GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

To: His Excellency Airlangga Hartarto, Coordinating Minister for Economic Affairs (Menteri Koordinator Bidang Perekonomian)

Cc: Her Excellency Sri Mulyani Indrawati, Minister of Finance (Kementrian Keuangan)
His Excellency Agus Suparmanto, Minister of Trade (Kementerian Perdagangan/Kemendag)
His Excellency Bahlil Lahadalia, Investment Coordinating Board (Badan Koordinasi Penanaman Modal)

Date: 24 January 2020

Subject: GFIA comments on OJK regulations regarding Indonesian reinsurance cessions

Dear Coordinating Minister Hartarto,

The Global Federation of Insurance Associations (GFIA), through its 40 member associations and 1 observer association, represents the interests of insurers and reinsurers in 64 countries. These companies account for around 89% of total insurance premiums worldwide. GFIA would like to draw your attention to a regulation adopted in Indonesia in 2017 and to ask you to reconsider. GFIA takes the view that this development will ultimately be harmful to Indonesia and its citizens.

GFIA's concerns stem from regulations promulgated by the Non-bank Financial Institutions division of the Otoritas Jasa Keuangan ("OJK"), OJK Regulation 14/2015 and OJK Circular Letter 31/2015 effective as of 15 January 2016 (the "Regulations"). The Regulations require that each insurer in Indonesia develops and implements a reinsurance support strategy that must be reviewed at least once a year. Under the Regulations, all motor, health, personal accident, credit, life and surety lines of insurance are required to be ceded 100% to domestic reinsurers (with minor exceptions that have proven to be unworkable). The OJK subsequently exempted reinsurance for catastrophic risks. Thus, most of the Indonesian reinsurance market is closed to competition from non-Indonesian reinsurers.

The largest reinsurer in Indonesia is PT Reasuransi Indonesia Utama ("Indonesia Re"), a state-owned enterprise. Four of the five other domestic reinsurance companies are also stated-owned with only one reinsurer, PT Maskapai Reasuransi Indonesia ("Marein"), publicly owned.

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This has the following deleterious effects:

- The hindrance of competition by protectionist regulation impedes the creation of economic value and growth by concentrating risk in the favoured participants and limiting innovation by more sophisticated international competitors. Such measures expose consumers to unnecessary risks, bring about deterioration in quality and service and ultimately lead to increased costs and less availability of insurance. Such measures will not encourage healthier insurance markets in Indonesia, let alone increase investment in the economy, a stated goal of the government.

- The coverage of natural catastrophic events in an effective way is only possible by the geographic diversification of the risk. Local compulsory cessions concentrate risk in Indonesia. This will give rise to additional budgetary strain on the government as the owner of Indonesia Re and other state-owned reinsurers that will have a large local exposure in a natural disaster, something to which Indonesia is especially vulnerable.

- The monopoly of domestic reinsurers and the near monopoly of state-owned ones suppresses competition. The cost of reinsurance has risen in the Indonesian market.

- Domestic reinsurers are not rated by internationally recognised rating agencies and have low ratings from domestic agencies. This makes insurers doing business in Indonesia reluctant to reinsure with them because of the credit risk and lower credit for reinsurance.

- Domestic reinsurers have limited capital and, therefore, limited capacity to take on reinsurance. This results in a reduction in the amount of insurance available and in turn lessens the long-term capital for insurance companies' investments in assets to support their liabilities under insurance contracts. This adversely affects the level of investment in Indonesian industries and infrastructure.

- The smaller insurance market lessens the opportunity for employment in the insurance industry, particularly for agents and particularly in rural areas that are underserved.

- Insurance companies in Indonesia often enter into reinsurance transactions to learn about new products and techniques available in other countries as well as to access facultative reinsurance expertise that resides with the multinational reinsurers. The development of the Indonesian insurance industry will be set back by impeding the use of offshore reinsurance. This will reduce the availability of new products for consumers, thwart the growth of the industry and reduce the amount of money that insurance companies invest in the Indonesian economy.

- Instead of encouraging the local insurance industry in Indonesia to improve on its risk management efforts and ensure better and more prudent underwriting by local players, which is the OJK's stated goal, the compulsory cession rules introduced by the OJK will have a negative effect on the risk management by insurers that will end up in a weakening of their resilience.

- The supervision and regulation of state-owned insurers and reinsurers is more difficult given the implicit conflict of interests from having ownership and supervision under one roof. Compulsory cessions to state-owned reinsurers concentrate significant risk into those companies that, because of their ownership, are unlikely to be strictly scrutinised and held to a high standard.

- The mandatory cession to domestic reinsurers is contrary to Indonesia's commitments in the World Trade Organization's General Agreement on Trade in Services to provide the companies of other member countries with "market access" and "national treatment". Indonesia's failure to abide by its trade agreements dampens confidence in its economy and discourages investment. Countries that do not abide by their trade obligations are less likely to be trusted by their trading partners.

- Because the domestic reinsurance companies do not have enough capacity (capital) to take 100% of "simple" reinsurance nor enough reinsurance expertise to help the insurance companies with underwriting and new products, two of the main roles of offshore reinsurers, insurers in Indonesia must deal indirectly with offshore reinsurers by working through the domestic reinsurers. This kind of arrangement is called "fronting" in the insurance industry. The domestic reinsurer keeps a portion of the economics of the transaction and passes on the reinsurance to the offshore reinsurer through retrocession. This adds an additional layer of cost to the transaction.

- As domestic Indonesian reinsurers are not rated by internationally-recognised rating agencies, the ceding companies are often reluctant to take on the counterparty risk of domestic reinsurers and ask that the retrocessionaire do a "cut out" in which the ceding company looks to the retrocessionaire for the entire payment in the event the domestic reinsurer does not pay. Due to this arrangement, the domestic reinsurer receives a substantial fee for potentially taking no liability and doing next to no work. This arrangement does not make domestic reinsurers competitive except to the extent that they see what the offshore reinsurers are doing. Their incentives to grow and learn through competition are small, although they do get access to the offshore reinsurer's intellectual property for free.

GFIA encourages you to review these observations on the impact of the current restrictions on reinsurance cessions and remains available to provide further information if required. GFIA's hope is that, after a deliberate and thorough examination, this regulation will be reversed through clear and direct communication that confirm Indonesia's long-standing practices to allow free and fair cross-border insurance access.

Kind regards,

Brad Smith
Chair of the GFIA Trade working group (BradSmith@acli.com)

About GFIA

Through its 40 member associations and 1 observer association, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 64 countries. These companies account for around 89% of total insurance premiums worldwide. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.