MARKET BULLETIN

REF: Y5018

Title	Draft standard requirements for collateral provided by syndicates writing offshore Chinese reinsurance
Purpose	To update the market on the draft guidance note on standard collateral requirements issued by the China Insurance Regulatory Commission
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Related links	Lloyd's Market Bulletin Y4977

This bulletin is addressed to all Lloyd's market stakeholders dealing with the placement and underwriting of reinsurance business from China, following the recent release of a draft guidance note on standard collateral requirements issued by the China Insurance Regulatory Commission (CIRC).

Under the China Risk Orientated Solvency System (C-ROSS), which has been effective since 1 January 2016, Chinese cedants incur a capital charge of 58.8% on unsecured reinsurance balances due from overseas reinsurers, reducing to 8.7% if secured. The ceding companies may choose to utilise collateral to reduce the credit risk but this is not mandatory.

Lloyd's has put in place a letter of credit (LOC) facility for syndicates writing offshore Chinese reinsurance (see Market Bulletin Y4977). The LOC facility in general satisfies the criteria in the draft guidance note issued by CIRC, so at this stage no significant changes to the facility are anticipated.

Draft Guidance Note

The draft guidance note does not impose additional collateral requirements rather it provides clarity over the requirements that will need to be considered if C-ROSS collateral clauses are requested in contracts, permitting collateral to be called by the cedant.

Under requirements issued by CIRC (article 29 of the Regulatory Rules governing Solvency of Insurance Companies No. 8: Minimum Credit Risk Capital), the following forms of collateral can be recognised by the ceding company when calculating solvency:

- deposit fund of a reinsurer retained by the cedant to secure the cedant's reinsurance recoveries; and

- LOC guarantee issued by a non-affiliated financial institution with a credit rating not less than AA- or a non-affiliated onshore bank with a capital adequacy ratio not less than 11%.

CIRC's draft guidance outlines standard requirements relevant to collateral measures, including the form and scope of the collateral, specific requirements on collateral measures and the use of collateral in solvency assessment. Further information regarding the proposed requirements is outlined at **Appendix A**.

As noted above, Lloyd's has already put in place a LOC facility which in general satisfies the criteria in the draft guidance. Accordingly, at this stage no significant changes to the facility are anticipated. Please note however that the Lloyd's facility does not permit syndicates to issue a single LOC against multiple reinsurance contracts.

Separate arrangements will apply to syndicates writing Chinese reinsurance business through Lloyd's China, which benefits from onshore reinsurance status.

Lloyd's will continue to monitor the development of the collateral guidance and will provide further information once the detailed guidance is finalised.

Further Information and Contacts

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Appendix A

C-ROSS Collateral Guidance – Key Points

1. Form and scope of collateral

The guarantee forms reaffirm that deposit funds and letters of credit (LOC) can be used as collateral, and it is also specified that the scope of the collateral shall be the credit risk exposure of an on-shore ceding company towards the off-shore reinsurer, i.e., the reinsurance receivables and reinsurers' share of technical provisions.

2. Specific requirements on collateral

2.1. Deposit fund

The Guidance prescribes the following conditions for deposit funds:

a. That the deposit fund as a means of collateral shall be placed in a commercial bank legally incorporated in China;
b. The deposit fund must be deposited in the ceding company's bank account;
c. The fund can be withdrawn by and is under the full control of the ceding company;
d. Such a fund shall not be transferred back to the bank account of the reinsurer within one year from the date of the amount being placed into the account of the ceding company, unless the reinsurance contract in question has already been settled; and
e. Where the deposit fund is used as collateral for multiple reinsurance contracts of the same ceding company, the specific guarantee amount for each reinsurance contract shall be stated and the sum of the guarantee amount from each reinsurance contract shall not exceed the total amount of the deposit fund.

2.2. Standby Letter of Credit

a. A standby LOC or a standby LOC guarantee shall satisfy the following conditions:
    i. It shall be irrevocable, clean and unconditional.
    ii. The beneficiary shall be the onshore ceding company in a reinsurance transaction.
    iii. It shall be stated that it is not restricted by any condition other than those specified in the LOC.
    iv. It shall be stated that the obligations of the standby LOC issuer are not conditional upon recourse of the LOC.
    v. Both the issuance date and expiry date shall be stated.
    vi. Any claim and payment shall take place in the People's Republic of China.
    vii. The term of the standby LOC shall be at least one year, and an "automatic extension clause" shall be provided. Automatic extension of the standby LOC shall be specified in such an "automatic extension clause"; the issuer shall inform the beneficiary in written form at least 30 days prior to the expiry date of the LOC if it decides not to extend the LOC duration.
    viii. It shall be stated that Chinese law will prevail if there is any conflict between the international transaction rules pertaining to the standby LOC and Chinese law.

ix. Where a standby LOC is used as guarantee against multiple reinsurance contracts, the specific guarantee amount for each reinsurance contract shall be stated in the LOC and the sum of the guarantee amount from each reinsurance contract shall not exceed the total guarantee amount of the standby LOC.

b. An “Issuer” must be a commercial bank legally incorporated in China, with a capital adequacy ratio no less than 11 % or a credit-rating no lower than AA-, which is consistent with that stipulated in the C-ROSS Code 8 Rules. Such banks should not be affiliated with either the ceding company or the reinsurer.