

Reinsurance of Insurers Directive 2080 (2023 A.D.)

Introduction

On May 22, 2023, Nepal Insurance Authority (“NIA”), the regulatory body which regulates insurance business in Nepal, issued Reinsurance of Insurers Directive 2080 (2023 A.D.) (“Reinsurance Directive”) with immediate effect. The Reinsurance Directive has repealed prior Reinsurance of Insurers Directive 2078 (2021 A.D.) (“Prior Reinsurance Directive”).

This Briefing aims to highlight major provisions of the Reinsurance Directive primarily applicable to foreign reinsurers and reinsurance brokers.

Definitions

The Reinsurance Directive has introduced definitions of the following key terms for clarity purposes which are otherwise not defined in other insurance legislation:

- **Cover Note:** A written document issued by a reinsurer or an authorized reinsurance broker in the course of reinsurance business which outlines the terms and conditions of a reinsurance contract.
- **Reinsurance Slip:** A document, agreed upon and signed by all reinsurers stating their share percentage, which provides the details of the proposed risk and the terms and conditions of reinsurance.

Types of Reinsurance

The Reinsurance Directive classifies “re-insurance business” into following three (3) categories:

- Treaty Reinsurance
- Facultative Reinsurance

- Insurance Pool

Allocation of Risk Coverage

The Reinsurance Directive mandates insurers to reinsure the following risks:

- the risk other than those assumed by it; and
- the risk that could not be assumed by it.

Insurers are not permitted to reinsure the entire risk covered by an insurance policy without retaining some portion of the risk. Insurers are under an obligation to diversify their risks while procuring reinsurance. Further, insurers must also ensure that reinsurance is procured in a manner that all the risks covered by the insurance policy are fully reinsured by the reinsurance policy.

Selection of Reinsurers

Insurers must procure reinsurance from the following reinsurers:

- domestic reinsurers licensed by NIA; or
- foreign reinsurers who are licensed by the insurance regulatory body of their home country and are enrolled with NIA.

Selection of Reinsurance Brokers

Domestic insurers must manage reinsurance either by itself or through:

- a domestic reinsurance broker licensed by NIA; or
- a foreign reinsurance broker who is licensed by the regulatory body of its home country and is enrolled with NIA.

Limits of Reinsurance Coverage

The maximum limit of the reinsurance coverage shall be according to per policy or per risk of an insurance policy issued by an insurer, however, not exceeding:

- 0.5 percent of its net worth within Nepal in case of life insurance; and
- 5 percent of its net worth within Nepal in case of non-life insurance.

The Reinsurance Directive has maintained the same 5 percent cap as the maximum coverage limit for non-life insurance as provided in the Prior Reinsurance Directive. Nonetheless, the Reinsurance Directive has increased the cap of the maximum coverage limit for life insurance to 0.5 percent from 0.3 percent as provided in the Prior Reinsurance Directive.

With respect to foreign insurance companies engaged in insurance business in Nepal through their branch offices, the net worth of such insurers shall be determined taking into consideration the net worth of their parent companies.

Preference to Domestic Reinsurers

Facultative Reinsurance

With respect to the Facultative Reinsurance, an insurer must first make an offer to domestic reinsurers. The insurer may reinsure the risk with foreign reinsurers only if the domestic reinsurers decline to reinsure the risk.

Treaty Reinsurance

With respect to the Treaty Reinsurance, an insurer must insure at least 30 percent of the reinsurance portion from the remaining cession from domestic reinsurers after providing the direct cession to them.

Domestic reinsurers are not allowed to decline certain types of reinsurance which must be fully reinsured in Nepal. They are:

- life insurance
- vehicle insurance
- agriculture and livestock insurance

- riots and terrorism insurance
- other types of insurance except for travel, trekking and health insurances

Allocation of Direct Cession to Domestic Reinsurers

Under the Treaty Reinsurance, domestic insurers must allocate the direct cession to domestic reinsurers at the following ratios:

Fiscal Year	Each Domestic Reinsurer
Up to 2079/2080 (2022/2023 A.D.)	10 percent
2080/2081 (2023/2024 A.D.)	8 percent
2081/2082 (2024/2025 A.D.)	6 percent
2082/2083 (2025/2026 A.D.)	4 percent
2083/2084 (2026/2027 A.D.)	2 percent
2084/2085 and onward (2027/2028 A.D.)	(no provision)

Domestic reinsurers are not allowed to decline the direct cession as prescribed by NIA proposed by insurers. The Reinsurance Directive provides for an exception for the above-mentioned mandatory direct cession in certain types of reinsurances, where domestic insurers are exempt from allocating the direct cession to domestic reinsurers. The types of those reinsurance categories are as follows:

- aviation insurance
- riots and terrorism insurance
- other types of insurance such as health, travel and trekking insurances

Insurance of Assets Located Abroad

The Reinsurance Directive allows domestic insurers to insure assets located as well as liabilities created abroad of Nepali citizens. It further allows domestic insurers to settle claims arising out of those insurance policies in Nepal in Nepali currency.

Enrollment Requirement

The Reinsurance Directives requires foreign reinsurers and reinsurance brokers, who wish to provide reinsurance services to domestic insurers, to enroll with NIA. In order for the enrollment

of a reinsurer, a foreign reinsurer must submit an application along with, among others, the following documents to NIA:

- A copy of the reinsurer’s license issued by the regulatory body of its home country;
- Financials of the reinsurer;
- Portfolio of the reinsurer and business to be carried out with domestic insurers; and
- Name of the rating agency, date of rating receipt and rating certificate.

Similarly, in order for the enrollment of a reinsurance broker, a foreign reinsurance broker must submit an application along with, among others, the following documents to NIA:

- A copy of the reinsurance broker’s license issued by the regulatory body of its home country;
- Financials of the reinsurance broker;
- Portfolio of the reinsurance broker and business to be carried out with domestic insurers; and
- A copy of the reinsurance broker’s professional liability insurance.

Upon fulfillment of the enrollment criteria, NIA shall enroll those foreign reinsurers and reinsurance brokers. The term of such enrollment shall be valid for a year and the foreign reinsurers and reinsurance brokers must renew their enrollment each year.

Exception to Enrollment

The Reinsurance Directive provides for certain exceptions to the following reinsurers and brokers from enrolling at NIA:

- domestic insurers and reinsurance brokers
- foreign reinsurers who have secured the following ratings from the rating agencies:

Rating Agency	Rating
AM Best Rating	A++
S&P Rating	AAA

Rating Agency	Rating
Moody’s Rating	Aaa
Fitch Rating	AAA

The onus of proving the required rating of a foreign reinsurer lies with an insurer which seeks to procure reinsurance from the foreign reinsurer.

Setting Up an Office by Reinsurance Brokers

A reinsurance broker, who is enrolled with NIA, must establish its office in Nepal within six (6) months from the date of the enrollment in one of the following manners:

- by incorporating a company in joint venture with a local company or individual(s)
- by establishing a branch office
- by establishing a liaison office

Diversification of Reinsurance

An insurer must sufficiently diversify its reinsurance portfolio while reinsuring its risks. In case of non-life insurance, an insurer must not reinsure in excess of 60 percent risk of its entire portfolio as well as each portfolio with a single reinsurer.

Similarly, a lead reinsurer and follower reinsurers may ensure up to 40 and 20 percent of the total reinsurance risk, respectively. Nonetheless, this cap is not applicable for the reinsurance of the life insurance.

Exceptions to Diversification and Cap for Reinsurers

As an exception to above, a single reinsurer may reinsure the following types of reinsurance in excess of the specified cap:

- catastrophe reinsurance
- facultative reinsurance
- special types of risk such as international travel, trekking, clinical trial, professional indemnity, medical and health
- other special types of reinsurance as approved by NIA.

Rating of Reinsurers

A reinsurer must have obtained at least one of the following ratings in order to issue Treaty Reinsurance:

Rating Agency	Leader's Rating	Follower's Rating
AM Best Rating	A-	B
S&P Rating	A-	BBB
Moody's Rating	A3	Baa1
Fitch Rating	A-	BBB

Similarly, a reinsurer must have obtained at least one of the following ratings in order to issue Facultative Reinsurance:

Rating Agency	Rating
AM Best Rating	B
S&P Rating	BBB
Moody's Rating	Baa1
Fitch Rating	BBB

Exception to the Rating Requirements

Following reinsurers are exempt from meeting the rating criteria outlined above:

- domestic reinsurers
- reinsurers operating in the member States of the South Asian Association for Regional Cooperation

Comments and Conclusion

The Reinsurance Directive provides clarity on certain issues which were otherwise undisclosed, however, adopted in practice for a long time in reinsurance business. For example, it introduced the concept of enrollment of foreign reinsurers and insurance brokers with NIA in order to engage in reinsurance business in Nepal. The Insurance Act 2079 (2022 A.D.) ("Insurance Act") and its predecessor legislation, Insurance Act 2049 (1992 A.D.) impose prohibition on engaging in insurance business without obtaining a license from NIA. Reinsurance business falls within the definition of "insurance business" under the

Insurance Act. As a consequence, according to the Insurance Act, foreign reinsurers and insurance brokers must obtain a license from NIA in order to engage in reinsurance business in Nepal. However, in reality, foreign reinsurers and insurance brokers had been conducting their activities in Nepal without obtaining a license from NIA. It was the undisclosed departmental view of *Beema Samiti*, the predecessor of NIA, as well as of NIA that foreign reinsurers and insurance brokers were not subject to the licensing requirements as long as their activities were limited to reinsurance business.

With the enrollment requirement introduced by the Reinsurance Directive, now there is much clarity on this issue. Further, this also allows NIA to supervise the activities of foreign reinsurers and insurance brokers who engage in reinsurance business in Nepal.

The Reinsurance Directive requires an insurer to first make an offer to domestic reinsurers while procuring reinsurance. It may reinsure the risk with foreign reinsurers only if domestic reinsurers decline to reinsure the risk. The Reinsurance Directive has adopted this concept in order to grow the reinsurance business domestically. Nonetheless, insurers are likely to engage in the lengthy forum shopping process in order to procure reinsurance which may not be practical as well as cost effective to procure reinsurance domestically in some cases.

Further, the Reinsurance Directive allows domestic insurers to engage in the insurance of assets located and liabilities created abroad. Clearly, this is outside the scope of the Reinsurance Directive as it is introduced to regulate the reinsurance business and not the insurance business.

This Briefing is authored by:



Devendra P.N. Pradhan
Managing Partner



Sadikshya Acharya
Associate

For further information about the subjects covered in this Briefing, please contact:

Sadikshya Acharya
Associate
Tel: +977 1 545 1900 (Ext. 108)
Email: sacharya@pradhanlaw.com

DISCLAIMER: INFORMATION CONTAINED IN THIS DOCUMENT IS ONLY FOR GENERAL INFORMATION PURPOSE AND SHALL NOT BE CONSIDERED TO BE LEGAL OPINION.

For further information about the subjects covered in this Briefing, please contact:



Pradhan & Associates Pvt. Ltd.

559, Bakhundole Marg (Maitri Marg), Bakhundole – 3
Lalitpur 44770, Nepal
Tel: +977 1 545 1900 | Fax: +977 1 543 3344
Email: info@pradhanlaw.com
Web: www.pradhanlaw.com