables 5.1, 5.2, 5.3 and 5.4)**

Table 5.1 looks at reinsurers' invested assets. It records financial instruments held by reinsurers at book value and at market value, by major type of financial instrument held. It also records the unrealised gains and losses on investments where there is a difference between book value and market value. Also included is the extent to which financial instruments are represented by investment in the affiliates or in the company's own shares.

The table thus gives a profile of the financial instruments held by reinsurers, at a global level, and will also indicate the level of unrealised gains/losses on potential sales of investments referred to above.

Analysis may be carried out on the extent to which reinsurers are exposed to the price/rating of their own shares and that of shares of companies within the group.

Table 5.2 gives a high level overview of reinsurers' profitability, both in overall terms and for 'life' and 'non-life' business. As a result of the fact that some jurisdictions account separately for 'non-technical' items in the revenue account, two alternative versions of this table have been designed, to be used by jurisdictions as appropriate



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The information should enable analysis to be made on overall profitability and by class of 'life' and 'non-life' business. For 'non-life' business, the loss ratio (claims compared with premiums) and the combined ratio (claims and operating expenses compared with premiums), will enable a high-level assessment of whether premiums are at a level sufficient to support insurance operations and related operating expenses. The contribution of investment income to overall profitability is included.

Table 5.3 compares the capital base with the size of recoverables arising out of reinsurance operations (direct business) and retrocessions (assumed reinsurance business). This is looked at both gross and net of collateral (and any other offsetting items).

The information enables analysis regarding the degree of exposure within the sector to reinsurance assets failing to be recovered.

Table 5.4 provides an analysis of capital. Capital is based upon the national GAAP (or regulatory reporting practice) of the reporting jurisdictions. Despite the obvious limitations in aggregating capital, which reflects the results of different accounting treatment for various items, some analysis on aggregate levels of capital and its evolution over the years may nevertheless be possible.

Supplementary information is also shown, where relevant, in respect of regulatory capital requirements, contingency reserves and net unrealised gains on potential sale of investments which have not been accounted for in the financial statements (see table 5.1 above). Contingency reserves are capital in nature and represent claims provisions where the event giving rise to the loss has not occurred (e.g. equalisation reserves). Contingency reserves which have been included as liabilities in the balance sheet (rather than as reserves within total capital), together with net unrealised gains on potential sale of investments, may indicate a level of 'buffer' when considering aggregate levels of capital. Contingency reserves are often tax-exempt and may hence be considered as a substitute to acquiring proportional reinsurance covers.

Further information on 'regulatory capital required' (i.e. the capital levels which the national supervisor requires reinsurers to maintain) has been requested at the national level, where relevant, together with separate explanatory notes on the bases for the capital levels required. A summary of the current basis of regulatory capital requirements for reporting jurisdictions is included in Appendix 6.

Due to the fact that 'regulatory capital required' does not apply to reinsurers in all jurisdictions, and as the bases differ, the aggregation of such data at a global level is not meaningful. This data may be more meaningful at the national level. Therefore the publication of B-level data, subject to the consent of the national supervisor, is in general recommended. It should however be noted that in certain jurisdictions there are different regulatory capital requirements for pure reinsurers and those reinsurers whose business includes an element of direct writing. Where this is the case, the interpretation of regulatory capital requirements, aggregated at the national level, will require great caution by taking into account these differences in any comparisons with capital available.

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**6. Resilience of reinsurers**

In the absence of a global solvency standard for reinsurers the Task Force proposed to design tables which could be used to assess the resilience of the global reinsurance market. For practical and technical reasons, discussed more fully in Chapter 5, some additional work is necessary in this regard. Further development in this area of the global reinsurance market statistics is one which will be pursued further by the Steering Group. This may take place within the context of the proposals for stress testing outlined in Chapter 5.

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**Chapter 4: Risk-oriented public disclosure by reinsurance companies**

Disclosure is critical to the operation of a sound insurance market. When provided with appropriate information that allows an assessment of a reinsurer's activities and its associated risks, markets can act on a more informed basis. This aspect of market discipline serves as an adjunct to supervisory oversight.

Making reinsurers' risk profile transparent must take into account specific challenges. Reinsurance business is complex, relatively concentrated, and international. Analysis of disclosed information is complicated by the limited scope for comparisons across peer groups, and due to divergent accounting policies and practices. A pre-requisite for useful disclosure is that material aspects of the risk profile be disclosed in a comprehensible manner. This makes disclosure meaningful for a systematic analysis of threats that may arise. In the case of reinsurers, this issue is receiving particular attention in view of the recent steps towards standardised regulation and supervision of reinsurers.<sup>24</sup>

**Current Level of Disclosure by Reinsurers**

As for direct insurers, public disclosure by reinsurers is largely determined by the regulatory regimes and the market environment they operate in.<sup>25</sup> Each reinsurer may be subject to prudential regulation, as well as to the market requirements for those which are publicly listed. At the same time, prudential regulation of the reinsurance industry appears to vary more across countries than is the case for primary insurance. While in some countries reinsurers are subject to regulatory requirements similar to those faced by insurers, in others they are supervised less extensively.<sup>26</sup> Moreover, for both direct insurers and reinsurers international comparability of risk-based disclosure is constrained by the lack of a common definition of the risk being measured and the absence of an international standard for measuring capital adequacy for a given risk or set of risks.

The Task Force has reviewed public disclosures of a number of reinsurers in jurisdictions represented in the Task Force Re. These reinsurers generally provide quantitative and qualitative information about their assets, liabilities, business strategy and risk management practices. (See Appendix 8.) However, because the current extent of public disclosure practices varies across jurisdictions, more work needs to be done in order to make reinsurers' risk profile transparent. Further, guidance is often lacking on the desired levels of, and relative mix of, quantitative and qualitative information.

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<sup>24</sup> See the recent IAIS *Standard on Supervision of Reinsurers* (issued in October 2003).

<sup>25</sup> It should be noted, however, that reporting to the regulator is usually different from public disclosure.

<sup>26</sup> IAIS has recently devoted considerable attention to reinsurance supervision, see IAIS *Principles on Minimum Requirements for Supervision of Reinsurers* (October 2002) and the IAIS *Standard on Supervision of Reinsurers* (October 2003).

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**Enhancing Disclosure: Existing Work**

The IAIS has been working on the enhancement of disclosure for some time.

The IAIS *Guidance Paper on Public Disclosure*, January 2002, suggests that public information should include descriptions of: (i) financial position, including descriptions of the nature and amount of assets, liabilities and capital; and (ii) financial performance: in order to take a prospective view of a firm's ability to meet obligations and provide return. Information of past performance (including in particular profitability and its variability over time) helps market participants to assess possible outcomes for future performance. It goes on to say that past information may be an imperfect predictor, therefore information on present and prospective risks<sup>27</sup> exposure, risk management strategies and practices, investment strategies, and information on management and corporate governance should supplement it. The paper also points out that greater disclosure entails increased costs and these need to be weighed against the potential benefits. Separately, while individual policyholders do not always have the ability to assess financial stability based on public disclosures, other market participants, such as equity analysts, rating agencies, insurance and reinsurance brokers and news media, help them monitor insurer activities.

The Guidance Paper outlines several key elements that should characterise good quality public disclosure by insurers. These comprise: disclosing information that is (i) relevant to decisions taken by participants; (ii) timely, so as to be available and up-to-date at the time those decisions are made; (iii) accessible without undue expense or delay; (iv) comprehensive and meaningful, so as to enable market participants to form a well-rounded view of the firm; (v) reliable as a basis upon which to make decisions; (vi) comparable between different firms; and (vii) consistent over time so as to enable relevant trends to be discerned.

Furthermore, the Guidance Paper stresses that disclosure on risk exposures helps market participants to assess a reinsurer's stability and financial viability. In the context of risk-based disclosure, the relevant areas include: (i) *technical risks (liability risks)*: Risks associated with the technical or actuarial basis of calculation for premiums and technical provisions; as well as risk associated with operating expenses and excessive or uncoordinated growth; and (ii) *investment risks (asset risks)*: Risks associated with the firm's asset management.

Work relating to enhancing and strengthening public disclosure by financial institutions, including reinsurers, is underway in several other fora. The work undertaken by the Multidisciplinary Working Group on Enhanced Disclosure established by the Joint Forum, the BCBS Transparency Group, and the IASB is noteworthy in this regard (see Appendix 9).

**Further Improvement**

A key area for improvement with respect to the present disclosure regimes relates to defining the way to express reinsurers' risk profile. Stress testing and scenario analysis performed by

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<sup>27</sup> For example, the deterioration of current reserves.

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the reinsurer should reflect the reinsurer's unique risk profile. A broad outline of the nature of the tests that have been undertaken and how the results are used gives users good insight. Further, disclosure of sensitivity analysis on technical performance and risk provides the information on the impact of variables which may have a material effect on reinsurers.

In this regard, further improvements are envisaged as a result of the work of other committees of the IAIS. Concerning technical performance and risks, a *Standard on Disclosures Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers* was approved by the Technical Committee in December 2003 and is expected to be adopted at the Annual General Meeting in October 2004. Based on the general requirement stipulated in the Guidance Paper, the Standard addresses various issues related to technical performance and risks. For analysis of technical performance, qualitative and quantitative information to be disclosed is identified in the areas of pricing adequacy (loss ratio, expense ratio etc.), provision adequacy (the run off result etc.), claims statistics, risk concentrations, reinsurance and capital. The standard also identifies items for which information should be provided by business classes. The Standard further addresses the need to disclose key assumptions and methodologies used as well as to indicate the level of uncertainty in association with reported amounts. It also identifies qualitative and quantitative information to be disclosed concerning sensitivity, stress testing and scenario analysis.

The Enhanced Disclosure Subcommittee is currently working on a *Standard on Disclosure Concerning Investment Performance and Risk*. The Standard will cover not only traditional investment assets (equities, bonds, etc.) but also other forms of investment tool such as derivatives. It will address various risks associated with investment; for example, market risk, liquidity risk, credit risk etc.

The Task Force finds the progress encouraging and urges reinsurers and supervisors to make efforts in line with the above-mentioned work. Observations on how further improvements could be achieved in future development within the field of risk-oriented disclosures are made in Appendix 10.

The Task Force believes that its successor Steering Group should monitor closely progress by other Committees of the IAIS and work in other fora in the field of risk-oriented disclosures, and that this should be done with reference to its own considerations on potential improvement in this area.

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**Chapter 5: Areas for further work and concluding remarks**

This Chapter recommends establishing a Steering Group to succeed Task Force Re. It addresses possible further development of the global reinsurance market statistics and makes concluding remarks both on the achievements which have been made toward increasing transparency of the global reinsurance market and on the importance of on-going work within the field of risk-oriented disclosures by individual reinsurers.

The work carried out by Task Force Re has indicated a number of areas which should form the basis for further investigation on improving the transparency of the global reinsurance market. These areas include further development of templates for collecting and analysing data, for assessment of:

- The exposure of counterparties to reporting reinsurers through credit risk transfer activity (i.e. the exposure of counterparties should reinsurers be unable to honour their obligations on CRT transactions); and
- The resilience of the reinsurance sector

It is proposed that further work to consider these issues be carried forward by a Steering Group, which is presented below.

**Credit risk transfer**

Task Force Re members recognised that the global reinsurance data in respect of credit risk transfer would be highly relevant for enhancing transparency of the reinsurance sector. However, representatives from most jurisdictions indicated that, unlike the data on counterparty exposure held by reporting reinsurers, the data on counterparties exposed to reporting reinsurers was not only currently not easily obtainable but also possibly substantively misleading. It was also pointed out that such data could be more easily collected from those entities which are exposed to reinsurers. Members agreed that further ways would be explored, taking into account the work of other national and supranational groups which were addressing the same issue<sup>28</sup>.

**Resilience**

In the absence of a global solvency standard for reinsurers, the Task Force looked into the possibility of designing tables which could be used to assess the resilience of the global reinsurance market and concluded that more time would be needed to resolve issues on the gathering and interpretation of the information. Given the limiting factors to the global reinsurance market statistics (noted in Chapter 3), and the work underway relating to risk

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<sup>28</sup> Task Force Re observes that the Joint Forum and the Committee of the Global Financial System, notably, are undertaking work to facilitate a better understanding of the CRT market.

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based disclosure, the Task Force finds that further work is needed to take this matter forward towards a resilience testing framework as part of the global reinsurance market statistics.

In the meantime the Task Force has carried out some analysis of the impact of historical large events on the global reinsurance market in anticipation of this area being further developed within the global reinsurance market statistics, and provides comments on how this discussion could be progressed further (see Appendix 7).

**Steering Group**

Following the development of the global reinsurance market statistics framework and its review of the existing standards and practices and ongoing work on risk-oriented disclosures, Task Force Re will disband in March 2004 and recommends that it be succeeded by a Steering Group on Transparency in the Reinsurance Sector. The Steering Group will, in the first place, take charge of the production of global reinsurance market statistics and the preparation of global reinsurance market reports, on an annual basis.

The first global reinsurance market statistics report is expected to be published in the fourth quarter of 2004.

The Steering Group will also be responsible for all future decisions with respect to the methodology adopted to produce global reinsurance market statistics. As the process of enhancing transparency will evolve with market developments, the Steering Group will periodically assess the need to continue producing global reinsurance market statistics and the context for presenting them.

Given the strong link with the work by Task Force Re, the organisation of the Steering Group will be based upon that adopted for Task Force Re, and its draft terms of reference are included in Appendix 11.

**Concluding remarks**

The key outcome of this work is the development by the Task Force, after extensive dialogue with representatives of reporting reinsurers, of a framework for collecting, processing and publishing global market statistics covering a significant proportion of the global reinsurance market. The Task Force believes that this represents a significant initial step towards increasing the transparency of the global reinsurance industry. The Task Force also believes that the making of appropriate, timely disclosures about the global reinsurance market has the potential to benefit all participants – including the capital markets and reinsurers themselves, as well as supervisors of financial institutions generally.

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**Appendix 1**

**Task Force on Enhancing Transparency and Disclosure  
in the Reinsurance Sector**

Terms of Reference

Having regard to potential sources of vulnerabilities in the global reinsurance markets and the industry's linkages with other financial sectors, the Task Force should develop a framework to enhance the transparency of the global reinsurance market and propose improvements in risk-oriented disclosure by individual reinsurance firms.

To this end, The Task Force should:

*Transparency*

1. Take stock of existing data and analyses on reinsurers in order to improve the understanding of aggregate reinsurance risks.
2. Develop a framework for the generation and regular publication of meaningful and timely data on the global reinsurance market that can be used to shed light on potential systemic concerns.
3. Develop, with others as appropriate, an implementation plan that assigns responsibilities and establishes procedures (including identifying funding and resource needs) for producing aggregated data on the global reinsurance market.

*Public Disclosure*

4. Define the scope and possible formats of improved risk-oriented disclosure by individual reinsurance companies reflecting the insurance, investment and other activities of major reinsurance companies.
5. Ensure that the above builds on the recommendations of the Report of the Multidisciplinary Working Group on Enhanced Disclosure, the Joint-Forum's Follow-up Working Group on Enhanced Disclosure and the IAIS Subcommittee on Enhanced Disclosure.
6. Set out how and by when industry implementation with the disclosure recommendations will be brought about.

\*\*\*\*\*

7. The Task Force should comprise senior representatives of the regulatory authorities of the jurisdictions in which the major reinsurance companies are incorporated, and such other public authorities as the Chairman deems appropriate.
8. The Task Force should actively engage the reinsurance industry in the above work, and consult other financial market participants (including rating agencies) and other financial authorities on perceived information gaps in respect of the reinsurance industry.



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**Appendix 1**

9. The Task Force should provide a progress report to the IAIS Technical Committee and to the FSF's next meeting 24-25 March 2003.

The IAIS and FSF Secretariats, and IMF staff will provide joint secretariat support for the Task Force.

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**Appendix 2**

**Organisation of Task Force Re**

To carry out the FSF's mandates, Task Force Re was organised as follows:

- the Task Force Re reports to the IAIS Technical Committee
- the Task Force Re membership comprises senior representatives of the regulatory authorities of the jurisdictions in which the major reinsurers are incorporated, and such other public authorities as the Chairman deems appropriate
- the Task Force Re actively engages reinsurance industry representatives, appointed by Task Force Re members, in the above work
- the Task Force Re consults other financial market participants and other financial authorities on perceived information gaps in respect of the reinsurance industry
- the IAIS and FSF Secretariats and IMF and World Bank staff provide joint secretariat support for the Task Force

List of Task Force Re members:

Henrik Bjerre-Nielsen (Chairman)	Danish Financial Supervisory Authority, Denmark
Jeremy Cox	Bermuda Monetary Authority, Bermuda
Olivier Paquier	Ministère de l'Economie des Finances et de l'Industrie, France
Florence Lustman	Commission de Contrôle des Assurances, France
Thomas Steffen	Bafin, Germany
Tomoko Amaya	Financial Services Agency, Japan
Jan Brockmeijer	Dutch Central Bank and Chair of the Basel Committee Transparency Group, Netherlands
Herbert Lüthy	Bundesamt für Privatversicherung, Switzerland
David Strachan	Financial Services Authority, UK
Alessandro Iuppa	Superintendent, Maine Bureau of Insurance/NAIC, USA
Michael Macciarioli	Securities and Exchange Commission and Chair of the MWGED, USA

List of Task Force Re industry representatives:

Michael Murphy	Association of Bermuda Insurers and Reinsurers
Arnaud Chneiweiss	Scor, France
Jean-Marc Smaragd	Scor, France

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**Appendix 2**

Hans-Jürgen Säglitz	GDV, Germany
Ralph Vogelgesang	Munich Re, Germany
Katsuo Matsushita	The General Insurance Association of Japan
Kazuhiro Kawachimaru	Nipponkoa Insurance Company, Japan
Kiyoshi Matsuhiro	Nipponkoa Insurance Company, Japan
Makoto Hori	Tokio Marine & Fire Insurance, Japan
Heinz Kaplanek	Swiss Re, Switzerland
Patricia Hakong	Lloyd's UK
Robert Graham	General Re, USA
Brad Smith	American Council of Life Insurers, USA
Carolyn Cobb	American Council of Life Insurers, USA
Debra Hall	Reinsurance Association of America, USA
Martin Carus	AIG, USA
Peter Boller	International Association of Actuaries

List of Technical Subgroup members (not included in above groups)

Anaïd Chahinian	Commission de Contrôle des Assurances, France
Lutz Janke	Bafin, Germany
Jörg Krause	Bafin, Germany
Robert Ebner	Munich Re, Germany
Piotr Andrzejewski	Bundesamt für Privatversicherung, Switzerland
Philipp Keller	Bundesamt für Privatversicherung, Switzerland
Alan Spence	Financial Services Authority, UK
David Simmons	Financial Services Authority, UK
Bryan Fuller	NAIC, USA

Task Force Re Secretariat

Jochen Metzger	FSF Secretariat
Kristel Poh	FSF Secretariat
Catherine Lezon	IAIS Secretariat
Peter Cooke	IAIS Secretariat

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**Appendix 2**

Udaibir Das	IMF
Nigel Davies	IMF
Richard Podpiera	IMF
Don McIsaac	World Bank
Craig Thorburn	World Bank
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**Appendix 3**

**Organisational set up of the global reinsurance market statistics**

**I. Introduction**

This Note discusses how global reinsurance market statistics (the Statistics) can be organised, and how confidentiality will be protected. It specifies the reporting requirements for participating reinsurers and supervisors, and it identifies the different groups of users and their access rights to the Statistics. It is a prerequisite that the Statistics be organised in a way that makes them relevant to both reinsurers' financial health and related systemic stability considerations and ensures that confidentiality is fully protected.

The set up of the Statistics shall be without prejudice to the laws and regulations of participating jurisdictions. The sharing of confidential data by supervisors shall be subject to authority under bilateral or multilateral agreements on the exchange of such data between participating supervisors. The role of the IAIS in taking on the function of administrator and organiser of the Statistics, and in particular the cost aspects, is addressed in a separate note.

**II. Data providers**

Data for the Statistics will be provided, taking its starting point in the generally accepted accounting principles of the relevant jurisdictions (including US statutory accounting principles for US reinsurers), by around 50 internationally active reinsurers<sup>29</sup> and 4 major bond reinsurers ("reporting reinsurers") using a template developed by the Task Force on Enhancing Transparency and Disclosure in the Reinsurance Sector. Supervisors may require reporting reinsurers to file a completed template, or may choose to fill in the template themselves. Supervisors will encourage voluntary reporting by reinsurers where information required is not covered by statutory reporting. Where generation of primary data would not be practical, meaningful or cost effective, best estimates should be provided.

**III. Compilation of data**

Using reinsurer-specific information (A-level data), and operating with the same template, participating supervisors will compile aggregate reports (B-level data) for their respective jurisdictions. Detailed guidelines shall be drawn up in order to facilitate

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<sup>29</sup> Internationally active reinsurers are pure reinsurers or insurers, whose main activity includes the issuance of reinsurance coverage, having cedants in at least one jurisdiction outside their own, cf. IAIS draft *Standard on Supervision of Reinsurers*.

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**Appendix 3**

this process and ensure timeliness and cost effectiveness. The accounting principles used in respective jurisdictions shall be identified.

On an annual basis, supervisors will transmit the aggregate reports (B-level data) for their respective jurisdictions to the IAIS. Supervisors shall indicate on that occasion any confidentiality restrictions on the data. Supervisors will not be expected to guarantee the validity of information received from reinsurers.

Based on the aggregate reports received from the supervisors the IAIS will compile the data into global tables (C-level data) and publish them. Subject to jurisdictions' consent, and to the condition that no individual reinsurer be identifiable (unless it consents otherwise), some tables aggregated at jurisdiction level (B-level data) may also be published by the IAIS. Supervisors shall review information concerning them prior to its dissemination. Should a supervisor object to any aspect or element of that material, it will be amended accordingly. The publication of data at C-level and at B-level, where permitted, does not preclude the publication of A-level data, either by the national supervisor where consent is given by reporting reinsurers or where this data is already publicly available, or by the reporting reinsurers themselves.

**IV. Access to data**

Company-specific information (A-level data) will not be transmitted to the IAIS. Unless A-level data is already publicly available or consent has been given by a reporting reinsurer, individual reinsurers must not be identifiable in B-level or C-level data without the consent of the relevant national supervisor.

Subject to confidentiality restrictions, B-level data received from each participating supervisor will be made available by the IAIS, or directly by the relevant supervisor, to financial stability organisations<sup>30</sup> and to participating supervisors. If the supervisor has previously indicated that there are confidentiality restrictions on the data (see section III above) the supervisor's prior informed consent will be required for release of the data to other supervisors or to financial stability organisations. This would require the other supervisors and the financial stability organisations to enter into, or already have, an agreement with the supervisory authority responsible<sup>31</sup>.

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<sup>30</sup> Relevant financial stability bodies are listed in annex 1

<sup>31</sup> These agreements have to be in accordance with the requirements set out in the domestic laws and regulations of the participating jurisdictions, and within the context of the IAIS *Supervisory Standard on Exchange of Information, January 2002*. The reporting supervisor applies its own confidentiality requirements to decide upon the appropriateness of the confidentiality requirements followed by the supervisor or authority receiving the information.

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The IAIS global reinsurance market statistics (C-level data) compiled from participating supervisors' data shall contain aggregate information only, and will be analysed and made available to the general public.

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**Annex 1**

Financial Stability Organisations as defined by the Task Force for purposes of having access to B-level data are authorities in participating jurisdictions and at the international level concerned with financial stability issues, including the Financial Stability Forum and its members. Those authorities comprise:

**Financial stability organisations from participating jurisdictions that are not member of the FSF:**

**Bermuda**

Bermuda Monetary Authority  
Ministry of Finance

**France**

Commission de contrôle des assurances

**Switzerland**

Swiss National Bank  
Federal Department of Finance  
Federal Banking Commission  
Federal Office of Private Insurance

**United States**

Members of the National Association of Insurance Commissioners (NAIC)

**Organisations that are FSF members:**

**Australia**

Reserve Bank of Australia

**Canada**

Department of Finance  
Bank of Canada  
Office of the Superintendent of Financial Institutions

**France**

Ministry of Economy and Finance  
Banque de France  
Commission des Operations de Bourse

**Germany**

Ministry of Finance  
Deutsche Bundesbank  
BaFin



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**Hong Kong**

Hong Kong Monetary Authority

**Italy**

Ministry of the Economy and Finance

Banca d'Italia

CONSOB

**Japan**

Ministry of Finance

Bank of Japan

Financial Services Agency

**Netherlands**

De Nederlandsche Bank

**Singapore**

Monetary Authority of Singapore

**United Kingdom**

H M Treasury

Bank of England

Financial Services Authority

**United States**

Department of the Treasury

Board of Governors of the Federal Reserve System

Securities & Exchange Commission

**Supra-national Organisations**

International Monetary Fund (IMF)

World Bank

Bank for International Settlements (BIS)

Organisation for Economic Co-operation and Development (OECD)

Basel Committee on Banking Supervision (BCBS)

International Association of Insurance Supervisors (IAIS)

International Organisation of Securities Commissions (IOSCO)

Committee on Payment and Settlement System (CPSS)

Committee on the Global Financial System (CGFS)

European Central Bank

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**Appendix 4**

**Financial Reporting - major GAAP differences identified**

The items below are the identified areas, in the financial statements (or regulatory returns) of reporting reinsurers, where a material difference between national GAAP and US GAAP could arise:

- |                     |   |
|---------------------|---|
| J-GAAP              | <ul style="list-style-type: none"><li>• Contingency reserves (including ‘catastrophe’ and ‘price fluctuation’ reserves)</li><li>• DAC</li><li>• IBNR (Minimal impact)</li></ul>   |
| UK (except Lloyd’s) | <ul style="list-style-type: none"><li>• Substantially the same as US GAAP</li><li>• Catastrophe reserves held as additional provision</li></ul>   |
| UK (Lloyd’s)        | <ul style="list-style-type: none"><li>• Fund accounting – results deferred for 3 years<ul style="list-style-type: none"><li>○ Cash accounting for open underwriting years</li><li>○ No DAC</li><li>○ Normally no technical provisions on open years but no profits can be taken and losses must be recognised</li><li>○ No UPR</li></ul></li><li>• Three year accounting moving to annual accounting on GAAP basis from 2005</li><li>• Claims provisions are not discounted</li><li>• Total realised/unrealised gains/losses on investments in income statement (no distinction between ‘held for trading’, available for sale’ and ‘held to maturity’)</li><li>• Financial assets normally at market value</li><li>• Equalisation reserves</li></ul>   |
| French GAAP         | <ul style="list-style-type: none"><li>• Intangibles (indefinite life not permitted)</li><li>• Investments (carried at historical cost, or amortised cost)</li><li>• Impairment provisions (valuation allowances) may be reversed if market conditions improve</li><li>• Realised gains/losses on fixed maturities sold before maturity are taken to capital reserves</li><li>• Unlisted derivatives are carried at cost</li><li>• Embedded derivatives are not recognised</li><li>• Treasury shares included as an asset</li><li>• No deposit accounting (no concept of financial reinsurance)</li><li>• Cost of reinsurance recorded in year in which reinsurance arrangement placed</li><li>• DAC (life) – significant difference in definition</li><li>• DAC (non-life) – indirect costs are deferred (rather than may be deferred); commission on reinsurance ceded not credited to DAC</li></ul> |

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- Premium deficiency reserve – based on historical benefits; DAC is not offset
  - Equalisation reserves
  - Universal life/investment contracts – total premiums recorded as revenue
  - Deferred tax – no discounting
  - No amortisation of debt with early redemption rights
  - Capitalisation reserve
  - Technical/claims provisions (more prudent)
- German GAAP (HGB)
- Financial assets (largely at market value under US GAAP)
  - Premium income (for life products only premiums related to risk transfer treated as premiums under US GAAP)
  - Provision for premium refunds (higher under HGB)
  - Equalisation reserve (under HGB)
  - Technical/claims provisions (more prudent under HGB)
  - Acquisition costs (capitalised and amortised under US GAAP)
  - Depreciation and valuation write-downs (not applied to temporary diminutions under US GAAP)
  - Equity accounting for interests in associates under US GAAP (dividend distributions only under HGB)
  - Goodwill (written off direct to reserves under HGB)
- Swiss GAAP
- Goodwill – capitalisation not mandatory
  - Reversals of impairment provisions permitted (as IFRS)
  - Investment properties – may be at market value
  - Unrealised gains/losses on financial assets may be included in revaluation reserve
- Bermuda
- Reports in US GAAP
- US SAP
- Non-admitted assets:
- Fixtures and fittings
  - Computer hardware and software(> 3% capital and surplus)
  - Intangibles generally
  - Goodwill > 10% capital and surplus
  - DAC (expensed as incurred)
  - Premiums/agents' balances outstanding for more than 90 days
  - Deferred tax assets > 10% capital and surplus
  - Investments > statutory maximum holdings
  - Prepaid expenses
- Liabilities:
- No discounting of loss reserves (exception for WCI)
  - Provision for uncollectible reinsurance (per prescribed calculation)

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- Dividends may be recorded earlier under GAAP than SAP
- Asset valuation reserves (against credit related investment losses)
- Interest maintenance reserve (deferral of realised gains/losses over remaining life of investments)

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Appendix 5

**Proforma global statistical output tables**

Table 1.1: Gross reinsurance premiums assumed by class of business and retrocessions by class of business and reporting status of retrocessionaire						
<b>Gross reinsurance premiums assumed by class of business and retrocessions by class of business and reporting status of retrocessionaire (US\$m)</b>						
Class of business		Gross reinsurance premiums assumed	Of which retroceded to reporting entities	Of which retroceded to non-reporting entities	Net reinsurance premiums assumed	
Life insurance (all)						
Non-life insurance						
of which	Property Liability					
	Financial lines					
Total Life and Non-Life						

Table 1.2: Gross Reinsurance premiums assumed by region of ceding insurer		
<b>Gross Reinsurance premiums assumed by reporting entities by region of ceding insurer (US\$m)</b>		
Region of ceding insurer	Gross reinsurance premiums assumed	
Europe		
North America		
Asia and Australia		
Africa, Near and Middle East		
Latin America		
Total		

Table 2.1: Reinsurance premiums assumed by class of business and type of contract				
<b>Gross reinsurance premiums assumed proportional/non-proportional by class of business (US\$m)</b>				
Class of business		Proportional	Non-proportional	
Life insurance (all)				
Non-life insurance				
of which	Property Liability			
	Financial lines			
Total				

Table 2.2: Technical performance by class of business				
<b>Net premiums earned and net claims incurred by class of business in respect of reinsurance business assumed (US\$m)</b>				
Class of business		Net premiums earned	Net claims incurred	
Life insurance (all)				
Non-life insurance				
of which	Property Liability			
	Financial lines			
Total Life and Non-Life				

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Table 2.3: Claims provision for reinsurance assumed by class of business						
Net claims provision for reinsurance assumed, by class of business and reporting status of claim (US\$m)						
Class of business	Net claims provision for reported claims	Net claims provision incurred but not reported (IBNR)	Total net claims provision	Net life assurance provision	Total net claims provision and net life assurance provision	
Life insurance (all)						
Non-life insurance						
of which	Property)					
	Liability Financial lines					
Total Life and Non-Life						

Table 3.1: Reporting entities' use of derivative financial instruments						
Derivative financial instruments by type of instrument (notional and fair values) (US\$m)						
Type of contract	Held for hedging purposes		Held for non-hedging purposes		Total	
	Notional amount (13)	Fair value (+/-)	Notional amount	Fair value (+/-)	Notional amount	Fair value (+/-)
Interest rate contracts						
Equity and index contracts						
Foreign currency contracts						
Credit derivatives						
Other						
Total						

Table 3.2: Reporting entities' participation in credit risk transfer (CRT) activity			
Participation in credit default-swaps and CDOs by notional and fair value (US\$m)			
Type of contract	Total (notional amount)	Fair value (+/-)	
Credit default swaps			
of which	Bought		
	Sold		
CDO investments			
of which	Bought		
	Sold		
Total Bought			
Total Sold			

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Table 4.1: Key counterparty exposures (selected assets) by sector of counterparty							
Key counterparty exposures (selected assets) by sector of counterparty (US\$m)							
Selected assets	Total	Insurers	Financial institutions			Sovereigns	Other
			Banks	Investment institutions	Total		
Recoverables from ceded reinsurance and retrocessions							
of which covered by collateral							
Debt securities							
Cash and cash equivalents deposited							
Shares and other equity investments							
Derivative financial instruments with positive fair value							
of which covered by collateral							
Receivables arising from insurance and assumed reinsurance business							
Other loans and receivables							
Total							

Table 4.2: Reporting entities' counterparty exposure (selected assets) by affiliation of counterparty				
Key counterparty exposures (selected assets) by affiliation of counterparty (US\$m)				
Selected assets	Total	Affiliate entities	Non-affiliate entities	
Recoverables from ceded reinsurance and retrocessions				
of which covered by collateral				
Debt securities				
Cash and cash equivalents deposited				
Shares and other equity investments				
Derivative financial instruments with positive fair value				
of which covered by collateral				
Receivables arising from insurance and assumed reinsurance business				
Other loans and receivables				
Total				

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**Appendix 5**

Table 4.3: Counterparties exposed (selected liabilities and paid up capital) by sector of counterparty							
<b>Counterparties exposed (key liabilities and paid up capital) by sector of counterparty (US\$m) - balance sheet values</b>							
Selected liabilities and paid up capital	Total	Insurers	Financial institutions			Sovereigns	Other
			Banks	Investment institutions	Total		
Gross claims provision and gross life assurance provision - primary business							
Gross claims provision and gross life assurance provision - assumed reinsurance business							
of which covered by collateral							
Derivative financial instruments with negative fair value							
of which covered by collateral							
Debt - lender identifiable							
of which subordinated debt							
Debt - lender unidentifiable							
of which subordinated debt							
Paid up capital							
of which shareholder identifiable							
<b>Total</b>							

Table 4.4: Counterparties exposed (selected liabilities and paid up capital) by affiliation of counterparty				
<b>Counterparties exposed (key liabilities and paid up capital) by affiliation of counterparty (US\$m) - balance sheet values</b>				
Selected liability and paid up capital	Total	Affiliate entities	Non-affiliate entities	
Gross claims provision and gross life assurance provision - primary business				
Gross claims provision and gross life assurance provision - assumed reinsurance business				
of which covered by collateral				
Derivative financial instruments with negative fair value				
of which covered by collateral				
Debt - lender identifiable				
of which subordinated debt				
Debt - lender unidentifiable				
of which subordinated debt				
Paid up capital				
of which shareholder identifiable				
<b>Total</b>				



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**Appendix 5**

Table 5.1: Reporting entities' investments					
Investments by type of financial instrument (US\$m)					
Financial instrument		At book value	At market value	Unrealised gains/losses on potential sale	
Debt securities					
of which	issued by affiliates				
Shares and other equity investments					
of which	Own and affiliate shares				
Non-negotiable loans (including non mortgage loans)					
Mortgage loans and real estate					
Other					
Total invested assets					

Table 5.2a: Reporting entities' profitability indicators and ratios					
Reporting entities' profitability indicators and ratios (US\$m)					
Revenue account items	Non-life	Life	Non-technical	Total	
Net premiums					
Net claims incurred					
Net operating expenses					
Investment income					
Other income/expenses (+/-)					
Technical result (before tax)					
Non-technical result					
Total result					
Loss ratio %					
Combined ratio %					

Table 5.2b: Reporting entities' profitability indicators and ratios				
Reporting entities' profitability indicators and ratios (US\$m)				
Revenue account items	Non-life	Life	Total	
Net premiums				
Net claims incurred				
Net operating expenses				
Investment income				
Other income /expenses (+/-)				
Total result				
Technical result (before tax) (memo)				
Non-technical result (before tax) (memo)				
Loss ratio				
Combined ratio				

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Table 5.3: Global gearing of reporting entities (reinsurance and retrocession dependency)						
Recoverables from reinsurance (direct business) and retrocessions (assumed reinsurance business) and reporting entities' gearing ratio (US\$m)						
Recoverables from reinsurance and retrocessions		Total capital available	Gearing	Gearing net of collateral		
Gross	Net of collateral and offsetting items					

Table 5.4: Reporting entities' total available capital		
Total available capital (composition) US\$m		
Capital items	Total	
Paid up capital		
Hybrid capital		
Retained earnings		
Adjustments to capital +/-		
Total available capital		
Memo items :		
Total regulatory capital required		
Contingency reserves		
Unrealised gains/losses on potential sales		

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**Appendix 6**

**Summary of regulatory capital requirements by reporting jurisdiction**

**1. Bermuda (Bermuda Monetary Authority)**

In Bermuda, the most significant professional reinsurance business is undertaken by companies falling into the Class 4 category, and these are required to have a statutory capital and surplus of at least USD 100 million.

The Minimum Solvency Margin is the amount the statutory assets (i.e. admissible assets under the Insurance Act) of the reinsurer must exceed the statutory liabilities (as determined pursuant to the Insurance Act) by the prescribed amount. The minimum solvency margin for a Class 4 company is the greatest of Figures A, B and C below:

- Figure A: \$100,000,000;
- Figure B: 50% of the net premiums written in its current financial year or projected to be written on premiums ceded by the Class 4 company for reinsurance (not exceeding 25% of gross premiums written), of the premiums written in that year in respect of general business of the Class 4 company;
- Figure C: 15% of the aggregate of the reinsurer's loss expense provisions and other general business insurance reserves.

A class 4 reinsurer which fails to maintain its solvency margin requirement is prohibited from declaring or paying dividends until the deficit has been made good. The Insurance regulations require prior regulatory approval before making a material reduction to statutory capital and surplus (for example, through the declaration of a dividend). In addition, where a class 4 reinsurer's statutory capital and surplus fall below US\$75 million, the Insurance legislation confers wide powers upon the Supervisor.

The reporting reinsurers for Bermuda all fall into the class 4 category.

**2. France (CCA)**

Insurance and reinsurance companies in France are supervised by the Commission de Contrôle des Assurances (CCA). The CCA ensures that undertakings are in a position to meet (financial supervision) and do meet (performance supervision) their underwriting liabilities.

Direct insurers assuming reinsurance are subject to full direct supervision of their whole business. French direct insurers are subject to licensing requirements, minimum solvency (i.e. capital requirements), reporting requirements and investment restrictions (based on EU directives – coverage of technical liabilities with admitted assets).

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For the time being, French professional reinsurers are subject only to limited direct supervision. There is currently no solvency margin requirement, nor any obligation to cover regulated commitments.

**3. Germany (Bafin)**

Insurance undertakings that carry on both reinsurance and insurance business have to subject their entire technical insurance business to the solvency requirements applicable to primary insurers (based on EU directives). At present, the solvency requirements for primary insurers are not directly applicable to insurance undertakings which undertake exclusively reinsurance business (reinsurers).

The capital requirements for pure reinsurers result from Section 1 (a) subsection 3 of the German Insurance Supervision Law. Pursuant to this section, the supervisory authority may take any orders which are necessary to ensure that reinsurance undertakings are able to meet at all times their obligations arising from the reinsurance relationships. That obligations under the reinsurance contracts are met at all times can only be guaranteed if the reinsurers' own funds are adequate. For the assessment of the equity situation of a reinsurer the solvency requirements applicable to primary insurers serve as a benchmark.

An amendment of the Insurance Supervision Law, expected by the end of 2004, will make the capital requirements for primary insurers shall applicable also to pure reinsurers.

**4. Japan (Financial Services Agency)**

Japan adopts a risk-based approach to regulatory capital requirements, which focuses on the major risks: insurance risk, assumed interest risk, asset management risk and operational risk (life and non-life business), and additionally catastrophe risk (non-life business).

Insurers are expected to maintain a regulatory minimum of 200% of the estimated value of the risks.

**5. Switzerland (Bundesamt für Privatversicherung)**

Pursuant to Art. 10 of the Insurance Supervisory Law (1978, as of 2000), Swiss reinsurers should provide necessary guarantee to the insured, in particular as regards their solvency and the organisation and conduct of their business.

Accordingly, Swiss supervision procedures and industry practices require that a reinsurer's eligible or free capital amount to at least 20% of net premiums earned, but no less than CHF 10 million.

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**6. United Kingdom (Financial Services Authority)**

The UK requirements are that firms must meet the European Community Directive requirements, and the key Principle set out in the FSA Handbook for Financial Prudence that "A firm must maintain adequate financial resources". The UK does not differentiate between insurers and reinsurers for these purposes.

The EC requirement is based on the higher of a percentage of premiums or a percentage of claims calculation, with a minimum. This amount is considered by the FSA to be too low for most firms, and therefore it assesses the capital required for there to be adequate financial resources. This assessment takes into account the nature of business, the risks, and the risk mitigation used by the firm. At present there is not a formulaic calculation which determines this assessment. Looking ahead, the FSA is presently consulting on a risk based calculation with percentages applied to premium, claims, and assets, with the percentages depending on the line of business. This amount will however be further assessed by the FSA on the basis on the firm's own assessment of the capital it needs given the nature of risks and risk mitigation that the firm has. The FSA will then give guidance to the firm as to the amount of capital the FSA considers it should hold. If the firm does not meet this level of capital, the FSA is able to restrict the amount of business the firm writes, or take other regulatory action. Lloyd's will also be subject to the capital assessment framework described in the previous paragraph.

For Lloyd's, the same principles apply, but the nature of this unique market means that there are differences. Each member has to hold a level of capital as assessed by Lloyd's annually. This assessment is made using Lloyd's own Risk Based Capital model. The level of capital is subject to the EC minimum and regulatory review.

**7. United States**

In the US individual States require reinsurers to maintain a minimum level of capital and surplus in order to establish and continue operations.

In addition, the NAIC has adopted a risk-based capital approach, which applies to both direct insurers and reinsurers, and requires a risk-based capital ratio of not less than 200%. Financial solvency is also monitored through the use of financial profile reports, prioritisation tools and financial analysis. Separate risk-based capital formulae exist for life (re)insurers, property/casualty (re)insurers and health (re)insurers, using a four-tier system to indicate the severity of any capital deficiency. These formulae include components to assess risks related to reinsurance.

Where the risk-based capital requirement is lower than a State's minimum capital requirement, the higher figure is required.

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**Appendix 7**

**Resilience Testing by Reinsurers**

As noted in Chapter 5, assessment of the resilience of the reinsurance sector is an area which needs to be taken forward by the Steering Group.

It should be noted that the Steering Group is likely to face a number of methodological challenges in developing resilience tests. Catastrophic or significantly large events have to be quantified according to frequency and severity. The probability and the expected loss of such events have to be calibrated to those events which the system should withstand and those events which may falter the system. Any stress test proposals should address the probability and frequency of well defined large events, within a defined time period, which should be sustained by the system once or twice in a row. In addition, any preliminary analysis should take into consideration relevant developments regarding underwriting policies as well as methods and changes in the development of insured values or changes in the exposures to the risk factors identified. Further methodological challenges of aggregate stress testing include adequate refinement of their design to fully capture specific reinsurance clearing patterns under various regulatory regimes and supply and demand mechanisms in the insurance markets. Finally, care needs to be taken to prevent theoretical inflation of potential loss-values without any reference to both regulatory regimes and underwriting techniques applied by the industry, else the analysis generates exactly those fluctuations in the financial markets that one does not want to see.

The narrative below provides preliminary comments on how this discussion could be progressed further, on the basis of analysis of historical large events.

**1. Rationale**

One of the main focuses of the systemic risk assessment in reinsurance should be on the aggregate vulnerabilities of the sector. Although there is a close connection between the resilience of individual companies and the resilience of the sector in aggregate, the distinction between company (or portfolio) level and the aggregate level is important for the appropriate design of stress tests. (See Box below.)

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**Aggregate stress tests<sup>32</sup>**

In general, an aggregate resilience or stress test can be defined as a measure of the risk exposure of a group of reporting firms to a specified stress scenario. Aggregate tests are different from tests on individual reinsurers firms because they have different objectives.

The objective of an aggregate stress test is to help identify structural vulnerabilities and overall risk exposures that could lead to a disruption in the financial sector and the real economy. The emphasis of an aggregate stress test is on potential externalities and market failures, for instance, when there is an evaporation of liquidity or flight to quality. Such tests cannot be regarded as aggregates of tests on individual reinsurers firms because they cannot account for factors such as access to parental capital. Allowing for such limitations, however, they can provide sectoral and comparative evidence of resilience and may assist in the development or calibration of capital adequacy standards.

The main objective of stress tests performed by individual reinsurers is to aid the risk management process within the firm. However, stress tests performed by individual firms tend to underestimate the impact on reinsurance capacity when many firms try to reduce their exposures simultaneously. Aggregation has the potential to expose the actual extent of the system vulnerabilities. It should be noted, however, that if aggregate data were to be stressed, the results would overestimate the resilience of the system due to the implicit assumption that capital is allocated among firms in line with the size of losses incurred. It is important, therefore, to aggregate firm-level stress test results and analyse the number and size of firms that would be insolvent under any given shock or scenario as well as any contagion effects caused by individual firm insolvency.

The range of potential stresses is wide. They range from conditions that already exist, but which could get worse, for example asbestos related disease liabilities, to sudden natural or man-made catastrophes. This necessarily means that the speed of crystallisation of liabilities can vary greatly. For example, the slower moving asbestos related disease problems give reinsurers the necessary time to take remedial action, such as raising capital or reorganising the business. The faster moving catastrophic losses, on the other hand, can cause drains on liquidity<sup>33</sup> as well as capital. It necessarily follows that the underwriting of such risk must be managed to ensure that plausibly severe loss scenarios are within the ability of the system to withstand large losses. However, this is not explained in sufficient detail under the current disclosure practices and publicly available information does not allow a reliable evaluation of the system's resilience to large loss events.

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<sup>32</sup> For references, see:

IAIS *Guidance Paper on Stress testing by insurers*, October 2003

IMF Working Paper No. 01/88: *Stress Testing of Financial Systems: An Overview of Issues, Methodologies, and FSAP Experiences*

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Shocks can apply to both non-life and life reinsurers, although the relative lack of reinsurance penetration into the life sector<sup>34</sup> renders the impact of the latter less important. The actual impact of a shock on reinsurers depends on the size of the resulting economic loss, its translation into insured loss, and further on the share of insured loss that is paid by reinsurers (reinsured loss). For instance, insured losses have been close to 15 percent of economic loss for natural catastrophes over the last 10 years and this ratio generally depends on the insurance penetration in a given area. The size of reinsured loss then depends on reinsurance coverage and any applicable government guarantees relief (e.g. for terrorism losses in some countries).<sup>35</sup>

The fact that large economic losses may not be insured or reinsured, however, does not make reinsurers immune to their consequences nor does it mitigate their systemic impact. Economic losses that are not covered by insurance will have to be absorbed by others—governments, households and corporations, including banks and insurers via their investment and financial lines exposures. In some economies, the lack of insurance cover of economic losses due to catastrophes may be of a higher systemic importance, than contagion due to a failing reinsurer.

## **2. Analysis of historical large events**

The analysis of historical large events, below, briefly examines trends in large liabilities and claims, but does not attempt to assess the effects when a series of catastrophe is co-incident with depressed financial markets.

Three examples of large events are:

- Natural and man-made catastrophes
- Mortality shocks

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Committee on the Global Financial System: *A Survey of Stress Tests and Current Practices at Major Financial Institutions*, April 2001

IMF Working Paper No. 03/138: *Insurance and Issues in Financial Soundness*

<sup>33</sup> It may be noted, however, that even the September 11 attacks have to date resulted in virtually no liquidity issues for the reinsurance industry.

<sup>34</sup> The non-life reinsurance market receives much more attention than does the life reinsurance market. It is, after all, much larger, it is subject to more volatility and to catastrophic losses, and it is crucial to commercial undertakings. Also, the technical reserves of non-life reinsurers represent a much larger part of the primary-insurance balance sheet than do the technical reserves of life reinsurers in the balance sheet of primary life insurers. This leads supervisors and the capital markets to focus primarily on non-life reinsurance.

<sup>35</sup> While the global reinsurance market is expected to bear some 60 percent of the US\$ 40 billion of insured loss from the September 11<sup>th</sup> attacks, a similar event in the U.S. in the future would be substantially less costly for the reinsurers since (i) they reduced terrorism coverage and (ii) the terrorism insurance bill adopted after the attacks would provide substantial relief. Reinsurance coverage tends to be higher in commercial lines.



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- Casualty lines of business

***Natural and man-made catastrophes***

Observed data suggest that the frequency and severity of natural catastrophes have been generally increasing, as illustrated by the table below which shows the trends in major natural catastrophes over several decades. It should be noted, however, that this trend may have been caused by an increased exposure to catastrophic risk factors over the observation period, rather than to the frequency or severity of the events themselves. Such an increase could have resulted from a variety of social, economic, and regulatory causes. Furthermore, the definition of economic loss is essential for the significance of such considerations

Largest losses to the insurance industry result from natural catastrophes occurring in areas with a high density of insured values – cities in developed countries. In general, the insured losses from catastrophes end up in the reinsurance sector subject only to deductibles on reinsurance contracts.<sup>36</sup> In this context, it is worth noting that Hurricane Andrew reached landfall 20 miles south of Miami. Thus, had it struck Miami, the insured loss would have been very much higher.

**Natural Catastrophes, 1950-2002<sup>37 38</sup>**  
(Losses in US\$ billions, 2002 constant prices)

Decade	Number of events	of Economic Loss	Insured Loss
1950 – 1959	20	42.1	–
1960 – 1969	27	75.5	6.1
1970 – 1979	47	138.4	12.9
1980 – 1989	63	213.9	27.0
1990 – 1999	91	659.9	124.0
Last 10 years	70	550.9	84.5

The above table shows a general trend of insured losses growing as a proportion of economic losses. But the severity of insured loss also depends on the regional level of insurance

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<sup>36</sup> Most primary reinsurers that write business in catastrophe exposed areas of the world have addressed their peak exposures through increased deductibles to their policyholders. This dramatically reduces their exposure and consequently that of the reinsurance industry.

<sup>37</sup> Great natural catastrophes are defined as those where the ability of the region to help itself is distinctly overtaxed, making inter-regional or international assistance necessary.

<sup>38</sup> Munich Re., *Topics 2002*.

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penetration. For example, the Kobe earthquake (January 1995) caused an estimated economic loss of US\$97.3 billion while the insured loss was US\$2.9 billion.

The three costliest catastrophes, whether natural or man-made, were<sup>39</sup>:

		Insured loss (US\$ million)	Victims
September 11	September, 2001	40,000	3,000
Hurricane Andrew	August, 1992	20,511	38
Northridge Earthquake	January, 1994	16,989	60

Sudden catastrophes of this type affect both solvency and liquidity. While a larger catastrophe than any experienced to date is also foreseeable, a plausibly severe loss scenario, based on a hurricane of Andrew's force hitting downtown Miami may cause an insured loss of at least US\$40 billion. Likewise, if an earthquake of the intensity of Northridge occurred in downtown San Francisco, it may cause an insured loss of at least US\$ 35 billion. These are approximately double the cost of the actual events to reflect the fact that they did not strike the most densely insured areas in their respective regions. Clearly, such two events would significantly affect the equity of the 25 major reinsurers, estimated to be close to US\$175 billion in June 2003.<sup>40</sup> The actual impact on reinsurers and the contagion scenario is impossible to estimate based on publicly available information.

***Mortality shocks***

The most severe mortality shock in the recent history was the 1918 flu epidemic which took approximately 20 million lives. Today, flu epidemic remains the largest risk factor regarding mortality risk despite AIDS and SARS.

Rather than an epidemic, which may take too long to develop to be covered by most reinsurance contracts, the mortality effects of natural or man-made catastrophe would likely have a more direct impact on reinsurers.<sup>41</sup> The September 11 events estimated losses include \$2.7 billion in life benefits. Hence a catastrophe with 50,000 victims may imply an insured loss of more than \$ 40 billion.<sup>42</sup>

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<sup>39</sup> Swiss Re, *sigma* 2/2003 and 5/2003.

<sup>40</sup> 25 reinsurers covered by Fitch (Fitch Ratings Special Report, Review and Outlook: *Global Reinsurance*, September 3, 2003). Fitch's sample, to a large extent, overlaps with the top 25 reinsurers covered by S&P.

<sup>41</sup> The U.S. federal terrorism insurance bill does not cover life insurance.

<sup>42</sup> The actual insured loss in such an event would likely be smaller, however, since it is unlikely that a mortality shock of 50,000 people would meet the same risk profile. The life insurance proceeds that were distributed to the survivors of the deceased on Sept. 11, 2001 included a significant amount of worker's compensation insurance in addition to large percentages of highly compensated persons that worked in the financial services sector.

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*Casualty lines of business*

The continued deterioration of asbestos related disease has also posed problems, and may continue to do so for some years to come. The effects of asbestos related disease have been widely reported, but the range of casualty perils is so wide that it is unhelpful to be specific. Nevertheless, a sharp increase in loss ratios on long-tail business should be included as a stress. The effects and the calibration thereof may be based on experience of asbestos related disease, but this should be considered further by the Steering Group.

**3. Proposals to be discussed in further work**

Based on the preliminary analysis above, three stress tests can be considered for further discussion by the Steering Group: (i) natural and man-made catastrophic losses; (ii) mortality shocks; and (iii) sharp deterioration in loss ratios of casualty lines of business. In light of the impact any large event could have on the economy, the Steering Group may also consider exploring the exposure of reinsurers' capital to fluctuations in financial markets— using standard methods used in the financial services industry—as well as major credit risk events. In designing stress tests, the Steering Group will need to consider the probability as well as expected loss of severe events.

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**Information on the level of current disclosures by reinsurers in participating jurisdictions**

A study was carried out to look at the public disclosures of a sample of groups including significant reinsurance operations, covering the jurisdiction represented within the global reinsurance market statistics. Reference was made to publicly available consolidated financial statements and website information. This has been supplemented by further information from national supervisors within participating jurisdictions.

It may be noted that EU listed groups will need to prepare consolidated financial statements in accordance with International Financial Reporting Standards with effect from 1 January 2005.

**Bermuda**

In Bermuda, the most significant professional reinsurance business is undertaken by companies falling into the Class 4 category. Most of the Class 4 companies licensed in Bermuda are publicly traded in the U.S. stock markets, and file extensive financial disclosure statements with the U.S. Securities Exchange Commission ("SEC"). The generally high level of financial security in Bermuda, coupled with very stringent solvency margin requirements for the Class 4 sector, has allowed most of the Class 4 companies to achieve A ratings from the internationally recognised rating agencies.

All prepare audited financial statements and obtain Bests, Standard & Poor's, Moody's, and/or Fitch Ratings to which they submit extensive financial disclosure materials including both material quantitative and qualitative information.

Reinsurers present consolidated financial statements (balance sheets, income statements, cash flow statements, and statements of changes in equity). In addition, SEC rules require the comprehensive disclosure regarding the use of financial instruments including their use of derivatives and other hedging activities. Further, the publicly traded companies are required to provide "market risk" disclosures, both quantitative and qualitative about all financial instruments presented "outside" the financial statements.

Moreover, market analysts such as Goldman Sachs and Merrill Lynch review detailed financial data and provide extensive reports on company performance and forecast for the future.

**France**

Insurance and reinsurance entities, in France, disclose considerable quantitative and qualitative information, some in published accounts, and report a lot more for the Commission de Contrôle des Assurances (CCA). These firms usually provide financial statements (balance sheets, income statements, cash flow statements and the complete list of investments with their localization, market and book value) with notes which provide details on their premiums, assets, investments, liabilities and debt. Some information is also provided in the annual report (technical result with premiums, claims, provisions and expenses by class of business, and also premiums and claims by region, information on risk management, business strategy corporate management and retrocession). Some firms also

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disclose information on their share capital, alternative risk transfer, derivative financial instruments and claims development triangle.

Parent companies also have to publish consolidated financial statements with notes on their consolidation methods and list of consolidated entities.

Further information is reported to the supervisor in the form of CCA returns, referred as “C reports”, which are not publicly available. The information provided by insurers and reinsurers in these returns includes: detailed technical results by class of business, liabilities and technical results by country, reinsurance accepted and ceded (with a distinction between intra-group and external reinsurance), premium per type of contracts and guarantees, information on provisions for annuities, claims development triangles by class of business(non-life), detailed information per contract (life), stress testing analysis on assets and provisions.

### **Germany**

Reinsurance companies in Germany disclose a significant amount of information. Firms present their consolidated financial statements (balance sheet, income, cash flow, stockholder equity, comprehensive income, and retained earnings) with informative notes with details on their assets, market value investments, and liabilities; premiums, investment results and expenses. For the sample of reinsurers reviewed, companies offer information on their financial products business, including useful comments on their market, credit and liquidity risks, including ratings. Fair value of financial instruments is also available.

According to Corporate Sector Supervision and Transparency Act (KonTraG) reinsurers have to set up a risk management system which identifies potential risks. Companies have an obligation to disclose information about such risks and the structure of the system. Additionally all reinsurers have to meet the requirements of the German Accounting Standard 5-20. Reinsurers have to prepare a risk report under the rules of this standard.

For the sample of reinsurers reviewed, disclosure includes details on the type, maturity, currency, and regional allocation of their assets and investments. Information on their provisions, debt (with some information on the characteristics of the instruments), and other liabilities is provided. Details on the class, claims, ratios, and regional allocation of premiums are available.

General information on their risk management, business strategy, affiliated and subsidiary companies and principal officers can be found.

### **Japan**

Insurance companies in Japan, including reinsurance companies, are subject to the disclosure requirements of the Insurance Business Law and Regulations. The industry association sets out further standards on disclosure. These result in highly comprehensive and standardised disclosures by Japanese insurers, including reinsurers. In addition to the primary consolidated financial statements (balance sheets, income statements, cash flow statements, statement of retained earnings), companies disclose general information on business strategy, organisational structure, senior management and

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shareholders, as well as detailed information on investment activities, insurance activities, risk and solvency.

Information on investment activities includes, for example, asset management policy (qualitative), investment by class of asset, return on investment by class of asset, information on maturity (for securities and loans), information on debtors (for loans) etc. Information on insurance activities includes, for example, details, by line of business, on policy liabilities, premiums, claims paid, insured amounts, underwriting profit, etc.

Also disclosed is information on derivatives such as the policy on the use of derivatives (qualitative) and notional and market values of derivatives by type of transactions. Information on risk includes a description on the risk management system and risk management policy. As for quantitative information, 'insurance risk', 'assumed interest risk' and 'asset management risk' are calculated and disclosed based on a formula set by the Financial Services Agency. The overall risk based capital adequacy ratio (solvency margin ratio) is also disclosed.

**Switzerland**

Swiss reinsurers publish balance sheets, income statements, shareholders' equity statements, and cash flow statements with informative notes to them. The consolidated information is complemented with information on business segments. These notes include information on investments (type of instrument, country, currency and maturity), derivative financial instruments (interest rate contracts, equity and index contracts, foreign currency and other instruments), acquisitions and dispositions, and debt (with some details).

Premiums are detailed by geographic allocation and line of business. Additional information on subsidiaries and equity investments is also available. Finally, general notes on the firms' risk management and business strategy complement the quantitative information.

**United Kingdom**

Companies in the UK generally adopt UK GAAP which requires a significant amount of disclosure (detailed in Schedule 9a to the Companies Act 1985) and comply with applicable accounting standards, the ABI SORP as well as the Combined Code on Corporate Governance.

In the UK, firms disclose considerable quantitative and qualitative information, some in published accounts but with a lot of data in the FSA returns. Reinsurers usually provide financial statements (balance sheets, income statements, and cash flow statements) with notes that provide aggregate information on their assets, investments, liabilities and debt. A considerable amount of further information is provided in the annual report (such as the segmental analysis usually provides an analysis of premiums, claims and expenses by region and major class of business). Information on assets and investments is normally summarised in the CEO's report, and details of the type of assets, their currency and investment returns are provided in the notes to the accounts. Information on risk the management framework and the management of key risk areas is included in the Statement of Corporate Governance.

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Further public information is included in the FSA returns. In addition to the financial statements, reinsurers complete FSA returns which contain full analysis of all key data by class of business and currency. Aggregate information on premiums and claims, by class and by currency is also provided, as well as information on investments and liabilities. Lloyd's FSA return extends to many hundreds of pages.

**United States**

In the United States, from a regulatory standpoint, reinsurers are subject to the same regulatory template as employed for direct writing insurers. That means that they are required to disclose the same level of extensive information as direct writers and that information is completely available to the public<sup>43</sup>. Moreover, the information is uniform notwithstanding the state by state regulatory system because of the use of a uniform annual statement template, uniform instructions therefor and uniform accounting standards. The statement templates and instructions are specific to property and casualty insurance, life insurance, and health insurance.

The disclosures include a balance sheet, income statement, statement of cash flows, underwriting schedules showing direct, assumed and ceded premiums, losses and loss adjustment expenses by line of business (about 30 lines of business are included). Many of the financial schedules also include subtotals for affiliated/non-affiliated, authorised/unauthorised and pooling arrangements. Investments schedules detailing each investment held as of a reporting date by type of investment (i.e., real estate, mortgage loans, bonds, preferred stocks, common stocks, other invested assets and derivative type investments with approximately 30 data items per investment, including statutory values and fair values), historical paid and incurred loss and loss expense development experience by line of business including reserve performance and detailed reinsurance information showing the source of all assumed premiums and the destination of all transferred business through cessions (facultative and treaty). In addition, the disclosures require answers to numerous regulatory questions and detailed and formatted footnote disclosures. The statements disclose all investment activity in the interim of reporting periods and those interims are quarterly. Profit and loss per investment transactions are readily discernible.

Additionally, companies are required to file statements prepared by independent certified public accountants that disclose differences between their findings and those presented by companies in their filed statements. Also, companies are required to file, in the case of life companies, actuarial opinions and memoranda, and in the case of property/casualty insurers, loss reserve opinions, from qualified actuaries. The independent certified accountants' reports and the actuarial opinions are publicly available.

Publicly traded companies are also required to file additional information of the type noted above with the securities regulators. This information is also publicly available.

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<sup>43</sup> See the NAIC website at <http://www.naic.org/insprod>.

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The regulatory system in the United States also provides that all material holding company transactions require filing prior to engagement. Some of those transactions above a relatively modest threshold actually require prior approval. Such transactions are disclosed to the public in the filed statutory statements. Mergers, acquisitions, changes in domicile, changes in form of an entity, changes in control, etc. all require prior regulatory approval. Sales of blocks of business require prior approval and appropriate disclosures. Dividends to stockholders are limited.



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**Appendix 9**

**Other Ongoing Work Relating to Enhancing Disclosure**

**Joint Forum**

The Joint Forum currently has two active working groups. The working group on risk assessment and capital is currently working on credit risk transfers across financial sectors. Primarily for the credit derivatives market, the group is trying to identify risks arising from these activities, how risk buyers and sellers manage them and what supervisory action should be taken, if any, to address these risks. A report is expected in 2004. The working group on enhanced disclosure has examined the extent to which the Fisher II report recommendations<sup>44</sup> have been adopted by financial firms and the ongoing disclosure projects of regulators and standard setting bodies. The Group consulted with financial institutions and analysts in all three sectors. It has also done some preliminary work in the disclosure areas identified in the Fisher II report that require further investigation and development and has identified some specific areas where firms should be encouraged to develop meaningful disclosures and related methodological approaches. A report of the group's findings is expected in 2004.

**International Accounting Standards Board (IASB)**

The International Accounting Standards Board recently published 13 revised International Financial Reporting Standards (IFRSs) and gave notice of the withdrawal of another IFRS. The revised standards mark the near-completion of the IASB's improvements project. The project addressed concerns, questions and criticisms raised by securities regulators and other interested parties about the existing set of IFRSs. Improved versions of two further standards, dealing with the complex issue of financial instruments, were issued on 17 December 2003.

*Changes Related to Disclosure*

- The definition of related parties and the disclosure requirement for related parties have both been expanded by adding parties (e.g. joint ventures and post-employment benefit plans) and by requiring disclosure of transactions, balances, terms and conditions, details of guarantees. (IAS 24 see paragraphs IN8 and IN11-IN13)
- Disclosure is required of critical judgments made by management in applying accounting policies. (IAS 1 see paragraph IN12)
- Disclosure is required of those assumptions made by management that are important in determining accounting estimates and could cause material adjustment to the carrying amounts of assets and liabilities. (IAS 1 see paragraph IN12)

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<sup>44</sup> Final report of the Multidisciplinary Working Group on Enhanced Disclosure (April 26, 2001), available at <http://www.bis.org/publ/joint01.pdf>.

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- Entities are required to disclose the compensation of key management personnel. (IAS 24 see paragraph IN5)
- In addition to the above, the IASB is currently working on the Exposure Draft for Phase 1 of an International Financial Reporting Standard on insurance contracts. Phase 1 of the standard includes disclosure requirements. In addition to prohibiting the netting off of insurance assets and liabilities, other disclosure requirements include information on assumptions, the effect of changes in assumptions, risk management policies, sensitivity analysis and claims development information for the last ten years. The Standard is expected to be issued soon, requiring compliance from 1 January 2005 (subject to transitional provisions) by those entities which report in accordance with International Financial Reporting Standards

**Basel Committee on Banking Supervision (BCBS)**

Pillar 3 of the New Basel Capital Accord recognises that market discipline has the potential to reinforce capital regulation and other supervisory efforts to promote safety and soundness in banks and financial systems. The BCBS believes that supervisors have a strong interest in facilitating effective market discipline as a lever to strengthen the safety and soundness of the banking system.

The BCBS aims to encourage market discipline by developing a set of disclosure requirements that will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment and management processes, and therefore the capital adequacy of the institution. The requirements in Pillar 3 take the form of complementary qualitative and quantitative disclosures covering each risk area.

In its current state, Pillar 3 of the New Capital Accord requires banks to make the disclosures prescribed in Pillar 3 on a semi-annual basis. However, qualitative disclosures that provide a general summary of banks' risk management objectives and policies, reporting system and definitions may be published on an annual basis.

In recognition of the increased risk sensitivity of the New Basel Capital Accord and the general trend towards more frequent reporting in capital markets, large internationally active banks and other significant banks must disclose capital adequacy ratios (and their components) on a quarterly basis. In addition, if information on risk exposure or other items is prone to rapid change, then banks must also disclose information on a quarterly basis. In all cases, banks must publish material information as soon as practicable.

The Basel Committee Transparency Group is responsible for considering disclosure issues promoting greater transparency within the banking system. The Group's primary focus has been the development of the *Third Pillar – Market Discipline* of the New Basel Capital Accord. Over the past several years, the Transparency Group has conducted surveys to monitor disclosure practices of internationally active banks headquartered in Basel Committee member countries as well as banks in emerging market countries.

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**Counterparty Risk Management Policy Group**

In January 1999, a group of 12 major, internationally active commercial and investment banks formed a Counterparty Risk Management Policy Group (CRMPG). The objective of the Policy Group was to promote enhanced strong practices in counterparty credit and market risk management. The Policy Group approached its work as an initiative by market practitioners mainly targeted at improving internal counterparty credit and market risk management practices. A 1999 report set forth the Policy Group's review of key risk management issues, its evaluation of emerging strong practices, and its recommendation for action. The package of recommendations of the Policy Group was aimed at representing a comprehensive set of proposals, and was built upon improvements to risk management practices already initiated by individual firms. The recommendation covered the following issues: (i) transparency and counterparty assessment; (ii) internal risk measurement, management and reporting; (iii) market practices; and (iv) regulatory reporting.

**Multidisciplinary Working Group on Enhanced Disclosure set up by the Joint Forum**

The Multidisciplinary Working Group on Enhanced Disclosure (MWGED) study highlights the differences and similarities across sectors. Some of the differences reflect intrinsic differences across financial sectors such as time horizons for risk management or the availability of data (for example, on long-tail losses for insurance and reinsurance risk). In certain areas, common cross-sectoral approaches in assessment of risk, such as the use of credit ratings for credit risk, are identified. In other areas less commonality is found, i.e. for firm-wide structural exposures to market risk. Different sectors are at different stages in the evolution of market risk measures and have different levels of confidence in the appropriate measure of market risk or indeed, what measure to use.

The MWGED has recommended a specific set of disclosures for financial institutions that incur a material level of relevant financial risks.<sup>45</sup> It suggests that disclosure of financial risks should describe an institution's risk profile in sufficient material detail. In addition to information about risk profiles, information that reveals the efficacy of a firm's risk management practices is also an important element of disclosure as firms' efficient management of risk has an important influence on the balance of risk. While these recommendations are addressed primarily to banks, they are also informative for insurers and reinsurers. The working group on enhanced disclosure is currently examining the disclosure practices of financial firms and assessing the extent to which financial sector regulators and/or standard setting bodies have considered new requirements to enhance disclosure of financial risks. The group will consider the practicality of developing recommendations for enhanced

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<sup>45</sup> Multidisciplinary Working Group on Enhanced Disclosure, Fisher Report (2001). The Group was established in June 1999 to provide advice to its sponsoring organizations (CGFS, BCBS, IAIS and IOSCO) on steps that would advance the state of financial institutions' disclosures of financial risks in order to enhance the role of market discipline

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public disclosure and evaluate as appropriate, the recommendations made by the Multidisciplinary Working Group on Enhanced Disclosure in its report of April 2001. A report is expected in 2004.

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**Considerations for the design of risk-oriented disclosures**

Observations on factors which could be considered within the context of the future development of risk-oriented disclosures<sup>46</sup> include the following:

*Clarity.* Disclosures must be comprehensive and meaningful. In particular, disclosures must be clear enough to identify adverse trends at a sufficiently early stage. Risks which lie on both sides of the balance sheet must be captured. In addition, risk transfer by innovative risk transfer tools should not be missed. This aspect of the work will require continuous surveillance and continued updating of monitoring techniques as risk transfer mechanisms become more diverse and as risk becomes more widely dispersed. Most importantly, the disclosures should be clear enough to highlight adverse trends at a sufficiently early stage. This would allow reinsurers and supervisors alike promptly to take the necessary remedial action, thus taking advantage of the slow moving nature of their difficulties.

*Comparability.* Quantitative disclosures based on results of standard stresses within a similar operational and regulatory environment facilitate a useful cross-company comparison<sup>47</sup>. It gives non-life cedants better tools to assess the stability of their reinsurers and draw conclusions about the persistency of cover at relatively stable prices. This is especially important in emerging markets or for the smaller insurers, where the cession rates are high, and where dependency on reinsurance is high. In this regard, a common framework for risk categories would be helpful.

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<sup>46</sup> The draft *Standard on Disclosure concerning Technical Performance and Risk for Non-life Insurers and Reinsurers* states that stress testing is a "key management tool to help insurers to understand the consequences of adverse situations. Stress testing might not achieve this key objective if insurers were required to publicly disclose the actual stress test results. For this reason, this standard does not require such disclosure".

<sup>47</sup> As pointed out by the IAIS *Guidance Paper on Stress Testing by Insurers*, standardized tests should not inhibit (re)insurers from undertaking their own thorough review of the inherent risks in their business or discourage them from adopting an effective, comprehensive, risk-based approach to business management.

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*Risk exposure and management.* Sensitivity, stress testing and scenario analysis must reflect vulnerabilities if they are to be beneficial to companies, investors, consumers or any other interest group. Vulnerabilities will change over time, and risk-oriented disclosure must be adapted to fulfil constantly the need to provide a risk analysis. Given the large differences among jurisdictions, the discussions about specific disclosure improvements could initially be based on the extent of disclosure made in the more open jurisdictions and in the light of disclosures made in other sectors<sup>48</sup>, where relevant. It is recommended that stress tests and other risk-oriented disclosures be developed on a common basis.

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<sup>48</sup> A recent attempt to make disclosure by reinsurers more comparable can be found in the recent IAIS *Standard on Supervision of Reinsurers* (October 2003), which states that financial statements of internationally active reinsurers should be prepared using internationally accepted accounting principles (e.g., International Financial Reporting Standards or U.S. GAAP) to facilitate market discipline.

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**DRAFT**

**Steering Group on Transparency in the Reinsurance Sector**

Terms of Reference

The Steering Group is a succession to the Task Force on Enhancing Transparency and Disclosure in the Reinsurance Sector (“Task Force Re”), and as such has been established to provide a framework to carry forward the work commenced by Task Force Re, the terms of reference of which are attached.

To this end the Steering Group should:

1. Prepare global reinsurance market reports (including analysis and interpretation of statistical data);
2. Be responsible for all future decisions with respect to the methodology adopted to produce global reinsurance market statistics (“the statistics”), namely:
  - Decisions on the types of data to be reported, notably on future amendments/additions to the categories of data currently being collected;
  - Decisions on which reinsurers are included in the statistics, including decisions required as a result of individual jurisdictions’ requests to exempt reinsurers from inclusion in the statistics and on the relevance of making any change, in future years, in the selection criteria for a reinsurer to be included in the statistics;
  - Decisions of the extent of historical data that will be available through the statistics;
  - Decisions on the general process of revising agreements relating to the statistics (including organisational set-up); and
  - Decisions on access rights to various levels of data;
3. Periodically assess the whether or not to continue producing global reinsurance market statistics and preparing global reinsurance market reports;
4. Resolve any issues that may arise from matters within its terms of reference.

Given the strong link with the work previously carried out by Task Force Re, the organisation of the Steering Group is based upon that adopted for Task Force Re, and is as follows:

- The Steering Group reports to the IAIS Technical Committee after consultation with the Subcommittee on Reinsurance and other forms of risk transfer.
- The Steering Group membership comprises senior representatives of the regulatory authorities of the jurisdictions in which reporting reinsurance companies are incorporated.
- The Steering Group actively engages the reinsurance industry representatives, appointed by Steering Group members, in the above work. The meetings of the Group are open to the representatives, except where it decides otherwise.

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- The Steering Group consults financial market participants and other financial authorities on perceived information gaps in respect of the reinsurance industry.
- The IAIS, with involvement from the FSF Secretariat and IMF and World Bank staff and other financial stability organisations, as necessary, provides secretariat support to the Steering Group.
- The Chair of the Steering Group is appointed from within the members of the Steering Group, and subject to normal IAIS procedures for the appointment of a Working Group Chair.

Members of the Steering Group, and reinsurance industry representatives nominated by national supervisors, should be the same as for Task Force Re, at least initially.

It is anticipated that the Steering Group liaises closely with the Subcommittee on Reinsurance and other forms of risk transfer, with the Enhanced Disclosure Subcommittee, and with any other working party as appropriate.