LICENSING AND SUPERVISION OF INSURANCE BUSINESS

Amendment to Manner and Criteria of Transacting Reinsurance Directive No. 117/2020

Whereas, reinsurance is an important risk management tool that can be used to reduce insurance risk and the volatility of financial results, stabilize solvency, make more efficient use of capital, better withstand catastrophic events, increase underwriting capacity, and draw on reinsurance companies' expertise;

Whereas, reinsurance exposes an insurance company to other risks including counter-party, operational, legal, liquidity, and the combination of these risks can make reinsurance complex and challenging to implement effectively;

Whereas, inadequate reinsurance risk management practices and procedures can materially affect an insurance company's financial soundness and reputation, and can ultimately contribute to its failure;

Whereas, reinsurance policy, program, procedures and practices should be guided, among other things, by the objective of optimizing premium retention but without compromising an insurance company's financial soundness and reputation;

Now, therefore, in accordance with Article 54 of Insurance Business Proclamation No. 746/2012 and Article 64(2) of Insurance Business Proclamation No. 746/2012 as amended by the Insurance Business (Amendment) Proclamation No.1163/2019, the National Bank of Ethiopia hereby issues this Directive.

1. Short Title

This Directive may be cited as **"Amendment to Manner and Criteria of Transacting Reinsurance Directive No. 117/2020".**

2. Definitions

In this Directive, unless the context provides otherwise:

2.1. **“board”** means the board of directors of an insurance company;

2.2. **“capital and reserves”** mean paid up capital and unencumbered reserves;

2.3. **“compulsory cession”** mean cession that an insurance company is required to cede to an Ethiopian reinsurance company;

2.4. **“cover note”** means a confirmation given by a reinsurance company or a broker to a cedant that coverage has been effected. A cover note is provided pending the issuance of a formal and comprehensive reinsurance contract;

2.5. **“credit rating”** means evaluation of credit worthiness or financial strength of a reinsurance company by A.M. Best, Fitch, Moody’s, Standard & Poor’s or any other such credit agencies acceptable to the National Bank;

2.6. **“due diligence”** means research, analysis and assessment of a reinsurance company prior to entering into a reinsurance arrangement;

2.7. **“due from reinsurance company(s)”** refers to receivables from reinsurance companies arising from reinsurance contracts;

2.8. **“due to reinsurance company(s)”** refers to payables to reinsurance companies arising from reinsurance contracts;

2.9. **“Estimated Maximum Loss (EML)”** means the estimated value of the largest expected loss that could result from an event assuming the normal functioning of protective features and proper functioning of most (perhaps not all) active suppression systems such as firefighting appliances;

2.10. **“exposure”** means the maximum amount of loss that an insurance company is liable to pay in respect of a particular risk or series of risks arising out of the occurrence of a certain specified event or events;

2.11. “**facultative reinsurance**” means reinsurance of individual risks by offer and acceptance wherein the reinsurance company retains the ability to accept or reject each risk offered by the ceding company;

2.12. **“fronting”** means an arrangement whereby an insurance company issues a policy on a risk with the intent of reinsuring all or most of that exposure for a fee or premium;

2.13. **“insurance company”** means an entity that issues an insurance policy for a given level of exposure;

2.14. **“large and catastrophic exposure”** means one or more related risks, under the insurance contract, whose consequences are extremely harsh in their severity if occur;

2.15. **“National Bank”** means the National Bank of Ethiopia;

2.16. **‘‘reinsurance”** means an agreement whereby a reinsurance company provides insurance for a risk or risks under-written by an insurance company;

2.17. **“reinsurance broker”** means an entity that places reinsurance for insurance companies or reinsurance companies;

2.18. **“reinsurance company”** means a person that provides protection through the sale of reinsurance contracts;

2.19. “**reinsurance program**” means a program that maps a hierarchical sequence of ceded reinsurance treaties founded on a sound reinsurance management framework and which provides a flexible and effective tool for the management of risks underwritten by an insurance company;

2.20. “**retention”** means the exposure, usually expressed as a monetary amount, which an insurance company keeps for its net account after reinsurance cession. The retention may apply to a single risk or an accumulation of risks materializing from a single event;

2.21. “**risk sharing scheme**” means an offer by an insurance company for placement of risk(s), that exceeded the treaty capacity or which is not within the scope of the treaty, to insurance companies operating in Ethiopia with the view to better utilize the national risk acceptance capacity;

2.22. **“slip”** means reinsurance broker’s confirmation to a cedant that coverage has been effected; and

2.23. **"treaty reinsurance"** means an agreement between an insurance company and a reinsurance company for the cession and assumption of certain risks as defined in the agreement.

3. Scope of Application

This Directive shall apply to all insurance companies.

4. Reinsurance Risk Management Policy and Program

An insurance company shall:

4.1. have a sound reinsurance risk management policy that is integral to its overall enterprise-wide risk management. The Board shall approve the program and monitor its implementation. The policy shall set out:

4.1.1. purpose and objectives of reinsurance, risk diversification objectives and concentration limits;

4.1.2. prohibition against accepting insurance exposures in excess of its net retentions unless reinsurance arrangements are in place;

4.1.3. a prohibition of fronting unless approved by the National Bank;

4.1.4. roles and responsibilities of the persons charged with implementing the policy and scope of their authorities;

4.1.5. types of reinsurance to be used and net retentions (both per risk and per event) for each line of business and the rationale for determining the net retentions, including results of any stress testing used;

4.1.6. criteria and process for selecting reinsurance companies;

4.1.7. criteria for using facultative reinsurance;

4.1.8. liquidity requirements taking into account possible mismatch between the payment of claims and the receipt of reinsurance recoveries; and

4.1.9. matters reserved for review and approval by the Board and Senior Management;

4.2. implement the approved reinsurance policy by formulating a reinsurance program that is consistent with the policy. The Board shall approve the reinsurance program and monitor its performance. Implementation of the reinsurance policy at a minimum shall:

4.2.1. arrange appropriate types of reinsurance, in accordance with the reinsurance policy;

4.2.2. set out limits on the amount and type of insurance that is covered by treaty reinsurance;

4.2.3. exercise due diligence in the process of selecting reinsurance companies and reinsurance brokers in addition to complying with the requirements stipulated under sub-article 5.3 of this Directive;

4.2.4. have specific processes in place to approve, monitor and confirm the placement of each facultative risk which shall be secured before the commencement date of the policy;

4.2.5. ensure compliance with risk sharing scheme;

4.2.6. ensure that reinsurance program and procedures are executed through dedication of adequate resources;

4.2.7. have adequate transaction tracking system, management, reporting and internal control of the overall reinsurance operations; and

4.2.8. be guided by the objectives to maximize retention within the country, develop adequate capacity, secure the best possible protection for the reinsurance costs incurred and simplify the administration of business;

4.3. promptly inform the National Bank in writing if it becomes aware of any reinsurance issues, including downward revision of the credit rating of the reinsurance company involved that could materially impact its financial condition;

4.4. ensure that reinsurance covers, particularly for large and catastrophic exposures, are adequately addressed and determine if the reinsurance arrangements entered into are sufficient to mitigate losses to acceptable levels as prescribed in the reinsurance policy;

4.5. strictly follow the prescription embedded in the reinsurance treaty for receipts, payments and accounting treatment; and

4.6. ensure that reinsurance program, procedures, placements, internal controls and reporting at a minimum conform to respective provisions of this Directive and material deviations from the requirements are reported to Management and the Board as identified.

5. <u>Reinsurance Arrangement</u>

5.1 <u>Retention</u>

5.1.1. Per risk gross retention for any line of business shall not be less than 5% (five percent) and greater than 10% (ten percent) of an insurance company's total capital and reserves. However, such retention should be protected by an appropriate reinsurance (working and catastrophic excess of loss).

5.1.2. If treaty reinsurance agreement dictates or for clear and justifiable reason(s) it becomes imperative to vary the retention limit stipulated under sub-article 5.1.1, the variation shall be notified to the National Bank.

5.1.3. Notwithstanding the provisions of sub-article 5.1.2, an insurance company may adjust the retention limit according to a surveyor's EML; and have in place a protection for EML error.

5.2. <u>Compulsory Cession</u>

An insurance company shall cede at least 25% (twenty five percent) of its treaty cession and 5% (five percent) of each policy it underwrites to a reinsurance company licensed under Insurance Business Proclamation No. 746/2012 as amended by Insurance Business (Amendment) Proclamation No. 1163/2019. The compulsory policy cession shall remain in force for a maximum of five years. In addition, the reinsurance company has the right of first refusal in all facultative placements.

5.3. <u>Use of Credit Rating</u>

5.3.1. An insurance company shall conclude reinsurance agreements with lead reinsurance company(s) rated at least A- or equivalent in a latest credit rating.

5.3.2. An insurance company shall conclude reinsurance agreements with follower reinsurance company(s) rated at least BB or equivalent in a latest credit rating.

5.3.3. Notwithstanding the provisions of sub-article 5.3.1 and 5.3.2 an insurance company may conclude reinsurance contracts with an Ethiopian reinsurance company regardless of rating. Similarly, the provision of sub-article 5.3.1 shall not apply to PTA Re as long as it maintains the B++ rating by A.M. Best or any equivalent rating by any equally recognized rating agency.

5.4. <u>Interim Reinsurance Arrangement Evidences</u>

Until such time of obtaining comprehensive reinsurance contracts, an insurance company shall secure duly signed and sealed cover note(s) and/or confirmation slips, by respective reinsurance companies, which at a minimum sets out:

5.4.1. the classes or risk(s) reinsured;

5.4.2. the period of reinsurance;

5.4.3. the scope of cover ;

5.4.4. the share of risk signed and the premium or consideration;

5.4.5. where applicable, any exclusions to terms of coverage; and

5.4.6. any standard clauses that are to be relied upon or incorporated by reference into the reinsurance contract.

5.5. <u>Final Reinsurance Contracts</u>

An insurance company shall conclude the final reinsurance contracts, including any amendments thereto, bear the duly authorized signature and seal of both the ceding company and the reinsurance company(s) within 45 (forty five) days of the effective date of the commencement of the reinsurance cover.

5.6. <u>Risk Sharing Scheme</u>

5.6.1. For any risk falling outside the scope of its existing treaty or that exceeds its automatic or gross capacity (the sum of its gross retention and treaty capacity) by 30% (thirty percent) an insurance company shall first obtain confirmation of acceptance from a lead facultative reinsurance company rated at least A- or equivalent in a latest credit rating or from an Ethiopian reinsurance company or PTA Re. before offering such risks to local insurance companies**.**

5.6.2. In any facultative arrangement the leading facultative reinsurance company shall be entitled to a priority cession of atmost 20% (twenty percent) of the business placed facultatively.

5.6.3. Any balance shall be offered to at least five insurance companies, an Ethiopian reinsurance company, and then to Africa Re and PTA Re local offices provided that the size of the risk is sufficient enough to involve them, prior to any offer to international reinsurance company(s).

5.6.4. Any offer under the risk sharing scheme shall strictly be on the same terms and conditions with that of the lead reinsurance company.

5.6.5. Under the risk sharing scheme, acceptance of risk by an insurance company in any case shall not exceed its gross capacity or any other applicable limit.

5.6.6. Insurance companies invited under the risk sharing scheme shall respond to an offer in writing whether or not they have accepted the offer within two working days or 48 hours.

5.6.7. If insurance companies fail to respond to the offer made to them in line with the risk sharing scheme within two working days, the underwriting insurance company shall place the risk with international reinsurance companies.

6. Accounting Treatment

6.1. An insurance company shall strictly follow the prescription embedded in a reinsurance treaty in so far as handling the accounting of the treaty is concerned.

6.2. Due to reinsurance companies shall be paid or cleared in accordance with the terms and conditions of the reinsurance agreements.

6.3. Claims shall be reported to the reinsurance company(s) in accordance with the terms and conditions of the reinsurance agreements.

6.4. Due from reinsurance companies shall be collected or cleared in accordance with the terms and conditions of the reinsurance agreements.

6.5. Due to and due from reinsurance companies shall be reported separately in the balance sheet.

6.6. All reinsurance transactions shall be reconciled at least once in a year and due to and due from balances, with respect to subsidiary and controlling accounts, shall be clearly documented and reported separately in the interim and audited statements.

7. Documentation on Reinsurance

An insurance company shall:

7.1. maintain a sound and comprehensive reinsurance policy as specified under sub-article 4.1 that shall be subject to revision whenever appropriate and at least once in every three years;

7.2. document the steps taken to ensure the adequacy and effectiveness of the reinsurance arrangements, particularly for large and catastrophic exposures;

7.3. document the manner in which it determines the net retention limits for each class of business, including the assumptions underlying the setting of such retentions;

7.4. keep a sheet that summarizes the calculation of EML, whenever applied, in respective policy files;

7.5. maintain documents evidencing the interim reinsurance arrangements, such as slip and/or cover note, and final reinsurance contract for all classes of business in timely and orderly manner; and

7.6. maintain written communication documents pertaining to risk sharing scheme.

8. <u>Submission of Documents to the National Bank</u>

An insurance company shall:

8.1. submit its reinsurance program to the National Bank, within 90 days after coming in to force of this Directive;

8.2. notify the National Bank, within 30 days, of any changes made to the reinsurance program;

8.3. deliver copies of its reinsurance contracts to the National Bank, within 60 days of the signing of the contracts;

8.4. provide to the National Bank, 15 days prior to the commencement of the insurance company's financial year, a description of its reinsurance program, copies of cover notes and/or slips and information on credit rating of its reinsurance companies together with information on their participation; and

8.5. provide the National Bank with any other information with respect to its reinsurance that the National Bank may require.

9. Prohibitions

9.1. An insurance company shall not accept risks in excess of its retention limits unless the necessary reinsurance arrangement is in place.

9.2. Fronting is prohibited.

10. Repeal

Manner and Criteria of Transacting Reinsurance Directive No. SIB/44/2016 is hereby repealed and replaced by this Directive.

11. Effective Date

This Directive shall enter into force as of the 17th day of August 2020.