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INVISIBLES: INSURANCE

Reinsurance security

Study by the UNCTAD secretariat

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PREFACE

1. At its eleventh session, the Committee on Invisibles and Financing related to Trade adopted resolution 28 (XI) requesting the UNCTAD secretariat to prepare, "in the interests of avoiding the adverse effects on insurance markets of the use by their markets of unreliable reinsurers, a study on all the criteria for assessing the security and credibility of reinsurers". The Committee also requested the UNCTAD secretariat to "seek the opinion of representatives of the various interests involved and other experts". The present report has been prepared in response to the above mandate.
2. Pursuant to the Committee's instruction, the secretariat submitted the draft report to a Group of Experts which met to discuss it in Geneva from 13 to 17 October 1986. The Group reviewed the draft and very valuable comments and suggestions were made, after which the secretariat prepared the study in its present form, for which it assumes full responsibility.
3. Owing to restrictions on the length of documents prepared by the UNCTAD secretariat, this study is issued in an abridged form. The introduction describes the present security situation in the international reinsurance scene. Chapter I deals with the criteria for insurance companies to select their reinsurers. Chapter II deals with the supervision of ceded reinsurance. Chapter III deals with the supervision of reinsurance sellers. Finally, Chapter IV deals with the possibilities of international co-operation in the regulation and supervision of reinsurance companies.
4. In order to give more details and statistical data on the subject, a more complete version of this study is being issued as a background document under the symbol TD/B/C.3/221/Suppl.1 (English only).

FACTUAL BACKGROUND

5. Reinsurance is a mechanism for the distribution and sharing of risks. Its main purpose is to allow primary insurers to respond to the needs of their insured when large values or new types of risks require cover which they cannot afford on their own. Reinsurance also provides a protection to primary insurers so that their underwriting and financial performances may not be unduly affected by negative experience or by unexpected occurrences. The reinsurer, for his part, gains an insurance portfolio and investible funds.
6. Initially, reinsurance was exchanged among primary insurers in the same market. However, by the middle of the nineteenth century, the first specialized reinsurance company was created in Germany and was followed by several other specialized reinsurers in Europe and North America. The emergence of specialized reinsurance institutions have signalled the internationalization of this type of activity.
7. Reinsurance premium receipts have been growing steadily before and after World War I. However, the fastest growth was recorded in the last 20 years. Such growth has exceeded the growth of the direct insurance premiums written during the same period. The background of such quick growth is obviously the unprecedented economic upswing which industrial countries have experienced since 1945. Technological progress and sociological developments have engendered larger and new needs for cover. World-wide reinsurance was the only way to generate sufficient capacity to cope with such needs.

8. A second reason for the dramatic growth of international reinsurance activities is the change in the structure of insurance markets in many parts of the world, and in particular in developing countries. An increasing number of these countries have limited or excluded altogether the operation of direct foreign insurance companies in their territory. Domestic insurance companies assumed the responsibility of covering local risks. Given the restricted size of some of such emerging markets and the lack of past experience, young domestic insurers could not produce enough capacity to cover their local risks. They were thus compelled to rely heavily upon international reinsurance facilities to make good such deficiencies.

9. Traditionally, there were few major markets that were in a position to offer reinsurance facilities on an international scale. Reinsurers from five countries dominated the international reinsurance scene, namely Federal Republic of Germany, Switzerland, the United Kingdom, the United States and France. However, the increased demand for reinsurance all over the world has spurred a tremendous expansion in the number of reinsurers not only in these five countries but also in many other parts of the world. New markets have sprung up, particularly in free zones and in countries that offer off-shore facilities. Also a number of reinsurance companies were set up in several developing countries on a national and regional basis.

10. Such growth in the number of reinsurers can be explained by several factors. The most obvious factor is the growing demand for reinsurance covers for the reasons stated above.

11. The second factor is the increase of the regulatory climate in respect of direct business, which prevented international companies from carrying their activities as primary insurers into foreign markets. To continue having access to some markets these companies had to switch to reinsurance, a field characterized by ease in transcending national frontiers due to the absence of strict regulation in this respect.

12. Moreover, the relatively slow growth and stagnation of direct insurance premium receipts compared with that of reinsurance have induced many insurers and other financial institutions to invest in reinsurance, particularly taking into consideration the modest capitalization and reduced management expenses required by this type of activity, and by the growth and profitability which the reinsurance business has achieved.

13. To illustrate the sharp rise in the number of reinsurance companies in the second half of this century, it is sufficient to mention that today there are about 376 professional reinsurance companies operating in the world, 3 per cent of these have existed for 100 years or more; 2 per cent have between 75 and 100 years; 8 per cent have between 50-75 years; 12 per cent have between 25 and 50 years, thus leaving a balance of nearly 75 per cent having under 25 years.

14. At first glance, the increase in the number of reinsurers and the expansion of the market appears to be a favourable development since one of the objectives of reinsurers is to protect the ceding companies and to achieve the widest international distribution and coverage of risks. Unfortunately, the proliferation of reinsurers in recent times has brought with it many serious problems. The reason for this is that a large percentage of this new capacity has lacked both knowledge and experience. It has viewed reinsurance

underwriting merely as a vehicle for developing investment funds at a time characterized by extraordinary high interest rates. Reinsurers in this category are blamed for much of the deterioration in the quality of underwriting and the depressed market situation. In face of the tough competition, traditional reinsurance markets felt obliged to hold on to their business at all costs, which inevitably meant undercutting rates.

15. Obviously, high interest rates earned on investment have been essential to the stability of the performance of reinsurers. However, as interest rates have dropped recently the investment earnings of many of these reinsurers have shrunk accordingly. This situation has resulted in cases of financial difficulties. Some reinsurers have not been able to meet their obligations towards their ceding companies owing to the depletion of their financial resources. Several other reinsurers had to go out of business or disappear, leaving their ceding companies without cover, and without payment of balances due to them.

16. Another disturbing phenomenon in recent years is that reinsurance payments of several billion dollars suffered considerable delays. Obviously, such delays in the settlement of reinsurance recoverables may indicate, among other things, serious deficiencies in the financial situation of some reinsurers. Moreover, millions of uncollected reinsurance recoverables have been written off or are in dispute.

17. Reinsurers facing financial difficulties because of insolvency or because of the non-flow of cash are not the only concern for buyers of reinsurance. Several cases of fraudulent dealings and notorious scandals have been committed by some unscrupulous reinsurers and intermediaries. Before such problems occurred, there was little question of closely vetting the list of one's reinsurers. Now the risks involved in unsafe reinsurance, have caused many insurance companies to worry over security. The need for proper security analysis was finally recognized, and various companies, brokers and specialized organizations began simultaneously to analyse the performance of reinsurers operating in the international market.

18. How do the problems of reinsurance security affect the insurance markets in developing countries? It is known that the insurance markets in most of these countries, reflecting the early stages of economic development, have not yet reached the level of growth and sophistication which characterize their counterparts in developed countries. Structural, financial and technical constraints such as under-capitalization, small size of markets, imbalanced nature of insurance portfolios, lack of sufficient experience and know-how - all these factors and others make the technical and financial dependence of these markets on international reinsurance very extensive. Besides, nothing indicates that the degree of such reliance would diminish in the near future.

19. The implication of such heavy technical and financial dependence on international reinsurance is that the insurance markets in developing countries become particularly vulnerable to any upheavals which may involve the international reinsurance field and its financial ability. In the face of such danger, it is desirable that certain measures be taken to create a situation where ceded reinsurance be offered only by credible and solvent reinsurers.

Chapter I

SECURITY ASSESSMENT BY CEDING COMPANIES

How to look at security

20. It would be fair to say that the exercise of a reinsurer's security assessment is the prime responsibility of the ceding company and this is in application of the principle of caveat emptor. The latter can carry the task of selecting reinsurers who meet the conditions of solvency, credibility and technicality.

21. In considering the criteria and the various pointers which can serve as a basis for security analysis due weight should be attached to two types of information: the first is related to the reinsurer itself, the other related to its country of domicile.

A. Information related to the reinsurer

The quality and reputation of staff

22. In considering reinsurance security and in setting up systems and procedures to evaluate companies the question of trust and integrity must be paramount. Given integrity, then the experience and past record of people is vital. Reinsurance is a long-term relationship of trust and judgement. Experience in the business is essential. For example, the very long tail business involved in some classes of reinsurance means that an underwriter's record, over a long period, must be proven before true faith can be accorded to him.

Technical and management skills

23. In the field of security assessment, a certain degree of knowledge of the quality and reputation of the reinsurer's management is required. The skill and the experience of such management is reflected in the long and continuous business relationship that ceding companies have with the reinsurer. Also, the diligence of the reinsurer in underwriting the risk and settling the claims indicate the degree of professionalism of the management. Finally, the continuity of the reinsurer's management can be seen as an indication of the reliability and stability of its business policy.

Ownership and inter-company relationships

24. One of the important elements in the qualification of reinsurers is the determination of who really owns and controls the reinsurer. Is he a part of a conglomerate? Light must be thrown on the relationship between parent and subsidiary. Where the reinsurer is a subsidiary of an insurance company, it is necessary to determine the value of the guarantee of the parent company. Where the insurance company is a subsidiary of the reinsurer, one has to determine the extent of damage to the reinsurer which would be caused by the failure of the subsidiary.

Past record of the reinsurer

25. The past is a good guide to the future. In order to study the past it is necessary to obtain financial information from the annual reports or statutory returns of the companies concerned. Annual reports are usually a good source of information, though many of them seem designed rather to conceal information than to display it.

Analysing trends

26. In looking at the past record the most important trends to consider are: growth in premiums, at both the gross and the net level, changes in underwriting profits or losses and their relationship, investment income, and movements in technical reserves.

Premium growth

27. The first test in this respect is to make sure that the reinsurer commands a reasonable volume of business. A progressive reinsurance company should show a growing volume of business rather than a redundant or falling account. Moreover, it is essential that the volume of business written by the reinsurer emanates from different countries in order to guarantee a reasonable degree of diversity and spread. It is generally admitted that a reinsurer having the bulk of its premium income deriving from one country (most probably its country of origin) and in its local currency may not be very attractive to reinsure with on a large scale.

Underwriting profits or losses

28. Second in the field of analysis of underwriting performance is the review of the past record of technical profitability. A reinsurer with consistently poor underwriting results is a potential insolvent, even if his investment yields have been able to make good the negative underwriting results. This is simply because losses may increase to an extent that investment yields would not be sufficient to cover them. However, reinsurance as a whole has been largely unprofitable for several years now, and companies have been looking at the total returns from underwriting business.

Reinsurers' assets

29. The assets of the reinsurer should be of a type that can be readily liquidated so that claims and potential claims can be paid. An excessive proportion in any one country or type of asset has dangers. Stock markets can go down and can close in certain countries. Property prices can slump, not only through supply and demand but through rent controls. Where potential liabilities and actual assets are in mismatched currencies there are significant dangers through currency movements.

Valuation of assets

30. In looking at assets it is necessary to establish the basis of valuation and to identify their real value and eventually to determine their admissibility.

Technical reserves

31. In examining the solvency of the reinsurer it is essential to examine the size of his technical reserves and to make certain that they are adequate to meet his liabilities on the business he has already written. Technical reserves comprise the unearned premium reserve, the reserve for the known outstanding liabilities, the reserve for incurred but not reported liabilities, i.e. IBNR. The first two reserves are normally factual, provided good records are kept. IBNR reserves present a major problem in analysing reserve adequacy of a reinsurer. To judge the adequacy of all these reserves, it is necessary to look to the historical record of reserving of the reinsurer as evidenced by his returns over a period of years. If such returns constantly show a negative balance on the revenue account for business relative to previous years, this can be taken as prima facie evidence of the inadequacy of technical reserves.

Test ratios

32. In the examination of the reinsurer's security, the analysis should cover a variety of test ratios which help to evaluate periodically the financial position of the reinsurer. Such test ratios include the solvency margins, changes in net premiums, reinsurance ceded to gross premiums, combined loss and expense ratio, technical reserves and shareholder's funds in relation to net premiums.

Solvency margin

33. This ratio indicates the extent of the company's trading or overtrading in relation to the net worth or shareholders' funds. Net worth is normally considered to be the initial investment of the shareholders and the accumulated undistributed profits over the years of operations. As a generic term it covers capital funds and surplus shareholders' equity, free assets and free reserves and sometimes policyholders' funds. The higher the net premium to net worth, the larger the impact of losses on net worth. It should be appreciated that a company with a relatively high net worth can safely write a higher ratio of premium to net worth.

34. This ratio and indeed other ratios derived from the annual report must be considered in the light of the territory in which the reinsurance company is operating. Different levels of disclosure exist in each country and account must be taken of insurance regulations and accounting practices in each.

35. It is also necessary to consider the type of business being written. For example, a company specializing in United States catastrophe covers will be expected to have a more modest and conservative ratio than one writing a short-tail fire account in a developing country.

36. In looking at the relationship between premiums and shareholders' funds one must remember that the actual amount of shareholders' funds and the minimum ratio required by statute in many territories is modest. To be told that a company's solvency ratio satisfies statutory requirements may not in itself be a sufficient test of security.

Changes in net written premium

37. This ratio focuses on a company's stability. Major changes in premium flows, be they an increase or a decrease, are worthy of investigation. Substantial increases or decreases may be a consequence of changes in underwriting policy, the lines of business written and even underwriting philosophy. It is appreciated that a new company will be increasing at a faster rate than a more stable mature company. However, when a reinsurer substantially increases net premium one must question, in the light of the poor profitability of reinsurance companies, where this additional business is coming from. Is sub-standard business being purchased? Are higher commission rates being paid or has the company diversified into new classes of business? In the event that premiums have experienced a decline one must question how the overheads of the business will be spread.

Reinsurance ceded to gross written premium

38. This ratio questions the extent of a reinsurance company's reliance upon retrocessionary covers. Where it retrocedes more than 40 per cent of its gross incoming premium it clearly has a substantial dependence on the continued health and indeed existence of its retrocessionaires. It is an unfortunate fact of life that too many reinsurers retain only a very modest part of the premium they write and retrocede the vast bulk of the risks. Such companies are effectively brokers or wholesalers and not genuine reinsurers. In view of the current capacity crunch, such reinsurers are fast disappearing as they find themselves unable to protect themselves adequately. Where companies retrocede substantially it is necessary to enquire as to the stability of the ultimate risk carrier and perhaps request a "cut-off" clause as it would be apparent that the ceding insurer or reinsurer will not be able to pay claims until full recoveries have been received.

Combined ratio

39. The combined ratio is the sum of the loss and expense ratio. Most insurance and reinsurance companies throughout the world today have a combined ratio in excess of 100 per cent, i.e. they are making an underwriting loss. Where investment income is not greater than the underwriting loss an overall loss situation will exist which, unless there are exceptional circumstances, will begin to erode the capital base of the company.

Technical reserves and shareholders' funds in relation to net premium

40. This ratio compares the net written premium with the total balance sheet reserves, i.e. all the technical reserves and all the shareholders' funds, which might under exceptional circumstances be available to pay claims. A company with a low level of these reserves clearly would have a "lower ultimate claims paying ability" than one with a higher level, though once again the type of business that is written must determine the extent of the reserve requirement. A rule used by many security analysts is that technical reserves plus shareholders' funds should be at least 150 per cent of net premium. A higher percentage may be required for long-tail business. This rule presumes that the assets in the balance sheet are not significantly understated and the company is writing a general book of business and not just a predominantly short-tail account.

B. Information related to the country of origin of the reinsurer

41. Such information relates to two main fields, the first concerns the government supervision and regulation applicable to the reinsurer in his country of domicile. The second relates to the economic situation, currency regulations, and fiscal provisions in the same country.

42. The assessment of security would be incomplete if the government supervision laws and regulations in the country of domicile of the reinsurer are not examined carefully. Obviously, if reinsurers are regulated in their countries of origin, they may have to adhere to certain requirements. They may have to be up to certain standards of solvency and may also be required to file financial information with the supervisory authorities. The existence of such regulation and supervision would create additional elements which can reinforce the feeling of security in the ceding companies, though they do not preclude the security tests carried out by the ceding companies themselves.

43. Reinsurance implies transactions and transfer of funds from one country to another. The ability of reinsurers to meet their obligations abroad depends to a large extent on the country's solvency. This is of particular importance at the present time because an increasing number of countries are defaulting in the payment of their debts. Thus financial uncertainty in a country may render its reinsurers unable to meet their commitments. It is also essential before the selection of a reinsurer to check currency regulations in the country of the reinsurer and to see if there are laws limiting the free passage of funds. Finally, it is also necessary to examine the fiscal policy of the country of the reinsurer to ascertain that no fiscal charges or withholding taxes are applied to amounts due to ceding companies abroad.

Sources of information for security assessment

44. Ceding companies, in order to analyse the security of their present or eventual reinsurers, should gather all possible information relevant to them. Annual reports, balance sheets and accounts are usually the main source of information about reinsurers. However, as accounts and reports published by reinsurance companies do not always reflect all the aspects which it is necessary to examine, it may be necessary in some cases to seek additional or alternative sources of information, such as statutory returns to local supervisory authorities if disclosure and recording are required by laws. It may also be useful to examine the information about the reinsurer in the insurance and non-insurance press and periodicals as well as through consistently reliable information in the marketplace. Furthermore, personal contacts with managers and staff of the reinsurer could help to disclose the ability and the reliability of the latter.

45. Reinsurance brokers, particularly the major ones, establish standards of their own in the selection of those with whom they are prepared to place their business. To this end, some large brokers have security committees to maintain records on reinsurers they deal with and often they produce security lists containing names of reinsurers usually divided in three categories, the ones to use, the ones to use after consultations with the ceding company, and finally the ones to avoid. Obviously, such lists are confidential and used exclusively in cases where the broker is required to place the business of a ceding company.

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Statistical services provided by independent organizations

46. Apart from security assessment services offered by some brokers, there are firms in the United States and United Kingdom which have established security reporting and assessment services.

47. One of the well-known services is the Best's insurance report in the United States which reviews data of many companies and allots every company a rating category ranging from "Excellent" to "Fair" and "Omitted". The Best's serves as a guide for anyone wishing to see the history, management structure, and technical and financial information of every company which transacts insurance and reinsurance business in the United States. This publication can be produced thanks to the fact that all insurance and reinsurance companies in the United States are required to file their returns with regulators on a pre-determined and standardized basis.

48. In view of the need for information available to the insurance market as a whole, three specialized organizations have made it their business to provide such information and to prepare reports on the financial stability of insurance and reinsurance companies, their solvency status and a host of other details. These three organizations are: the Insurance Solvency International, International Insurance Financial Service, and the Financial Intelligence and Research.

Insurance Solvency International

49. Insurance Solvency International (ISI) is the first European-based security analysis service. It presents and publishes key financial data of non-life insurance and reinsurance companies in a standard and easily used form. This London-based organization is designed primarily to assist ceding companies and reinsurance brokers in evaluating the security of reinsurance companies. Their publication includes about 1,000 companies in some 60 countries, covering the vast majority of world-class names. The analysis transforms a mass of statutory numbers into a single standardized presentation enabling security analysts to focus on investigation and judgement rather than on spread-sheet analysis.

International Insurance Financial Service

50. The IIFS, based in Stamford, Connecticut, provides a service similar to ISI and evaluates the financial strengths and weaknesses of companies domiciled outside the United States. While their coverage and speed of reporting cannot compete with ISI, some analysts prefer their more American style and the classification they offer. Their information is taken from the annual reports of the companies rather than from the accounts which are submitted to the regulatory authority. In addition to the standardized financial information there are paragraphs dealing with the business background of the company concerned, its major subsidiaries or affiliates.

Financial Intelligence and Research

51. This service analyses the principal companies authorized to accept business in the United Kingdom. The information it produces is available to international subscribers who wish to have access to FIR data base. The data

provided is generally based on information filed to regulatory authorities, in the United Kingdom but could also cover information regarding overseas subsidiary companies.

Validity of the assessment exercise

52. After having enumerated the judgemental yardsticks for assessing the security of reinsurance and highlighted the possible sources of information on reinsurers, it may be necessary to evaluate the effectiveness and cost of such an exercise when carried out by ceding companies or by their brokers, particularly in the context of insurance markets in developing countries.

53. The exercise of security assessment carried out by ceding companies is a complex and uncertain task which deserves special attention. Complex, because the reports, accounts and statements published by the reinsurers do not reflect all the financial and technical realities relevant to them. A great deal of information needed for the assessment of security is not even contained in these published accounts. Uncertain, because security analysis is still far from being a science or a perfect technique. Here it must be appreciated that the information on the basis of which the analysis is done is subjective. Because of the absence or little supervision of reinsurance in many countries, reinsurance companies often take full advantage of such freedom or flexibility to present their accounts in the manner that suits them. Even if they are subject to certain regulations, nothing prevents them from interpreting these regulations in different ways. Also, owing to the fact that most countries do not subject reinsurers to specific control similar to that of direct insurers, there are no public files on reinsurers from which ceding companies can elicit additional information for evaluation purposes. In addition to the above considerations remains the fact that retrocessions follow the first reinsurance, probably through several generations of reinsurers and across several frontiers. Beyond the first reinsurers the ceding company would not be in a position to check the security of the retrocessionnaires. Recognizing these constraints, the security exercise probably needs more than the mere assessment by ceding companies.

54. Even supposing that adequate information regarding reinsurers is available, not many ceding companies, particularly those in developing countries, may be able to cope with the tasks and the requirements of evaluating reinsurers by themselves. Such tasks require, among other things, a highly qualified and experienced staff with sufficient grasp and in constant touch with the developments in the world reinsurance markets.

55. Many insurers, particularly in developing countries, recognizing the difficulties in carrying out the assessment exercise by themselves, resort to brokers for placing their reinsurance abroad. Naturally, the broker should examine the security of the reinsurer with whom the business is to be placed. Brokers are obviously in a better position than most ceding companies in appraising the security and solvency of reinsurers because they are, by the nature of their work, in constant contact with the international reinsurance markets. Yet how safely can insurers rely upon the judgement of their brokers? The past few years have shown a constant trend towards disappearance of the financial independence of brokerage firms. Many reinsurance brokers have been acquired by insurance and reinsurance companies. Inversely, some brokers have acquired an interest in insurance and reinsurance companies. The latest cases of fraud in the reinsurance world have revealed that many

insurance and reinsurance entities have become mere subsidiaries of broker's conglomerates. Thus the independence of the brokers, which is the very essence of their profession, is becoming more of a fiction than a reality.

56. It has also been observed that some brokers select reinsurers and exclude others on merely political grounds, a situation which does not match with their duty of independence, compromises the need to have wide open markets and finally undermines their commitment to choose the best reliable reinsurers with the keenest price for cover.

57. Finally, it should be pointed out that, in principle, brokers do not incur any legal liability in the case of default or insolvency of reinsurers selected by them (law cases are very deficient in this area). All these considerations make the selection of the reinsurance broker himself a matter of crucial importance to the ceding company. Until the situation is resolved either by some measure of control or by some other means, the choice of the broker by the ceding company has to be guided by the caveat emptor principle.

58. In view of these shortcomings which insurers face in this field it may be necessary for insurance regulators to lend a hand in checking the reinsurance security. In other words, the regulation of insurance may have to be extended to cover ceded reinsurance by direct writing companies. Such proposed regulatory involvement, which would take place at source, is not intended to share the privilege of the insurer in selecting its reinsurers, or even to monitor its choice. It is mainly designed to oblige the ceding company to require certain guarantees which would spare it the negative effects of a reinsurer's failure or insolvency.

Chapter II

SUPERVISION OF CEDED REINSURANCE

Objectives of insurance control

59. Regulators all over the world, notwithstanding the different systems of insurance supervision, concentrate their regulatory and supervisory efforts on the organizational, financial and transactional aspects of insurer's activities which fall under their jurisdiction. It will be agreed, however, that such aspects of regulation and supervision cannot by themselves guarantee a full protection for the consumer and for the national economy, if a considerable portion of the insurers' business passes through reinsurance to other insurers, particularly those domiciled outside the scope of jurisdiction of the supervisory authority.

60. Hence the necessity for the insurance supervisory authority to have a look at the reinsurance arrangements of insurance companies.

61. The control of the reinsurance programmes of primary insurers can be achieved through the obligation to report the details of these programmes and the lists of reinsurers selected. Some countries require the prior approval of such programmes before they become effective. Others do not require such approval but the obligation of disclosure is maintained. In a third group of countries remittances under reinsurance contracts are not allowed before the approval of such arrangements by the financial authorities.

Supervision of reinsurance terms

62. In practice most supervisory authorities make no attempt to scrutinize such programmes in detail. Probably the reason for this is that a detailed supervision is likely to be ineffective. Reinsurance contracts are in fact tailor-made to each insurer. The structures and terms of such contracts stem from particular factors inherent to the insurer himself, his capitalization, portfolio, experience, expectations, staffing, etc. No supervisory authority can replace an insurer in its choices.

Supervision of the choice of reinsurers

63. It is reasonable to assume that the choice of reinsurers belongs to the reinsurance buyers. Not only because they have the greatest interest in checking the solvency and reliability of their reinsurers but also because such a prerogative is essential for their functioning. Given the huge increases in values at risk and the continuous emergence of new and technological risks which require both know-how and capacity, it is of utmost importance to allow primary insurers the liberty of utilizing the international reinsurance markets, and to maintain the ability to shift from one reinsurer to another to take advantage of the best deals and the most appropriate terms and services.

64. The freedom which ceding companies should enjoy in choosing their reinsurance partners should not in principle preclude a reasonable control by the supervisory authority to see that law requirements concerning cessions to local and/or regional reinsurance institutions or pools are fully implemented. They also have to intervene to guarantee the utilization of

local market capacity before resorting to foreign reinsurers in the cases where laws or regulations so require. They may also intervene in the placing of reinsurance to guarantee an appropriate distribution of shares between several reinsurers and markets with a view to minimizing the impact of political or monetary upheavals which may occur.

65. Insurance supervisors could also be entitled to intervene on a formal or informal basis in cases where insurers under their jurisdiction cede shares of their business to reinsurers who are known to have become insolvent, or when there are serious doubts about their capacity to meet their obligations. In such cases the supervisory authority should be empowered to terminate the reinsurance agreements with these reinsurers or eventually to reduce their respective shares.

66. From what has been explained earlier, it is clear that the role which could be played by the supervisory authorities in the shaping and distribution of the reinsurance programmes of companies is rather minimal. It is therefore understandable that greater attention is to be paid to certain requirements in the reinsurance contract, the most important of which is the withholding of funds backing ceded reinsurance. The gist of this withholding is to make certain that such funds are earmarked to discharge specific liabilities. The ceding insurer brings such funds into settlement only after they have been fully earned by the reinsurer.

Withholding of reserves

67. Insurance regulators can formalize the practice of withholding reserves in two ways, directly by expressly requiring the technical reserves corresponding to the share of business ceded to the reinsurer (premium reserve and loss reserve) to be withheld by the ceding company, or indirectly by requiring technical reserves constituted by the insurer to be calculated on a gross basis without credit being given for the cover obtained from the reinsurer.

68. Reinsurers consider the requirement of withholding premiums from them as a deviation from the principle that a reinsurer is entitled to his full premium from the moment of inception of liability until the next annual premium falls due under the original policy. They also object to the withholding of outstanding loss reserves on the basis that the reinsurer is not obliged to indemnify the ceding company until the latter is obligated to indemnify the policyholder or the aggrieved third party. They feel that the deposit of outstanding liability reserves for at least 12 months does not take into consideration the situation where a reinsurer would have settled a good part of the claims to which the reserves for outstanding liabilities relate. Furthermore, the reinsurers claim that the funds blocked in deposits are exposed to the exchange risk as far as they exceed the final obligations.

69. Despite the fact that the measure of withholding reserves, all alone, does not offer the sufficient protection which ceding companies seek, particularly in the case of large losses, many regulators and many ceding companies realize that in the absence of adequate solvency controls exercised over reinsurers by supervisory authorities, the withholding of deposits from reinsurers becomes the only option available to the insurers to guarantee the collectibility of their reinsurance recoveries.

Forms of deposits withheld

70. The most common form of deposits withheld by ceding companies is cash, and the two parties to the reinsurance contract determine the rate of interest which the reinsurer receives on the deposit. However, in some cases reinsurers may offer securities deposit instead of cash. This type of deposit may satisfy the direct insurer from the security point of view, but it does not allow it to earn any money, since the interest or dividends corresponding to these securities accrue exclusively to the reinsurer. This is why several countries have regulations requiring the presentation of reserves of direct writing companies exclusively in local investments, a matter which excludes the practice of depositing foreign securities.

71. Some countries accept as a substitute for deposits, letters of credit issued by certain locally accredited banks. Such letters of credit pledge these banks to pay the ceding company a certain amount upon demand. In order to be acceptable such letters of credit have to be irrevocable and unconditional and must specifically state that letter of credit is payable upon the presentation of a sight draft without the requirement of presenting any other document.

Fronting

72. It is theoretically possible for a insurer to cede by way of reinsurance a very large proportion or even the whole of the business or risks it writes. There may be good technical and commercial reasons for the insurer to do so. However, such fronting creates a situation where the insurer virtually takes a risk of unprecedented magnitude because of the complete reliance on a reinsurer to meet its commitments to the policyholder. It would inevitably be catastrophic to the insurer if his reinsurer becomes insolvent or defaults payment. This is why, in several countries, supervisory authorities in the normal course of their duties seek explanations as regards the cases of fronting. Some countries even go further and fix a minimum retention for the ceding company.

Chapter III

REGULATION AND SUPERVISION OF REINSURANCE SELLERS

73. Reinsurance activities are engaged in either by mixed insurers, that is to say, those who accept reinsurance business beside direct insurance, or by specialized reinsurers whose business is reinsurance exclusively. In most countries mixed insurers are treated as if all their business is direct business and, as such, they can be considered fully supervised. Unlike mixed insurers, specialized reinsurers have so far been largely unencumbered by State regulation or have received in practice more lenient treatment. The reasons for this lie in the very special nature of reinsurance and its logic. The principal consideration for such an approach is that specialized reinsurers have no dealings with the public. The policyholders or aggrieved persons who are the very subject of protection by supervisory systems or direct insurance have no title or links with the reinsurers.

74. Moreover, direct writing companies, in their capacity as ceding companies, do not need the same protection as policyholders. In fact, they enjoy a knowledge and expertise in technical and financial matters comparable to that of their reinsurers, a fact which qualifies them as equal business partners.

75. In most countries insurers are subject to State supervision which applies to their gross portfolios, i.e. gross premiums and gross liabilities. Such a comprehensive control has been viewed as an optimum security, making the supervision of reinsurers an unnecessary and superfluous exercise.

76. A fourth consideration justifying a less restrictive approach to reinsurance is that reinsurance transactions are, by nature as well as by necessity, international. Therefore, subjecting reinsurers to local regulations would defeat or obstruct the main objective of reinsurance which is the spreading of risks, and may have an adverse impact on the competitiveness of the reinsurer.

77. There are other factors which have deterred Governments from treating reinsurers in the same way as direct insurers. In fact, the ability to check reinsurer's activities requires a great deal of information permitting not only a quantitative analysis but also a qualitative appraisal of their activities. It is hardly possible for a Government or a supervisory authority to check the countless international involvements of reinsurers. The fulfilment of such tasks would require, among other things, a thorough knowledge of different markets, their laws, structures, currency risks, investments, etc. A control on all those elements would virtually amount to the supervisory authority running the business itself.

78. Even supposing the ability of the supervisory authority to monitor and control the performance of reinsurers, such control would depend greatly on the timely input of information which the reinsurers should provide. Given the world-wide scale of reinsurance transactions and the endless chains of retrocessions, returns to be provided to the supervisory authority would inevitably be too belated to serve as a basis for a useful and up-to-date judgement. Therefore, the chances of the supervisory authority to remedy immediately any adverse situation are in practice rather remote.

79. In the light of all these considerations, many countries with well developed local reinsurance markets have refrained from regulating the activities of reinsurance companies. This is the case of countries such as Belgium, France, and Luxembourg. Other countries, some of them the home of large specialized reinsurance companies, do not require local specialized reinsurers to be licensed. However, they have to comply with certain requirements such as disclosure and reporting, in order to ensure that their business is conducted with due diligence. This system is applied in Austria, the Federal Republic of Germany, and the Netherlands.

80. In the United Kingdom, the supervision of local specialized reinsurers extends beyond licensing and reporting. It includes also control over the reinsurer's solvency, and the supervisory authority is entitled to intervene in the affairs of a reinsurer, such as stopping him from taking on further business, or petitioning for his winding up on grounds of insolvency.

81. Other variations of regulation and supervision exist in Italy, Sweden, Switzerland and the United States of America. In Italy, specialized reinsurers, before being allowed to operate, are subject to prior technical authorization. During their operation they are also supervised. In Sweden, local direct insurers and specialized reinsurers are subject to the same form of supervision. However, the Government may in respect of reinsurance allow certain exemptions from supervision requirements. In Switzerland, local insurers and reinsurers are regulated by a Federal law which provides for authorization and licensing procedure, the constitution of technical reserves. However, in contrast with direct insurance, solvency margins are not specified for reinsurance business. In the United States, the regulation and supervision of insurers and reinsurers are not federal, but are exercised at the individual state level. Generally, a domestic reinsurer has to apply for authorization before being allowed to accept business. For authorization and admission purposes it must give evidence of solvency and competence. Once it is admitted it becomes subject to reporting requirements. Such reporting is thoroughly scrutinized. Alien (non-American) specialist reinsurers do not need licensing to operate in the United States. However, if they sought licensing they would be subject to the same laws regulating the United States insurers and reinsurers. For reinsurance ceded to reinsurers licensed locally, whether local or alien, financial credit is recognized allowing the ceding insurer to reduce its unearned premiums reserve and loss reserve to the extent of reinsurance recoverables. In all other transactions with reinsurers not licensed in the State such credit is not given, and ceding companies are required to withhold full premium and loss reserves.

82. Regulation of reinsurance in the developing world varies from country to country. However, as the bulk of these countries are buyers rather than sellers of reinsurance, and since they invariably suffer from heavy dependence on foreign reinsurance, their regulatory systems are largely marked more by the need to curb such dependence - which causes an increased outflow of funds - than by concern about reinsurance security. In many of these countries, laws and regulations limit the freedom to place reinsurance outside national boundaries through the imposition of compulsory or legal cessions to local reinsurers as a device to minimize foreign-exchange outflow. Some of these reinsurers are State-owned, some others are private or mixed but enjoy State backing. In most cases such local reinsurers are subject to special legislation which specifies their purposes and their methods of operation.

Beyond these measures, aimed at curtailing excessive resort to foreign reinsurance and promoting the use of local capacity, there is hardly any framework in developing countries that provides control over reinsurers' activities.

Reinsurance regulation versus reinsurance freedom

83. It would be difficult to challenge the validity of the arguments in favour of reinsurance freedom. Indeed, such freedom has contributed and still contributes largely to the development of insurance markets and to producing the needed capacity to cover the world's complex and expensive risks. However, it has to be emphasized that reinsurance freedom is not an abstract concept. It can only remain valid to the extent that the reinsurance security is maintained. Unlike insurers, reinsurers have all along been given wide freedom in doing their business. However, the reinsurance market has changed greatly in recent times with so many new entrants to the marketplace and with the growing complexity of the corporate entities involved in such transactions. Such recent developments were associated with failures, abuses and frauds involving some reinsurance practitioners.

84. The need for regulating local and international reinsurance is more pressing in less developed insurance markets than in the developed ones. One must bear in mind that reinsurance buyers in advanced markets have more ability and more access to the information serving as basis for security analysis. The situation is totally different in less developed markets. Information about reinsurers is hardly obtainable, and companies do not generally have either the resources or the know-how to proceed by themselves to security analysis.

Regulatory concerns

85. With regulation in mind, a number of specific concerns emerge. If reinsurance is to be regulated and supervised such regulation and supervision should apply both to domestic and foreign reinsurers alike. It is obvious that regulation and supervision of local reinsurers are easy to implement. However, unlike insurers who need to have a local set-up in every country where they intend to operate, foreign reinsurers do not have in most cases such local presence. They procure their business centrally from their head office or through reinsurance brokers.

86. An equal concern in regulating reinsurance is the necessity to avoid as far as possible in the pursuit of security, unnecessary restrictions to the freedom of reinsurance. Drastic and hasty measures in this respect may put local companies in difficulties when reinsuring their surpluses, particularly in the field of high-valued and complex target risks.

87. Finally, it has to be realized that any regulation of reinsurance activities would never establish a hermetic control. Because reinsurers retrocede extensively the regulator faces the reality of having the local risks channelled through retrocessions into the larger international market. Once they pass outside his jurisdiction, the security can no longer be ascertained. Moreover, given the diversity of the legal, structural, financial and accounting background of reinsurers from different countries, the problems of bringing them under one order would be enormous.

Possible forms of reinsurance regulation

88. With all these concerns in mind, State regulation of reinsurance still can be directed to making parties seeking reinsurance aware of the characteristics of the reinsurance companies they intend to deal with. This may be achieved through compelling reinsurers willing to write business in the market to provide information about themselves and thus become listed. Such information would then be put at the disposal of reinsurance buyers for the purpose of selecting their reinsurers. This form of regulation is in fact a quasi passive one.

89. A more active form of State regulation consists of requiring licensing from reinsurers, coupled with non-discriminating standards for admission, which would assure solvency and competence of those permitted to write business in the country. Moreover, such regulation would facilitate surveillance by the supervisory authority of standards and requirements, as well as the ability to impose sanctions on failure to perform.

90. The choice between these two forms of regulation depends very much on the leverage which a given market enjoys in relation to international markets and also on the ability of the supervisory authority to take the responsibility for evaluating and monitoring the reinsurers, with all that this implies in terms of controls and checks.

Reinsurance regulation in the context of developing countries

91. The greater part of reinsurance cessions in developing countries is transacted by foreign reinsurance companies. Yet in some of these countries locally incorporated reinsurance institutions operate. Thus any reinsurance regulation should in principle apply both to local and to foreign reinsurers. However, since foreign reinsurers seldom have local representation in the countries from which they receive their business, they may have to be subject to a different type of control. It is, however, necessary in this respect to caution against burdening local reinsurers with requirements that could put them at a disadvantage in comparison with foreign reinsurers. It may be advisable that the extent of regulation be limited as far as practicable to the questions of solvency, reliability and technical expertise.

Case of direct insurance companies writing international reinsurance business (mixed reinsurers)

92. The first measure which may be proposed in this respect is to subject such companies to prior licensing procedures before engaging in international reinsurance acceptances. Companies which do not show both enough capitalization and sufficient expertise in this field may be barred from transacting reinsurance. This is not only to protect their ceding companies but also to protect their own policyholders from risks of insolvency. If license is granted to a direct insurer to transact international reinsurance business, their reinsurance transactions should be treated as a distinct class of business thus maintaining corresponding premiums, reserves, and investments separate from other accounts. The reason for this is to protect direct insurer policyholders who could be prejudiced by the effect of the instability of the accepted reinsurance account. Regulations may also envisage the possibility of intervention on a formal or informal basis with direct insurers

accepting international reinsurance business to restrict the size of their acceptances to a level commensurate with their net worth in order to avoid the risk of their insolvency.

Case of locally incorporated specialized reinsurers

93. Companies incorporated locally to carry out reinsurance business exclusively may equally be subject to some sort of licensing and their activities may be supervised. Such supervision will be of particular importance in the case of companies provided with obligatory legal cessions, as is the case in many developing countries. The State which rendered such reinsurance compulsory has the particular responsibility to ensure that the obligatory reinsurance covers are provided with absolute security. The failure to provide such a guarantee may mean that the companies in the market find themselves in a position in which they are compelled by law to cede business to reinsurers that are insolvent or unreliable. On the other hand, the fact that a reinsurance company belongs to the State, or has State backing, does not preclude the necessity of regulation and supervision. A mere government guarantee may not always be sufficient, particularly in case of large losses which the State budget would not be able to afford. Moreover, subjecting State reinsurance companies to regulation and supervision may help to add to them more credibility in their international reinsurance transactions.

Capitalization

94. The first step in regulating local reinsurance companies is to introduce a system of licensing which entails the fulfilment of certain requirements, among which is the minimum share capital. At the beginning a reinsurance company needs sufficient paid-up capital to develop its risk-carrying capacity. However, as such share capital will soon become insufficient to cope with the expanding premium income and the increasing commitments of the reinsurer, it may be necessary for the supervisory authority to ensure that the reinsurer constantly increases his capital base, particularly through the requirement of earmarking sufficient portions of profits to constitute free reserves.

Technical reserves and IBNR

95. A reinsurance company has also to set up and to maintain technical reserves, i.e. unearned premium reserves, outstanding loss reserves, as well as a reserve for incurred but not reported losses (IBNR). In respect of unearned premium reserves, its methods of calculation are similar to those of direct writing companies and the reserves should normally be equal to those corresponding to direct business accepted. As for reserve for outstanding losses, it should in principle follow the estimates made by the ceding companies in their accounts. However, nothing prevents a reinsurer from reassessing his liabilities, in particular in cases of large losses or in case of past experience of unreliable estimates made by some ceding companies. Regulatory initiatives could also be directed towards ensuring that local reinsurers take the element of IBNR into consideration when calculating their liabilities. Many claims falling under the scope of the reinsurance cover may take years before they are known and reported to the reinsurer.

96. In spite of all the preceding precautions which may be taken by the reinsurer for the correct estimate of his technical reserves, these seldom reflect a true picture of his liabilities at a given moment. This is mainly because of the considerable delay in the submission of reinsurance accounts by ceding companies. To present a picture nearer to reality, the reinsurer may be urged to use his run-off statistics to estimate the figures of technical reserves and the IBNR for the accounts which are not available at the time he is establishing his balance sheet.

Solvency margins

97. A principal regulatory tool for the effective control over the financial standing of insurers is the requirement of solvency margins. The significance of the solvency margin is that, because it is represented by the capital and free assets of the company, it provides a capital base which should be sufficient to ensure protection against a protracted deterioration of operating results, a major underwriting catastrophe or an investment collapse. The application of the concept of a solvency margin to professional reinsurers, especially the small and the less experienced ones, could be very beneficial in the sense that it fixes for them parameters for the volume of business which they can more or less safely retain for their own account. Should these parameters be exceeded the supervisory authority may have to intervene to take quick action to restore the required margin. It could also be useful in the calculation of the solvency margin of the reinsurer to fix an upper percentage for retrocession which would be deducted from its gross premium income.

Investment of reinsurer's funds

98. Regulatory authorities may also supervise the methods of investment of reinsurers' funds. However, it would not be advisable to establish percentages to be placed in real estate, bonds, stocks, bank deposits, etc., since conducting reinsurance business requires a great deal of flexibility to cope with reinsurance commitments. However, in supervising the investment policy of the reinsurers, it is essential to take into consideration that its assets should be placed in secure investments which give the optimum yields, since technical profits in reinsurance are scarce or infinitely thin, and that it is only through the investment income that a reinsurance company can survive and flourish. It is also important to see that reinsurance funds become readily marketable and realizable. Finally, such funds as well as other assets of the reinsurer should be diversified and not be placed in investments which form a second risk situation.

Valuation of assets

99. Regulatory initiatives should be directed principally towards setting up adequate and clear systems of valuation of assets of the reinsurer, since such valuation is a crucial factor for the calculation of the reinsurer's solvency. In fixing such systems, regulators particularly in developing countries should take into consideration the fact that often money markets and stock exchanges do not exist in their respective countries, a situation which renders the task of valuation of assets extremely delicate. Perhaps the safest and most prudent method of valuation in such circumstances is to take as a basis the cost of purchase less depreciation if the current value of an asset is lower than the cost of its purchase. If the value of the assets is

more than the cost of purchase, then the cost of purchase has to be retained as the basis of valuation. Such a system, if applied, would help to create invisible reserves which could strengthen the reinsurer's security.

Reporting to the supervisory authority

100. Once a reinsurance company has been licensed, it may be supervised through the scrutiny of its annual returns submitted to the supervisory authority. Such returns should therefore be as informative as possible.

101. At this point, it is important to underline that the regulation and supervision of local reinsurers should be made as flexible as possible, and should not subject them to stringent conditions which could put them in a difficult position that harms their performance. Moreover, it would be vital to these local reinsurers to have specific exemptions from exchange control regulations and to have specific facilities for the settlement of balances corresponding to their reinsurance liabilities.

Regulation of foreign reinsurers

102. As mentioned earlier, regulation of foreign reinsurers is rendered difficult by the fact that they do not have a local presence in every country from which they wish to receive business. Requiring such presence as a condition for placing business with them may result in restraining the free flow of reinsurance which is necessary for the coverage of risks. However, since not all reinsurers operating in the international market are technically and financially fit, it would seem necessary for regulators to do something to make sure that foreign reinsurers entering into business relations with locally licensed insurers are adequately screened by the latter. This type of necessary information has to be determined through a regulation.

103. In the light of these constraints, a simple and feasible way in which regulators can intervene is to establish a register of listed foreign reinsurers. Foreign reinsurers wishing to write business in the country would have to provide financial and technical information about themselves as mentioned in the following paragraph. The role of the supervisory authorities would then be confined to the checking whether information provided is sufficient to serve as a good basis for objective security assessment by the ceding companies.

104. According to this proposed system, foreign reinsurers seeking admission would be required to file with the supervisory authority a copy of their constitution, their articles of association or act of incorporation, copies of rules governing their activities, current lists of their controlling shareholders, the names, qualifications and designations of persons entrusted with top management, etc. They would also provide statements showing that their capital and surpluses are at least equivalent to those minimums laid down under the laws of their domiciliary jurisdictions. They may also be required to provide the supervisory authority with copies of their annual accounts and balance sheets for the last five years, certified by an accounting or auditing firm in the countries of their domicile, and this in order to assess their underwriting and financial performance.

105. The supervisory authority may also require from foreign reinsurers seeking admission a written agreement to abide by the laws and regulations of the country and the terms of reinsurance treaties with their ceding companies, including the concept of withholding by ceding companies of deposits as security for the fulfilment of foreign reinsurer's obligations under the relevant treaties.

106. Consistent with the purpose of ensuring the security of reinsurance, the supervisory authority may also require reinsurers seeking admission to present sufficient proofs that no laws, regulations and practices in their countries of domicile would hamper the prompt settlement of balances and claims due under the reinsurance agreements. After their admission, reinsurers should be under the obligation to advise the relevant supervisory authority of any measures taken in their countries of domicile which would affect the transfer of such balances.

107. To enforce such system of admission on foreign reinsurers, it may be necessary to restrict the right of local insurers and reinsurers to enter into contractual relations with foreign reinsurers whose names have not been entered on the register of admitted reinsurers. This means in practice that foreign reinsurers willing to accept business from local companies have to apply for admission and, consequently, to submit all the necessary information about their solvency and competence.

108. The act of admission should be subject to periodic review. If at any time after the admission of a foreign reinsurer, the supervisory authority has reasons to believe that such reinsurer is knowingly in breach of his obligations under the country's laws and regulations, or does not settle balances under reinsurance agreements within a reasonable time, the admission act may be repealed, and such cancellation has to be notified to the reinsurer. The latter would, however, be entitled to make an appeal against the decision to repeal its admission.

109. In the choice of reinsurers, the final responsibility rests always with the ceding company that makes the choice, and the supervisory authority does not incur any liability nor does it guarantee the solvency of the financial viability of the reinsurer.

Chapter IVINTERNATIONAL CO-OPERATION IN THE REGULATION AND
SUPERVISION OF REINSURERS

110. Bearing in mind that regulation is not necessarily a guarantee of the security and credibility of the reinsurer, it is in the interest of both reinsurers and ceding companies that reinsurers provide the maximum information necessary to permit ceding companies to be satisfied with the security and credibility of the reinsurer in question. Unfortunately, there are doubts about whether all reinsurers dealing with the developing countries have been prepared in the past to provide such information - all the more so because there are no recognized standards of information for this purpose.

111. Also, one must question whether, in today's volatile and ever-changing world reinsurance market, it is possible to conceive, through co-operation among supervisory authorities, an international system of reinsurance regulation, under which the supervisory authority in each country would do its bit to ensure that reinsurers under its jurisdiction operate on a sound basis and remain financially solvent. If such a system is established, no doubt a large part of the worries on reinsurance security would disappear.

112. Agreements or co-operation between supervisory authorities in banking, finance, and fiscal sectors are commonplace. Moreover, such international agreements may help to deter individual Governments from acting individually to restrain trade or to interfere with the free flow of business.

113. At the foundation of such a proposed system there would be an international agreement whereby Governments undertake to bring reinsurers within their jurisdiction under some form of licensing procedures and statutory surveillance. The aim of such measures would be to ensure the solvency and stability of reinsurers, and to provide reasonable assurance of the reliability of information which ceding companies use for the selection of their reinsurers.

114. Each country adhering to this international system would make a commitment to recognize licenses granted by other countries joining the international system by giving full credit to reinsurers holding a reinsurer's licence in their country of domicile. In other words, the licensing in one country would ipso facto be taken as licensing in other countries joining the system. Reinsurers that did not satisfy the requirements of licensing in their own countries would thus be automatically barred from other markets. This arrangement would have far-reaching effects on the problem of reinsurance security. Those reinsurers that elect domicile in off-shore areas where no effective and serious regulation exist, would be deprived of the possibility to operate in world markets.

115. As an international agreement on reinsurance regulation and supervision should not affect the prerogatives of every country to enact its insurance laws and to set up its own supervisory system, it may be necessary that such international agreement be based on common regulatory standards. These standards should obviously take into consideration both the international character of reinsurance and the broad objectives of reinsurance supervision.

Steps towards an international reinsurance regulation system

116. Promoting international co-operation and international standardization in the field of reinsurance supervision is clearly the responsibility of Governments. UNCTAD, as a forum for inter-State negotiations, could serve as a vehicle for initiating action in this respect. It might convene an international working group, representing the various interests involved in reinsurance business in developed and developing countries, to discuss the various aspects of reinsurance security and its requirements.

117. Such a working group might then address itself to the idea of reinsurance regulation as an instrument for reinsurance security issues which cannot be settled otherwise. Admittedly, the divergent interests and the keen competition in the reinsurance business would make it difficult to conceive solutions which satisfy everybody. Nevertheless, at a certain point, it would be realized that there are common concerns about reinsurance security and that, through an international co-operative effort, these concerns or some of them can be resolved. All in all, it would be difficult to imagine any coherence in the supervision of international reinsurance if such inter-State co-operation does not exist.

118. If the working group came to look favourably on the idea of an international system for reinsurance supervision, its next task would be to work out some form of standardization of licensing procedures, disclosure, accounting, investments and evaluation. To get the best, in this respect, there will have to be a co-operative effort on the part of the reinsurers as well as by the entire insurance industry in establishing such standards.

119. The findings and recommendations of the working group in the field of reinsurance supervision should be discussed by an international conference, possibly convened by UNCTAD. The ultimate aim of such a conference would be to achieve an international agreement in which individual Governments would undertake to confirm the viability and the financial strength of reinsurers domiciled in their jurisdiction. Such confirmation would be based on a system of domestic supervision of reinsurers deriving its main characteristics from internationally agreed criteria.

120. Even if difficulties arose to prevent a consensus on the proposal for a co-operative international system of reinsurance regulation and supervision, it may be possible to secure agreement on some international standards for reinsurance performance and accounting. Clearly, this would be less effective than agreeing on a comprehensive international system of regulation and supervision, but such standards may still help to deal with many of the problems of reinsurance security and may pave the way for such international agreement in the future.