GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

To: Mr Gaurav Masaldan
Director,
Foreign Investment Promotion Board (FIPB), India

Date: 4 April 2016

Subject: GFIA comments on recent reinsurance restrictions in India

Dear Mr Masaldan,

GFIA, the Global Federation of Insurance Associations, represents the interests of insurers and reinsurers in 60 countries accounting for around 87% of total insurance premiums worldwide. Many of these insurance and reinsurance undertakings have a long-term interest in India.

GFIA wishes to commend you and your colleagues at Invest India for your efforts to advance economic liberalisation and establish an investor-friendly environment in your country. It believes that your agency has a real opportunity to strengthen the Indian economy.

GFIA believes that the (re)insurance sector, with the appropriate participation of international players, can help to unleash the full potential of the Indian economy. This is why GFIA strongly welcomed the India's Parliament approval on 12 March 2015 of the long-awaited Insurance Bill. This important Bill allows foreign investors to increase stakes in local insurers from 26 per cent to 49 per cent, as well as the opening of foreign reinsurers' branches.

In this context, GFIA would like to make you aware that the recent implementing regulations from the IRDAI[1] (Insurance Regulatory Development Authority of India) risk hindering the intended outcome of the initiative. In particular, Regulation 28(9) establishes a discriminatory, uneven regulatory playing field, by requiring Indian insurers to give a first order of preference, or right of first offer, to local Indian reinsurers with at least a 3-year record of good credit ratings (which would in practice mean the state-owned reinsurer GIC Re), ahead of foreign reinsurers' branches (Article 5).

These regulation will constrain insurers' freedom to access international reinsurance support. Reinsurance is an international business-to-business transaction between sophisticated market players, which benefits from freedom of establishment and open markets to support the diversification of risk. In particular, reinsurance provides an essential instrument for insurers to reduce their underwriting risk. Insurers thereby strengthen their own solvency and are able to expand their capacity to absorb different types of risk. Furthermore, the use of reinsurance helps to limit the volatility in insurers' underwriting results and reduces their own amount of funds at risk, hence improving insurers' solvency margin. Limiting access to reinsurance will constrain insurers' ability to reduce their risk exposure and the corresponding capital requirements and will increase costs for customers and primary insurers. In addition, it will result in the accumulation of risks within insurers, compromising their underwriting performance.

These factors will hinder the development of the capacity of existing Indian insurers to take risk, will concentrate risk and will deter new investors. By requiring the preference, the government will be minimizing incentives for foreign reinsurers to invest heavily in India or develop their presence in the market.

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[1] IRDAI (Registration and Operations of Branch Offices of Foreign Reinsurers other than Lloyd's) (First Amendment) Regulations, 2016

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It should be stressed here that, on top of the investment capacity, the participation of foreign (re)insurers in the Indian market can also bring operational expertise in underwriting skills and discipline, a wide range of products, risk management culture, technological advancement and training, which can be transferred to other companies and sectors in India.

In short, GFIA believes that this mandated preference will cause India to miss a significant opportunity to establish closer ties to the global reinsurance market that has so much to offer to India. Further, as detailed in the Annex of this letter, restricting the ability of local insurers to use international reinsurers can also have adverse consequences to India's economy after an extreme natural catastrophe. Due to India's exposure to a wide array of natural disaster perils, including flood, seismic activity, cyclones and tsunami, the first order of preference to local Indian reinsurers do not consider adequately the economic risks of concentrating catastrophic risk.

This is of particular concern at a time when India seems to need additional reinsurance protection to claims from cyclones, flooding and drought. For instance, at the Paris COP 21 Climate Risk conference in December India was identified by the UN Office for Disaster Risk Reduction (UNISDR) as the county with the second highest population in the world exposed to weather related disasters. In addition, restrictions on reinsurance will also impede the G-7 commitment to increase the number of insurance policyholders by 400 million by 2020.

GFIA is aware that the IRDAI regulations, and in particular the aforementioned right of first refusal has been delayed and that it is subject to a review after one year. GFIA believes that such a review provides a welcome opportunity to eliminate the order of preference and return to the position set out in the Gazette Regulations dated 19 October 2015, which did not discriminate against Branches of foreign reinsurers.

GFIA appreciates the opportunity to provide these comments for your consideration.

Yours sincerely,

Brad Smith
Chair, GFIA trade working group
BradSmith@acli.com

About GFIA

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Annex 1 – The key positive role of international (re)insurance after natural catastrophes

By limiting access to the global reinsurance market, India risks concentrating significant amounts of catastrophe risk, exposing itself to the possibility that its insurers face liquidity and solvency concerns. Claims payments from international reinsurers provide, after a natural catastrophe, the necessary liquidity for insurers to timely meet obligations to consumers and, more importantly, provide an economic stimulus that benefits the affected local economy.

However, without appropriate access to the international reinsurance market, the post-catastrophe recovery can be seriously endangered. First, any delay in the payment of claims could harm customers and the speed at which India would recover from the catastrophe. Second, Indian insurers would have to liquidate significant portions their investment portfolios to meet their claims payment obligations, limiting their ability to invest in Indian debt and to be prepared for additional catastrophic events, such as aftershocks.

A large event would also likely put additional pressure on the Indian government to repair the damaged infrastructure, address the immediate post-disaster needs of its citizens for food and shelter, and to provide support to Indian insurers and reinsurers.

If India's regulation were designed to enable Indian (re)insurers to access the global reinsurance market before an event, the financial implications of the catastrophe would be noticeably different. While the government would still need to address infrastructure damage and post-disaster security, food, water and shelter needs, the influx of global claims payments could bolster the financial condition of Indian insurers and provide a needed stimulus to India's post-disaster economy.

A recent paper by the Bank for International Settlements[2], finds that "major natural catastrophes have large and significant negative effects on economic activity, both on impact and over the longer run." The paper contrasts the differing experiences of Haiti and New Zealand after their relatively equivalent (in terms of GDP impact) 2010 earthquakes. The paper demonstrates the benefits of pre-disaster risk transfer "to help mitigate the macroeconomic costs of natural catastrophes." Haiti, which had low level of insurance and global reinsurance penetration, saw its real growth rate drop from 3.5% pre-disaster to -5.1% during 2010 alone.

A markedly different economic result occurred in New Zealand in 2010. First, the level of globally backed insurance in New Zealand insurance was significant. After the event market, in addition to the immediate direct benefits of reinsurance payments to aid in claims payments, the immediate, positive indirect macroeconomic effects - estimated to add 1.2% and 1.7% to the economy in the third and fourth quarters of 2010, respectively. Similar, but slightly lower, positive benefits followed the February 2011 earthquake.

The principal difference between the respective economic positions of Haiti and New Zealand post-event was the level of risk transfer to the global insurance market and the economic benefits of that risk transfer. The Bank of International Settlements paper found that "risk transfer to insurance markets has a macroeconomic value. This value may be particularly high for smaller nations that lack the capacity to (re)insure themselves against major natural disasters."

[2] BIS Working Papers No. 394: Unmitigated disasters? New evidence on the macroeconomic cost of natural catastrophes

GFIA strongly encourages India and its economic advisors to review these papers, to consider the long-term macroeconomic benefits of global reinsurance risk transfer, and to repeal potentially economically devastating restrictions on reinsurance risk transfer to the global market.

References:

- BIS Working Paper on disaster mitigation
- Global Reinsurance Forum — "Global reinsurance: strengthening disaster risk resilience."

GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

To: Mr Amitabh Kant
Chairman of Invest India
Investor Facilitation Cell, Make in India
Federation House, Tansen Marg, New Delhi - 110 001
Email: info@investindia.org.in; makeinindia@nic.in

Date: 4 April 2016

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