



To: President Zhu Jinyuan
Insurance Association of China
Floor 7, Xinmao Building
No.15, Jinrong Street, Xicheng District
Beijing 100140 China

Date: 18 December 2014

Subject: GFIA concerns on C-ROSS's treatment of foreign reinsurers and the new rules for Credit Rating Agencies

Dear Mr. Jinyuan,

On behalf of the Global Federation of Insurance Associations (GFIA), whose 38 member associations represent insurers which account for approximately 87% of total insurance premiums worldwide, and in accordance with our mission to comment on a broad range of issues affecting the insurance industry internationally, we are pleased to offer these comments reflecting our concern over several draft provisions in the China Risk Oriented Solvency System (C-ROSS). In our view, these provisions would impose excessive capital charges and collateral requirements on cross-border transactions between Chinese ceding insurers and reputable, financially sound reinsurers located in foreign jurisdictions.

The GFIA supports strong prudential regulation of the insurance and reinsurance industry and open and competitive markets, which best serve consumers as well as insurers and reinsurers.

The GFIA welcomes C-ROSS as a significant step in the modernization of China's solvency regime in alignment with the global trend toward risk-oriented capital requirements. We strongly support the improvement of policyholder protections and internal market developments promised by C-ROSS, and believe C-ROSS to be an important advance in the development of the insurance industry in China.

However, we believe that some of the requirements in the current draft of C-ROSS deserve careful reconsideration. We are concerned in particular by provisions in two areas:

- i. Requirements that overweigh credit risk resulting from the cession of reinsurance to international reinsurers which would disadvantage foreign reinsurers; and
- ii. Proposed rules for Credit Rating Agencies (CRAs), that would have a significant negative impact on the operation of (re)insurance companies in China.

We provide below additional detail on these two areas of concern.

i. C-ROSS treatment of foreign reinsurers

The GFIA believes that reinsurance cessions to international underwriters do not warrant higher capital charges simply because such reinsurers are not supervised by the China Insurance Regulatory Commission (CIRC). Any concerns that CIRC may have about the standing of international reinsurers can be readily resolved through direct contact with jurisdictional insurance supervisors. As such, we recommend that CIRC subject cross-border transactions with reinsurers domiciled in reputable, cooperative jurisdictions to the same rules and requirements as those applied to on-shore reinsurers, and not impose unnecessary collateral requirements or excessive capital charges. The global reinsurance market is made up of a diverse set of reinsurance groups that are predominantly domiciled in these jurisdictions outside of China: Bermuda, the European Union, Japan, Switzerland and the United States. Each of these jurisdictions observe the international insurance standards (such as the International Association of Insurance Supervisors' (IAIS) Insurance Core Principles (ICPs)), and all participate (or have member states that participate) in the IAIS's Mutual Memorandum of Understanding (MMOU).

C-ROSS specifically should not disadvantage foreign providers of reinsurance so long as (i) the jurisdiction of their domicile is credible, and (ii) the reinsurers themselves are suitably financially sound as measured by either the regulatory requirements in their own jurisdictions or the financial strength tests of the CRAs.

We believe that the draft provisions impose excessive capital charges on Chinese insurers using international reinsurance and inevitably will make the local reinsurance market less competitive, thereby increasing prices for Chinese consumers. The draft provisions may well lead to a concentration of risk on Chinese domestic reinsurers, which in turn will make it difficult to increase insurance penetration in China. This would actually run counter to the sound goal of increasing insurance penetration to better manage catastrophic risk pronounced by the State Council earlier this year in the "Several Opinions of the State Council on Accelerating the Development of the Modern Insurance Service Industry in the People's Republic of China".

China's rapid development into the world's largest economy will lead to an increasing demand for insurance market capacity. A large share of this needed reinsurance can come from China and its domestic companies, but another large share will need to come from international reinsurers by necessity. However, the currently envisaged rules risk deterring the cession of reinsurance to international reinsurers, which in turn will increase concentration among Chinese reinsurers. Such geographic concentration of risk is imprudent and can endanger the functioning and stability of Chinese society and economy.

The global reinsurance market has the proven capacity to absorb "mega events". Statistics on global catastrophic losses documented by the Global Reinsurance Forum indicate that reinsurance has absorbed between 40% and 65% of insured losses from large disasters.ⁱ For example, global insured catastrophic losses in 2011, amounting to some USD 105 billion, were the highest ever recorded in a single year. The bulk of such losses were incurred in Asia and Oceania. And yet, insurance capital remained ample. This was because some USD 48 to 50 billion (62%) were covered by reinsurers rather than borne by primary insurers, and much of the reinsured share was ceded to international rather than domestic reinsurers.ⁱⁱ In

addition, a Bank of International Settlements' research paper concluded that economic growth, quicker recovery and hazard mitigation incentives are all tied to increased insurance penetration and the use of reinsurance to protect against natural disaster events.ⁱⁱⁱ

ii. Rules for CRAs

The GFIA believes that the proposed rules for CRAs would have a significant negative impact on the operation of (re)insurance companies in China. For example:

- In the current proposal, CRAs will rate local firms as standalone entities, without reference to, or recognition of, the capital strength, rating, oversight framework and management of the parent. The GFIA believes that such recognition should occur, and that credit should be given to the subsidiary for the parent's financial, economic and legal situation.
- With this proposal, it is doubtful that many of the existing CRAs used by (re)insurers would currently meet the criteria specified. This would create additional costs for companies that would have to use a different team of analysts in the rating process.
- The proposed rating system ignores the fact that existing international CRAs have their own highly developed, internationally recognised, grading systems based on specific publicised methodologies which (re)insurers and their customers understand and are familiar with.
- We believe that foreign reinsurers may suffer further unfair disadvantages because onshore and cross-border CRAs will differ. Onshore reinsurers will be rated by CRAs registered in China while large international CRAs are generally barred from operating in China. As a result, onshore and foreign reinsurers will be rated by different CRAs using different methodologies.

The provisions on credit ratings should be revised. For example, the current calculation of credit risk minimum capital in Appendix 7 disadvantages cross-border reinsurers. This is because it imposes different base factors in determining the credit rating of domestic and international reinsurers.

The GFIA further believes that the draft provisions on CRAs should be re-evaluated to take into account the solvency capital adequacy ratio of the foreign reinsurer as a whole.

Conclusion

In sum, we believe that higher capital charges and collateral requirements for international reinsurance:

- Will lead to higher concentration of risk within China that will eventually undermine the financial standing of some local insurers;
- Will lessen competition in the Chinese market, which in turn will lead to higher prices for Chinese policyholders;
- Deprive local reinsurers of the benefit of diversification of risk which in turn will lower their own capital costs;
- Deny China the benefit of infusion of foreign capital post-event;
- Impede the development of joint venture partnerships between the government and foreign (re)insurers, which may be desirable.

Therefore the GFIA would like to make the following comments:

- Cross-border reinsurers from reputable jurisdictions should be treated the same way as on-shore reinsurers and therefore not subject to unnecessary collateral requirements, and cedents doing business with these reinsurers should not be subject to additional and excessive capital charges;
- If collateral requirements are to be imposed, then they should be substantially reduced based on the financial standing of the reinsurer as measured by the CRAs;

GFIA would welcome the opportunity to share these views directly with CIRC officials in detail at CIRC's convenience prior to the finalization of C-ROSS.

Sincerely,



GOVERNOR DIRK KEMPTHORNE,
Chair, Global Federation of Insurance Associations

GFIA contact:

Brad Smith, Chair of the GFIA Trade Working Group, BradSmith@acli.com

ⁱ *Global Reinsurance Forum, Global reinsurance: strengthening disaster risk resilience, September 2014, page 10*

ⁱⁱ *Association of Bermuda Insurers and Reinsurers, Insurance Europe, Reinsurance Association of America, Letter to IAIS Reinsurance Subcommittee, March 22, 2012*

ⁱⁱⁱ *Bank of International Settlements, Working Paper, No. 394, Unmitigated Disasters? New Evidence of the Macroeconomic Impact of Natural Disasters, Dec. 2012*



Through its 38 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 58 countries. These companies account for around 87% of total insurance premiums worldwide. The GFIA is incorporated in Switzerland and its secretariat is based in Brussels.