To: Ms Ceyla Pazarbasioglu

Date: 30 October 2014

Subject: Letter to IMF Financial Stability Executives and GFIA Member Nations Executive Directors

Dear Ms Pazarbasioglu,

The Global Federation of Insurance Associations (GFIA) is writing to inform you of our concerns regarding the Ecuadorian Financial and Monetary Code which became effective as of September 12, 2014. The recently reformed Code grants authority to a newly created Board of Financial and Monetary Regulation to define insurance retentions limits and cessions to reinsurance.

The GFIA believes that if reinsurance restrictions are introduced as expected under the new code it will concentrate risk in the Ecuadorian economy resulting in potential financial stability concerns. The GFIA would like the IMF to carefully consider these concerns in the context of Article IV consultation and when communicating with the Ecuadorian authorities more generally.

We believe unless moderated by a strong prudential focus which includes strong compliance with international insurance standards as set by the International Association of Insurance Supervisors (IAIS) in their Insurance Core Principles (ICPs), that these actions create a potential to create a moral hazard to concentrate risk in the furtherance of balance of payments which are not in the interest of Ecuador for the following reasons:

- Over-emphasis on domestic retention will harm economic growth and consumers by limiting the ability of (re)insurers to transfer risks offshore and benefit from geographic diversification. Ecuadorian consumers would consequently have to subsidize the costs that arise from concentrating risk inside the country.
- The Ecuadorian insurance market is unlikely to have the capacity to retain most of the risks on their own. Therefore, cross-border reinsurance should not be restricted from providing the support needed by the Ecuadorian insurance sector.
- Also, insurance companies in Ecuador often enter into reinsurance transactions to learn about new products and techniques available in other countries. The development of the Ecuadorian insurance industry could be set back by a lack of offshore reinsurance. This reduction in the amount of insurance available would also lessen the long-term capital that comes from insurance companies' investments in assets to support their liabilities under insurance contracts affecting adversely the Ecuadorian industry and infrastructure.

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In addition, if reinsurance restrictions are introduced it would be at odds with the recently concluded and published Article IV Consultation between the IMF Executive Board and Ecuador (please see Annex 1). While these statements were initially made for the banking sector, we believe that they are relevant for involvement of the insurance sector. This is because insurance not only provides risk protection from catastrophic and regular losses, but generates long term capital for investment in infrastructure and other underpinnings of growth and job creation. For the insurance sector in Ecuador to be sustainable over the long term it can not be isolated from global reinsurance capacity which provides the risk diversification necessary to assure a stable and productive Ecuadorian market that will be able to face a major natural event or economic stress.

Specifically, we have seen elements in the new financial code that could not only retrench the private sector activity in insurance but also undermine its proper functioning. In the Executive Board Assessment you rightly noted that better communication of the provision of the new financial code are necessary as misunderstandings could affect the positive image that Ecuador has been gaining in the eyes of the international private sector in insurance.

In addition, reinsurance restrictions will result in the non-observance of several of the ICPs as stated by the IAIS, for instance:

- The standard stating "*the supervisor requires that cedants have reinsurance and risk transfer strategies appropriate to the nature, scale and complexity of their business, and which are part of their wider underwriting and risk and capital management strategies*" will be very hard to observe. The reinsurance restrictions will severely reduce the ability of insurers to access good quality reinsurance and thus adopt appropriate reinsurance strategies.

The GFIA has communicated with the President of Ecuador in the form of a letter. We would like to communicate these concerns to you for further consideration on the Article IV consultation (see attachment).

Furthermore, we would like to invite the IMF to urge the Ecuadorian authorities not to hinder the development of the financial services market in Ecuador by limiting reinsurance cessions.

Sincerely,

GOVERNOR DIRK KEMPTHORNE,
Chair, Global Federation of Insurance Associations

GFIA contact
Brad Smith, chair GFIA Trade Working Group, BradSmith@acli.com

Annex 1: Article IV Consultation between the IMF Executive Board and Ecuador

In the document published on August 20th 2014, the IMF noted the importance of a stronger involvement of the private sector for economic growth and to act as buffer to avoid potential fiscal and external imbalances:

- *“While the public sector was an important engine of growth over the past several years, the private sector needs a larger role to avoid potential fiscal and external imbalances.”*

Further, in the conclusions Executive Board Assessment you underscore the relevance of an efficient and well-regulated banking sector:

- *“Directors underscored the importance of an efficient and well-regulated banking sector in supporting growth and the private sector’s participation in the economy.”*

In addition, the IMF encourages authorities to phase out restrictions on foreign transactions in favor of macro prudential measures.

- *“Directors encouraged the authorities to better communicate the provisions of the new financial code, and welcomed their clarification that more directed lending is not envisaged under the framework. They also encouraged the authorities to phase out restrictions on foreign transactions; instead, macro prudential measures could be considered to better control cross-border capital flows. Strengthening the anti-money laundering regime remains an urgent policy priority”.*

[Annex 2: GFIA-14-10 GFIA letter on Ecuadorian reforms] – *see attached*