Licensing and Supervision of Insurance Business
Manner and Criteria of Transacting Reinsurance
Directives No. SIB/44/2016

Whereas, reinsurance is an important risk management tool that can be used to reduce insurance risk and the volatility of financial results, stabilize solvency, make more efficient use of capital, better withstand catastrophic events, increase underwriting capacity, and draw on reinsurers' expertise;

Whereas, reinsurance exposes an insurer to other risks including counter-party, operational, legal, liquidity, and the combination of these risks can make reinsurance complex and challenging to implement effectively;

Whereas, inadequate reinsurance risk management practices and procedures can materially affect an insurer's financial soundness and reputation, and can ultimately contribute to its failure;

Whereas, reinsurance policy, program, procedures and practices should be guided, among other things, by the objective of optimizing premium retention but without compromising an insurer's financial soundness and reputation;

Now, therefore, the National Bank of Ethiopia has issued these directives pursuant to the authority vested in it by Articles 54 and 58(2) of the Insurance Business Proclamation No. 746/2012.

1. Short Title

These directives may be cited as "**Manner and Criteria of Transacting Reinsurance Directives No. SIB/44/2016**".

2. Definitions

In these directives, unless the context provides otherwise,

2.1. "**National Bank**" means the National Bank of Ethiopia;

2.2. **"board"** means the board of directors of an insurer;

2.3. **"capital and reserves"** mean paid up capital and unencumbered reserves;

2.4. **"compulsory cession"** mean cession that an insurer is required to cede to an Ethiopian reinsurer;

2.5. **"cover note"** means a confirmation given by a reinsurer or a broker to a cedent that coverage has been effected. A cover note is provided pending the issuance of a formal and comprehensive reinsurance contract;

2.6. **"credit rating"** means evaluation of credit worthiness or financial strength of a reinsurer by A.M. Best, Fitch, Moody's, Standard & Poor's or any other such credit agencies acceptable to the National Bank;

2.7. **"due diligence"** means research, analysis and assessment of a reinsurer prior to entering into a reinsurance arrangement;

2.8. **"due from reinsurer(s)"** refers to receivables from reinsurers arising from reinsurance contracts;

2.9. **"due to reinsurer(s)"** refers to payables to reinsurers arising from reinsurance contracts;

2.10. **"Estimated Maximum Loss (EML)"** means the estimated value of the largest expected loss that could result from an event assuming the normal functioning of protective features and proper functioning of most (perhaps not all) active suppression systems such as firefighting appliances;

2.17. **"reinsurer"** means a person that provides protection through the sale of reinsurance contracts;

2.18. **"reinsurance broker"** means an entity that places reinsurance for insurers or reinsurers;

2.19. "**reinsurance program**" means a program that maps a hierarchical sequence of ceded reinsurance treaties founded on a sound reinsurance management framework and which provides a flexible and effective tool for the management of risks underwritten by an insurer;

2.20. "**retention**" means the exposure, usually expressed as a monetary amount, which an insurer keeps for its net account after reinsurance cession. The retention may apply to a single risk or an accumulation of risks materializing from a single event;

2.21. **"risk sharing scheme"** means an offer by an insurer for placement of risk(s), that exceeded the treaty capacity or which is not within the scope of the treaty, to insurer(s) operating in Ethiopia with the view to fully exhaust the national risk acceptance capacity prior to ceding it facultatively;

2.22. **"slip"** means reinsurance broker's confirmation to a cedant that coverage has been effected;

2.23. **"treaty reinsurance"** means an agreement between an insurer and a reinsurer for the cession and assumption of certain risks as defined in the agreement.

3. Scope of Application

These directives shall apply to all insurers.

4. Reinsurance Risk Management Policy and Program

An insurer shall:

4.1. have a sound reinsurance risk management policy that is integral to its overall enterprise-wide risk management. The Board shall approve the program and monitor its implementation. The policy should set out:

4.1.1. purpose and objectives of reinsurance, risk diversification objectives and concentration limits;

4.1.2. prohibition against accepting insurance exposures in excess of its net retentions unless reinsurance arrangements are in place;

4.1.3. a prohibition of fronting unless approved by the National Bank;
4.1.4. roles and responsibilities of the persons charged with implementing the policy and scope of their authorities;
4.1.5. types of reinsurance to be used and net retentions (both per risk and per event) for each line of business and the rationale for determining the net retentions, including results of any stress testing used;
4.1.6. criteria and process for selecting reinsurers;
4.1.7. criteria for using facultative reinsurance;
4.1.8. liquidity requirements taking into account possible mismatch between the payment of claims and the receipt of reinsurance recoveries; and
4.1.9. matters reserved for review and approval by the Board and Senior Management.

4.2. implement the approved reinsurance policy by formulating a reinsurance program that is consistent with the policy. The Board should approve the reinsurance program and monitor its performance. Implementation of the reinsurance policy at a minimum should:

4.2.1. arrange appropriate types of reinsurance, in accordance with the reinsurance policy;
4.2.2. set out limits on the amount and type of insurance that will be covered by treaty reinsurance;
4.2.3. exercise due diligence in the process of selecting reinsurers and reinsurance brokers in addition to complying with the requirements stipulated under Sub-Article 5.3 of these directives;
4.2.4. have specific processes in place to approve, monitor and confirm the placement of each facultative risk which shall be secured before the commencement date of the policy;
4.2.5. ensure compliance to risk sharing scheme;
4.2.6. ensure that reinsurance program and procedures are executed through the dedication of adequate resources;
4.2.7. have adequate transaction tracking system, management, reporting and internal control of the overall reinsurance operations; and
4.2.8. should be guided by the objectives to maximize retention within the country, develop adequate capacity, secure the best possible protection for the reinsurance costs incurred and simplify the administration of business.

4.3. promptly inform the National Bank in writing if it becomes aware of any reinsurance issues, including downward revision of the credit rating of the reinsurer involved that could materially impact its financial condition;

4.4. ensure that reinsurance covers, particularly for large and catastrophic exposures, are adequately addressed and determine if the reinsurance arrangements entered into are sufficient to mitigate losses to acceptable levels as prescribed in the reinsurance policy;

4.5. strictly follow the prescription embedded in the reinsurance treaty for receipts, payments and accounting treatment; and

4.6. ensure that reinsurance program, procedures, placements, internal controls and reporting at a minimum conform with respective provisions of these directives and material deviations from the requirements are reported to Management and the Board as identified.

5. Reinsurance Arrangement

5.1 Retention

5.1.1. Per risk gross retention for any line of business should not be less than 5% and greater than 10% of an insurer's total capital and reserves. However, such retention should be protected by an appropriate reinsurance (working and catastrophic excess of loss).

5.1.2. If treaty reinsurance agreement dictates or for clear and justifiable reason(s) it becomes imperative to vary the retention limit stipulated under Sub-Article 5.1.1, the variation shall be notified to the National Bank.

5.1.3. Notwithstanding the provisions of Sub-Article 5.1.2, an insurer may adjust the retention limit according to a surveyor's EML estimate; and have in place a protection for EML error.

5.2. Compulsory Cession

An insurer shall cede at least 25% of its treaty cession and 5% of each policy it underwrites to a reinsurance company licensed under Insurance Business Proclamation No. 746/2012. The compulsory policy cession shall remain in force for a maximum of five years. In addition, the reinsurance company has the right of first refusal in all facultative placements.

5.3. Use of Credit Rating

5.3.1. An insurer shall conclude reinsurance agreements with lead reinsurer(s) rated at least A- or equivalent in a latest credit rating.

5.3.2. An insurer shall conclude reinsurance agreements with follower reinsurer(s) rated at least BB or equivalent in a latest credit rating.

5.3.3. Notwithstanding the Provisions of Sub-Article 5.3.1 & 5.3.2 an insurer can conclude reinsurance contracts with an Ethiopian reinsurer regardless of rating.

5.4. **Interim Reinsurance Arrangement Evidences**

Until such time of obtaining comprehensive reinsurance contracts, an insurer shall secure duly signed and sealed cover note(s) and/or confirmation slips, by respective reinsurers, which at a minimum sets out:

5.4.1. the classes or risk(s) reinsured;

5.4.2. the period of reinsurance;

5.4.3. the scope of cover ;

5.4.4. the premium or consideration;

5.4.5. where applicable, any exclusions to terms of coverage; and

5.4.6. any standard clauses that are to be relied upon or incorporated by reference into the reinsurance contract;

5.5. **Final Reinsurance Contracts**

An insurer shall conclude the final reinsurance contracts, including any amendments thereto, bear the duly authorized signature and seal of both the ceding company and the reinsurer(s) within 45 days of the effective date of the commencement of the reinsurance cover.

5.6. **Risk Sharing Scheme**

5.6.1. An insurer shall offer any risk falling outside the scope of its existing treaty or that exceeds the treaty capacity as set out under Sub-Article 2.21 to all insurers; provided that, the size of the risk is sufficient enough to involve all insurers.

5.6.2. Any balance shall be offered to an Ethiopian reinsurer as stated under Sub- Article 2.21.

5.6.3. Under risk sharing scheme, acceptance of risk by an insurer in any case shall not exceed its gross retention.

የኢትዮጵያ ብሔራዊ ባንክ
NATIONAL BANK OF ETHIOPIA
52

5.6.4. Insurers or Ethiopian reinsurer(s) shall provide written notification regarding their acceptance or rejection of the offer, within 48 hours.

5.6.5. If insurers and Ethiopian reinsurer(s) fail to respond to the risk sharing scheme within 48 hours, the insurer shall place the risk with international reinsurers.

5.6.6. An insurer shall ensure fairness and equity in selecting insurers who will be sharing a risk under the risk sharing scheme as appropriate.

6. Accounting Treatment

6.1. An insurer shall strictly follow the prescription embedded in a reinsurance treaty in so far as handling the accounting of the treaty is concerned.

6.2. Due to reinsurers shall be paid or cleared in accordance with the terms and conditions of the reinsurance agreements.

6.3. Claims shall be reported to the reinsurer(s) in accordance with the terms and conditions of the reinsurance agreements.

6.4. Due from reinsurers shall be collected or cleared in accordance with the terms and conditions of the reinsurance agreements.

6.5. Due to and due from reinsurers shall be reported separately in the balance sheet.

6.6. All reinsurance transactions shall be reconciled at least once in a year and due to and due from balances, with respect to subsidiary and controlling accounts, shall be clearly documented and reported separately in the interim and audited statements.

7. Documentation on Reinsurance

An insurer shall:

7.1. maintain a sound and comprehensive reinsurance policy as specified under Sub-Article 4.1 that shall be subject to revision whenever appropriate and at least once in every three years;

7.2. document the steps taken to ensure the adequacy and effectiveness of the reinsurance arrangements, particularly for large and catastrophic exposures;

7.3. document the manner in which it determines the net retention limits for each class of business, including the assumptions underlying the setting of such retentions;

7.4. keep a sheet that summarizes the calculation of expected maximum loss(EML), whenever applied, in respective policy files;

7.5. maintain documents evidencing the interim reinsurance arrangements, such as slip and/or cover note, and final reinsurance contract for all classes of business in timely and orderly manner; and

7.6. maintain written communication documents pertaining to risk sharing scheme.

8. Submission of Documents to the National Bank

An insurer shall:

8.1. submit its reinsurance program to the National Bank, within 90 days after coming in to force of these directives;

8.2. notify the National Bank, within 30 days, of any changes made to the reinsurance program;

8.3. deliver copies of its reinsurance contracts to the National Bank, within 60 days of the signing of the contracts;

8.4. provide to the National Bank, 15 days prior to the commencement of the insurer's financial year, a description of its reinsurance program, copies of cover notes and/or slips and information on credit rating of its reinsurers together with information on their participation; and

8.5. provide the National Bank with any other information with respect to its reinsurance that the Bank may require.

9. Prohibitions

9.1. An insurer shall not accept risks in excess of its retention limits unless the necessary reinsurance arrangement is in place.

9.2. Fronting is prohibited.

የኢትዮጵያ ብሔራዊ ባንክ
NATIONAL BANK OF ETHIOPIA
52

10. Transitional Provision

Insurance policies and reinsurance agreements that are in force as of the effective date of these directives, and until such time of renewal, shall not be subject to the requirements stipulated in these directives.

11. Penalty

An insurer who fails to comply with the provisions of these directives shall be penalized in accordance with Article 57(7) of Insurance Business Proclamation Number 746/2012.

12. Effective Date

These directives shall enter into force as of the 1st day of August 2016.

TEKLEWOLD ATNAFU
GOVERNOR

የኢትዮጵያ ብሔራዊ ባንክ
NATIONAL BANK OF ETHIOPIA
52