



IAIS

INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

Public

INSURANCE CORE PRINCIPLES, STANDARDS, GUIDANCE AND ASSESSMENT METHODOLOGY

ICP 13 (revised)

as adopted on 2 November 2017

ICP 13 Reinsurance and Other Forms of Risk Transfer

The supervisor requires the insurer to manage effectively its use of reinsurance and other forms of risk transfer. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.

Introductory Guidance

- 13.0.1 Reinsurance refers to insurance purchased by an insurer (the ceding insurer) to provide protection against certain risks, primarily underwriting risks of the insurance policies issued by the insurer. Reinsurers assume these risks in exchange for a premium. Other forms of risk transfer include alternative reinsurance arrangements, such as risk transfer to the capital markets. For simplicity, this ICP uses “reinsurance” to refer to both mainstream reinsurance and other forms of risk transfer.
- 13.0.2 Geographical diversification of risk, which typically involves risk transfer across jurisdictional borders, is a key element of ceding insurer’s and reinsurer’s capital and risk management. Geographical diversification can also have an impact in the jurisdiction of the ceding insurer, in particular jurisdictions exposed to catastrophes. By ceding insurance risk across borders, ceding insurers in the jurisdiction, and the jurisdiction as a whole, can benefit from a reduced concentration of insurance risk exposures at the ceding insurer and jurisdiction level respectively. This may also contribute to the financial stability of the jurisdiction.
- 13.0.3 Ceding insurers and reinsurers may face external limitations to geographical diversification, for example, in the form of constraints to cross-border risk transfer. The supervisor should be aware of and take into account the potential impacts of such limitations on individual ceding insurers and reinsurers as well as on the soundness and efficiency of the insurance market.
- 13.0.4 A reinsurance contract is one of indemnity between the reinsurer and ceding insurer and does not constitute a legal transfer of part of the underlying risk in the same way as, for example, a novation. Nonetheless, reinsurance contracts have the effect of transferring part of the underlying risk in an economic sense. The supervisor should remain aware that while reinsurance transfers insurance risk from the ceding insurer to the reinsurer, it also creates other risks. In a standard transaction, the ceding insurer reduces its insurance risk and assumes other risks such as credit, operational and basis risk; the reinsurer assumes risks such as insurance, timing, operational and credit risk.

13.0.5 A reinsurance contract is by nature a business-to-business transaction, made between professional counterparties as part of a wider risk and capital management approach. For this reason, the sort of asymmetry of expertise and knowledge associated with insurance contracts involving general consumers is usually not an issue in the reinsurance sector, although some asymmetry of bargaining power can exist, depending on the precise dynamics of the market. Thus, typically, it is not necessary for the supervisor to seek the same level of protection for ceding insurers as it does for general consumers (see ICP 19 Conduct of Business).

13.0.6 The supervisor should be able to assess whether ceding insurers make effective use of reinsurance. This involves gaining an understanding of, and comfort with, at a minimum:

- the ceding insurer's reinsurance strategy and reinsurance programme,
- the systems of risk management and internal controls put in place in order to implement the reinsurance strategy and execute the reinsurance programme,
- the economic impact of the risk transfer originating from the ceding insurer's reinsurance programme, and
- the impact of reinsurance on the ceding insurer's liquidity management.

13.0.7 The standards and guidance under this ICP are applicable to insurers and reinsurers, thus throughout this ICP:

- references to ceded reinsurance should be taken to include ceded retrocession (i.e. the reinsurance ceded by reinsurers);
- references to ceding insurers should be taken to include ceding reinsurers (i.e. retrocedants); and
- references to reinsurers should be taken to include retrocessionaires (i.e. reinsurers that assume reinsurance from ceding reinsurers).

13.1 The supervisor requires ceding insurers to have a reinsurance programme that is appropriate to their business and part of their overall risk and capital management strategies.

13.1.1 A ceding insurer's risk and capital management strategies should clearly articulate the part played by reinsurance, in particular:

- the objectives that are pursued by using reinsurance;
- the risk concentration levels and ceding limits as defined by the ceding insurer's risk appetite; and
- the mechanisms to manage and control reinsurance risks.

- 13.1.2 When articulating the part played by reinsurance in the overall risk and capital management strategies, the ceding insurer should take into account its business objectives, levels of capital and business mix, with particular reference to:
- risk appetite (both gross limit and net retention);
 - peak exposures and seasonality in the insurance book;
 - levels of diversification in the insurance book; and
 - appetite for credit risk posed by reinsurers.
- 13.1.3 The reinsurance programme comprises the detailed implementation of the reinsurance related elements of the risk and capital management strategies in terms of coverage, limits, deductibles, layers, signed lines and markets used. It should reflect the ceding insurer's overall risk appetite, comparative costs of capital and liquidity positions determined in the reinsurance strategy. Therefore, reinsurance programmes can vary significantly in complexity, levels of exposure and number of participants.
- 13.1.4 In some instances, an insurer may have a business strategy and risk appetite to retain all risk and therefore a reinsurance programme would not be necessary.
- 13.1.5 Senior Management develops the reinsurance related elements of the risk management strategy as well as the reinsurance programme. Senior Management is also responsible for establishing appropriate systems and controls to ensure that these are complied with. The Board is responsible for approving the strategy and ensuring an appropriate oversight and consistent implementation of the reinsurance programme.
- 13.1.6 Senior Management of the ceding insurer should regularly review the performance of its reinsurance programme, to ensure that it functions as intended and continues to meet its strategic objectives. It is likely that such a review would take place as part of the feedback loop that is part of the risk management framework.
- 13.1.7 The supervisor should understand the ceding insurer's business objectives and strategies, how reinsurance fits into these, and assess the extent to which objectives and strategies are adequately reflected in the reinsurance programme. The supervisor should challenge the ceding insurer where it identifies inconsistencies between the objectives and strategies and the reinsurance programme.
- 13.1.8 The supervisor's assessment of a ceding insurer's reinsurance programme should be based on a number of factors, such as the:
- structure of the programme, including any alternative risk transfer mechanisms;

- proportion of business ceded so that the net risks retained are commensurate with the ceding insurer's financial resources and risk appetite;
- financial strength and claims payment record of the reinsurers in question (both in normal and stressed conditions);
- levels of exposure to a single reinsurer or different reinsurers being part of the same group;
- extent of any credit risk mitigation in place;
- expected resilience of the reinsurance programme in stressed claims situations, including stress related to the occurrence of multiple and/or catastrophic events;
- cession limits, if any, applicable in the jurisdiction;
- the supervisory regime in place in the jurisdiction of the reinsurer.
- level of effective risk transfer; and
- extent to which relevant functions are outsourced by the ceding insurer, including the criteria for the selection of reinsurance brokers.

Group perspectives

13.1.9 The group-wide supervisor should require a reinsurance strategy for the insurance group that includes the following issues:

- its interaction with the group-wide risk and capital management strategies;
- how the risk appetite is achieved, on both a gross limit and net retention basis;
- the appetite for reinsurer credit risk, including approved security criteria for reinsurance transactions and aggregate exposure criteria to individual or related reinsurers;
- the autonomy afforded to individual insurance legal entities to enter into "entity specific" reinsurance arrangements, and the management and the aggregation of these exposures in the group-wide context;
- procedures for managing reinsurance recoverables, including required reporting from insurers;
- intra-group reinsurance strategy and practice; and
- use of alternative risk transfer, including capital markets risk transfer products.

13.2 The supervisor requires ceding insurers to establish effective internal controls over the implementation of their reinsurance programme.

- 13.2.1 Control of the reinsurance programme should be part of the ceding insurer's overall system of risk management and internal controls (see ICP 8 Risk Management and Internal Controls). The supervisor should require that the controls and oversight in place are suitable in the context of the ceding insurer's business.
- 13.2.2 The ceding insurer should ensure that the characteristics of its reinsurance programme, including the credit risk posed by the reinsurer, are reflected in its capital adequacy assessment as well as its ORSA (See ICP 16 Enterprise Risk Management for Solvency Purposes).

Credit risk posed by the reinsurer

- 13.2.3 When developing the reinsurance programme the ceding insurer should consider its appetite for reinsurer credit risk. Reinsurers may face solvency issues, leading to delayed payment or default, and this can have significant consequences for the solvency and liquidity of the ceding insurer.
- 13.2.4 In practice, ceding insurers have various options to mitigate reinsurer credit risk, for example:
- establishing criteria on the financial strength and claims payment record of eligible reinsurers;
 - setting limits on risks ceded to a single reinsurer;
 - ensuring a spread of risk amongst a number of reinsurers;
 - incorporating rating downgrade or other special termination clauses into the reinsurance contract;
 - requiring the reinsurer to post collateral (the ability to require this may depend upon the relative commercial strengths of the ceding insurer and reinsurer);
 - proactively monitoring reinsurance claims recoveries; and
 - withholding reinsurer's funds.

Approved security criteria

- 13.2.5 The ceding insurer should have in place procedures for identifying reinsurers that meet its security requirements. If a ceding insurer develops a pre-approved list of reinsurers, there should also be processes for dealing with situations where there is a need to assess reinsurers outside any pre-approved list. Ceding insurers may have their own credit committees to make their own assessment of the risk.
- 13.2.6 In line with other approaches to identifying appropriate reinsurers, any approved security criteria should be derived from a high level statement of what reinsurance security will be acceptable to the ceding insurer, which may be based on:

- external opinions;
- the ceding insurer's own view of the reinsurer;
- minimum levels of capital;
- duration and quality of relationship;
- expertise of the reinsurer;
- levels of retrocession;
- reinsurance brokers' security criteria; or
- a mixture of these and other factors.

Aggregate exposure limits or guidelines

- 13.2.7 A ceding insurer should set prudent limits or guidelines reflecting security and size of the reinsurer, in relation to its maximum aggregate exposure to any one reinsurer or to a group of related reinsurers, which would be complementary to any supervisory limits or guidelines.
- 13.2.8 The ceding insurer should have in place procedures for monitoring this aggregate exposure to ensure that these limits or guidelines are not breached. The ceding insurer should also have procedures to manage excess concentrations going forward, such as bringing them back within limits or guidelines.

Matching of underlying underwriting criteria

- 13.2.9 The ceding insurer should give due consideration to the risk posed by a mismatch in terms and conditions between reinsurance contracts and the underlying policies. The ceding insurer may bear a greater net exposure than it initially intended because of this gap.

Criteria and procedures for purchasing facultative cover

- 13.2.10 The ceding insurer should have appropriate criteria in place for the purchase of facultative coverage. Any facultative reinsurance coverage bought should be linked to the procedures for aggregations and recovery management.
- 13.2.11 The ceding insurer should have a specific process in place to approve, monitor and confirm the placement of each facultative risk. If facultative reinsurance is necessary to ensure that acceptance of a risk would not exceed maximum net capacity and/or risk limits, such reinsurance should be secured before the ceding insurer accepts the risk.

Operational risk related to contract documentation

- 13.2.12 In order to reduce the risk and scope of future disputes, the ceding insurer and the reinsurer should have in place processes and adequate controls to document the principal economic and coverage terms and conditions of reinsurance contracts clearly and promptly.
- 13.2.13 Ceding insurers and reinsurers should finalise the formal reinsurance contract without undue delay, ideally prior to the inception date of the reinsurance contract.
- 13.2.14 All material reporting due to and from reinsurers should be timely and complete, and settlements should be made as required by the reinsurance contract.
- 13.2.15 The ceding insurer should consider how its reinsurance contracts will operate in the event of an insolvency of itself or its reinsurer.
- 13.2.16 The supervisor should have access, on request, to material reinsurance documentation. In case of indications of significant uncertainties in terms of reinsurance documentation, the supervisor should take into account the resulting underwriting, operational and legal risks when considering the effects of reinsurance on the ceding insurer's solvency.

13.3 The supervisor requires ceding insurers to demonstrate the economic impact of the risk transfer originating from their reinsurance contracts.

- 13.3.1 The supervisor should regard as a reinsurance contract an agreement that transfers sufficient insurance risk to be considered insurance under jurisdictional rules.
- 13.3.2 In general, a contract should be considered as a loan or deposit if, during its development, the ceding insurer has the unconditional obligation to indemnify the reinsurer for any negative balances that may arise out of the contractual relationship. This characteristic does not result in risk transfer. All liabilities of the ceding insurer should be contingent on the proceeds of the underlying insurance business.
- 13.3.3 Upon request from the supervisor, the ceding insurer should provide sufficient information about its reinsurance contracts to allow the supervisor to make informed judgments about the substance of the risk transfer (i.e., the degree of risk transfer in an economic sense).
- 13.3.4 Where there are concerns of inappropriate reporting with respect to the degree of risk transfer, the supervisor should assess the substance of the reinsurance contract entered into by the ceding insurer and how it has been reported by the ceding insurer. Further, the supervisor should be able to assess the impact that the ceding insurer's reinsurance contracts have on the ceding insurer's capital requirements. The supervisor should challenge Senior Management of the ceding insurer on the purpose of individual contracts where appropriate.

Finite reinsurance

- 13.3.5 Finite reinsurance is a generic term that, for the purposes of this ICP, is used to describe a spectrum of reinsurance arrangements that transfer limited risk relative to aggregate premiums that could be charged under the contract.
- 13.3.6 Finite reinsurance transactions are legitimate forms of reinsurance arrangements; however, it is essential that they are accounted for appropriately. In particular, only contracts that transfer sufficient insurance risk in order to meet the requirements of the relevant accounting standards in force in each jurisdiction can be accounted for as reinsurance.
- 13.3.7 The supervisor should pay particular attention to reinsurance contracts that have, or appear to have, limited levels of risk transfer which may change over the duration of the contract. Only the amount of risk transferred under finite reinsurance contracts should be included in the regulatory capital calculations of the ceding insurer.

13.4 When supervising ceding insurers purchasing reinsurance across borders, the supervisor takes into account the supervision performed in the jurisdiction of the reinsurer.

- 13.4.1 The cross-border nature of reinsurance transactions, together with the relative sophistication of the market participants involved in reinsurance, are key elements that the supervisor should consider when supervising ceding insurers.
- 13.4.2 Taking into account the supervision performed in the jurisdiction of the reinsurer may help the supervisor to assess the overall risk profile of the ceding insurer. This can be done, for example, by reviewing the supervisory framework and practices in the jurisdiction of the reinsurer, or by engaging in supervisor-to-supervisor dialogue.

Supervisory recognition

- 13.4.3 The supervisor can benefit from relying on supervision performed in the jurisdiction of the reinsurer. Benefits may include, for example, strengthened supervision as well as a more efficient use of resources by the supervisor of the ceding insurer.
- 13.4.4 Where supervisors choose to recognise aspects of the work of other supervisory authorities, they should consider putting a formal supervisory recognition arrangement in place (see ICP 3 Information Exchange and Confidentiality Requirements).
- 13.4.5 Supervisory recognition can be conducted through unilateral, bilateral and multilateral approaches to recognition. All three approaches recognise the extent of equivalence, compatibility or, at least, acceptability of a counterparty's supervisory system. Bilateral and multilateral approaches typically incorporate a mutuality component to the recognition element, indicating that this is reciprocal.

13.5 The supervisor requires the ceding insurer to consider the impact of its reinsurance programme in its liquidity management.

- 13.5.1 Given the nature and direction of cash flows within a ceding insurer, liquidity risk historically has not been considered to be a major issue in the insurance sector. However, there can be liquidity issues within an individual ceding insurer which could arise specifically from the ceding insurer's reinsurance programme.
 - 13.5.2 Reinsurance contracts do not remove the ceding insurer's underlying legal liability to its policyholders. The ceding insurer remains liable to fund all valid claims under contracts of insurance it has written, regardless of whether they are reinsured or not. For this reason, a large claim or series of claims could give rise to cash flow difficulties if there are delays in collecting from reinsurers or in the ceding insurer providing proof of loss to reinsurers.
 - 13.5.3 The supervisor should require ceding insurers to take appropriate measures to manage their liquidity risk, including funding requirements in adverse circumstances. As with all risks, the insurer should develop its own response to the level of risk it faces and the supervisor should assess these responses. There are a number of ways in which liquidity risk may be mitigated. For example, some insurers choose to arrange a line of credit from a bank in order to deal with short-term liquidity issues.
 - 13.5.4 Ceding insurers may make arrangements with their reinsurers in order to mitigate their liquidity risk. These arrangements, if used, may include clauses that trigger accelerated payment of amounts due from reinsurers in the event of a large claim and/or the use of collateral or deposit accounts, giving ceding insurers access to funds as needed. Use of such arrangements is a commercial matter between the ceding insurer and reinsurer.
 - 13.5.5 13.5.5 External triggers can give rise to liquidity issues, especially where reinsurers have retroceded significant amounts of business. If a reinsurance contract contains a downgrade clause that gives the ceding insurer the right to alter the contract provisions, or obliges the reinsurer to post collateral with a ceding insurer to cover some or all of its obligations to that ceding insurer, such action may cause liquidity issues among reinsurers and may be pro-cyclical. Therefore, the supervisor should be aware of the potential consequences of such triggers for the overall efficiency and stability of the market.
- 13.6 In jurisdictions that permit risk transfer to the capital markets, the supervisor understands and assesses the structure and operation of such risk transfer arrangements, and addresses any issues that may arise.**
- 13.6.1 A wide range of techniques has been developed to allow the transfer of insurance risk to the capital markets, resulting in a diversity and complexity of risk transfer arrangements.
 - 13.6.2 In general, arrangements used to enable risk transfer to the capital markets operate like mainstream reinsurance. For example, risk is

transferred via a reinsurance contract with similar terms and conditions to any other reinsurance contract. Further, the risk assuming entity is a reinsurer subjected to licensing conditions like any other reinsurer. The defining feature of these risk transfer arrangements is the direct funding of the reinsurance risk exposure with funds raised, often exclusively, in the capital markets.

13.6.3 Insurance risk transfer to the capital markets can occur by making use of a wide variety of arrangements. Arrangements in the non-life sector are often broadly classified into four groups: 1) catastrophe bonds (cat bonds); 2) collateralised reinsurance; 3) industry loss warranties (ILWs); and 4) sidecars. These four groups, which are not mutually exclusive, focus on different elements of the risk transfer arrangements:

- cat bonds take the name from the financial instrument (i.e. a debt security) issued to fund an insurance exposure, usually a catastrophe;
- collateralised reinsurance is generally used to highlight a credit risk mitigation feature of certain insurance transactions (i.e. the collateralisation of the insurance exposure);
- ILWs refer to a range of financial instruments used by counterparties, who may or may not be insurers, to buy or sell protection related to insurance risks; and
- sidecars refer to a legal entity created 'on the side' of an insurer that is used to transfer insurance risk, usually to the capital markets.

To illustrate that these are not mutually exclusive, there could be a sidecar that underwrites insurance risk via an ILW and funds the exposure through an issuance of cat bonds, the proceeds of which are used to collateralise the reinsurance risk assumed.

13.6.4 In the life sector, some arrangements are similar to the non-life sector (for example, mortality bonds, which operate like cat bonds). Other life insurance arrangements have specific features that are not used in non-life insurance, such as the funding of certain portions of the ceding insurer's reserves.

13.6.5 Despite the many similarities with mainstream insurance, transactions transferring insurance risk to the capital markets have special features that the supervisor should bear in mind in order to assess the appropriateness and effectiveness of their use by ceding insurers and reinsurers.

Initial assessment

13.6.6 Insurance risk transfer to the capital markets usually entails the creation of a dedicated entity or a legally ring-fenced arrangement, specifically constituted to carry out the transfer of risk. These are

referred to by a variety of names, such as special purpose vehicles, special purpose reinsurance vehicles, or special purpose insurers; for the purpose of this ICP, they are collectively referred to as special purpose entities (SPEs).

13.6.7 The main purpose of an SPE is to assume insurance risk, funding the exposure by raising funds in the capital markets, and to be dismantled once its purpose has been fulfilled. Importantly, as SPEs conduct insurance business, the supervisor should consider licensing them as insurers (see ICP 4 Licensing). Licensing of SPEs should be appropriately tailored to take into consideration the unique characteristics of SPEs. In this respect, close collaboration among those supervising ceding insurers and those supervising SPEs before authorisation of the SPE and on an on-going basis can be particularly helpful.

13.6.8 Key elements of any SPE structure include:

- the insurance risk that it assumes is “fully funded” (i.e., that the exposure taken by the SPE is funded across a range of foreseeable scenarios from the time the SPE goes on risk to the time it comes off risk);
- the claims of any investors in the SPE are subordinate to those of the ceding insurer; and
- the investors in the SPE have no recourse to the ceding insurer in the event of an economic loss.

13.6.9 In order to be able to understand and assess whether an SPE structure meets the criteria above, the supervisor should take the following into account:

- ownership structure of the SPE;
- suitability of the Board and Senior Management of the SPE;
- the SPE's management of credit, market, underwriting and operational risks;
- investment and liquidity strategy of the SPE; ranking and priority of payments;
- extent to which the cash flows in the SPE structure have been stress tested;
- arrangements for holding the SPE's assets (e.g. trust accounts) and the legal ownership of the assets;
- extent to which the SPE's assets are diversified; and
- use of derivatives, especially for purposes other than risk reduction and efficient portfolio management.

13.6.10 Understanding the role of all the parties to the SPE arrangement is critical to understanding the underlying risks, particularly as these

may be fundamentally different from those involved in a traditional reinsurance transaction. The supervisor should understand and assess, among other things, the:

- extent to which key parties have been fully disclosed (e.g. sponsor, (re)insured, investors, advisors, counterparties) and are known to the supervisor;
- extent to which potential conflicts of interest between all parties to the SPE have been adequately disclosed and addressed (such as situations where sponsors also take a managing role);
- credit risk associated with key service providers, including financial guarantors used to protect the position of investors.
- degree of basis risk that is assumed by the ceding insurer and to what extent this could have immediate ramifications for the ceding insurer's financial position in case of a loss;
- details of the SPE's management arrangements and key personnel;
- third party assessments of the SPE structure (e.g. by credit rating agencies);
- expertise of the legal advisors involved;
- robustness of any financial or actuarial projections, if applicable (e.g. if triggers are indemnity based); and
- disclosure of outsourcing agreements.

13.6.11 As many SPEs are designed to operate with a minimum of day-to-day management, the supervisor should understand and assess the extent to which the systems of risk management and internal controls are adequate and proportionate to the nature of the underlying risks and to the complexity and expected lifespan of the SPE structure.

13.6.12 The systems of risk management and internal controls of the SPE should ensure that, at a minimum:

- investment restrictions are not breached;
- interest payments, dividends, expenses and taxes are properly accounted for;
- movements above established thresholds in assets and collateral accounts are reported;
- assets are legally existent and technically identifiable; and
- liabilities can be determined on a timely and accurate basis and obligations satisfied in accordance with the underlying contracts.

13.6.13 The supervisor should understand and assess:

- the systems of risk management and internal controls of the SPE, particularly the extent to which these are sufficient to ensure effective operation in compliance with the SPE's legal and supervisory obligations; and
- operational risks within the SPE structure and any mitigation arrangements.

Basis risk

- 13.6.14 The supervisor should understand and assess the extent to which SPE arrangements give rise to basis risk. This arises where the trigger for indemnity under the SPE arrangement is different from the basis on which underlying protected liabilities can arise.
- 13.6.15 Where SPEs contain indemnity triggers (i.e., recovery from the SPE is based on the actual loss experience of the ceding insurer) basis risk is unlikely to be an issue. However, many SPEs contain non-indemnity triggers, such as parametric triggers (driven by objectively measurable events) or modelled triggers (driven by the outcome of modelled, industry-wide losses). In such cases, there may be events where the ceding insurer will remain exposed to its underlying policyholders without having recourse to the SPE.
- 13.6.16 Basis risk should be considered with reference either to the amount of credit given by the supervisor of the ceding insurer for the SPE arrangement or in the capital requirement of the ceding insurer, where such mechanisms are used.
- 13.6.17 Additionally, in some jurisdictions the accounting and regulatory treatment of insurance risk transfer that uses non-indemnity triggers may be different from the accounting treatment of indemnity-based insurance. The supervisor should understand these accounting differences and the impact these may have on the financial statements of the ceding insurer and the reinsurer.

Ongoing Supervision

- 13.6.18 The supervisor should understand the various issues that emerge in the ongoing supervision of SPEs and their use. Consideration should be given to the following areas:
- measures to be taken by the supervisor if any of the licensing or authorisation conditions are breached;
 - level of capital and ability of the SPE to continue to respond adequately should covered events occur;
 - level of reporting required by the supervisor in order to understand and assess whether the SPE is complying with its obligations;
 - the SPE's response in the event of fluctuations in the values of invested assets (e.g. match/mismatch between collateral

account and exposure, flow of premiums, fees, commissions);

- arrangements put in place in the SPE to ensure that the “fully funded” condition is maintained in the case that the insurance risks assumed are rolled over from one risk period to another; and
- where the SPE undertakes multiple transactions, arrangements put in place in the SPE to ensure that the funds corresponding to each transaction are appropriately segregated and legally insulated.

Unwinding of SPE arrangements

13.6.19 The unwinding of SPEs is often influenced by the dynamics of insurance losses. The supervisor should understand and gain comfort with the provisions in place to require orderly unwinding of SPEs. In particular, the supervisor should understand the process related to the generation, mitigation and management of any residual risk emerging from the unwinding of the SPE.

13.6.20 In addition, the supervisor should understand the process and stages that the SPE goes through when it comes to a natural end and its obligations have been fulfilled and the SPE is liquidated. There is a distinction between unwinding in the event of a loss and unwinding a transaction reaching legal maturity (without a loss having occurred). While the latter case is usually simple and straightforward, unwinding in a full or partial loss situation deserves close attention. Consideration should be given to the following areas:

- issues relating to share buy-back and conditions to its materialisation;
- issues relating to disposal of the investment portfolio;
- “dismantling” of the SPE and residual risks;
- where the SPE undertakes multiple transactions, issues relating to the segregation and legal insulation of assets per transaction; and
- supervisory issues relating to risks which revert to the ceding insurer on termination of the arrangement.

Considerations for supervisors of insurers ceding risks to SPEs

13.6.21 Although in many jurisdictions insurance risk transfer to the capital markets is not permitted, the supervisor should consider that some of the insurers in its jurisdiction may be transferring insurance risk to SPEs located in another jurisdiction that permits insurance risk transfer to the capital markets. In this case, the supervisor of the ceding insurer should consider, among other things:

- whether the risk transfer taking place involves an SPE that is licensed in the jurisdiction where the insurance risk is assumed;
- the supervisory regime to which the SPE is subject in its jurisdiction; and
- the extent to which the ceding insurer has adequately provided for the identification, assessment and management of the risks associated with transferring insurance risk to an SPE (e.g. credit risk, basis risk).