

A Framework for an International Supervisory System for Reinsurance Companies Summary

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By its very nature, reinsurance is an international business. Reinsurers transact business in many and widely differing markets. In so doing, they become subject to a multitude of national supervisory regimes with varying standards and sometimes conflicting reporting requirements. The appointment of a lead supervisor to oversee worldwide operations from a reinsurer's home country on the basis of coordinated standards would align the needs of supervision with the quickly evolving risk management and capital models of reinsurers, thus creating value for all parties concerned.

Geographical spread and diversification of risks are essential elements of good risk management practice in reinsurance. A widely diversified portfolio has a balancing effect on loss performance and reduces the required risk capital. Current supervisory regimes, focused on national requirements and the protection of policyholders, do not do justice to reinsurers' need for freedom of trade. Multiple or even conflicting reporting requirements lead to inefficiencies; local solvency requirements hamper effective capital employment and thus negate diversification benefits – reinsurers are supervised where decisions are executed, not where they are made and where risks are ultimately controlled.

The paper argues in favour of a globally coordinated reinsurance supervisory system. Using the EU draft directive as starting point for a concerted system and taking this several steps further, it suggests that reinsurers should be supervised by only one authority. Regulation should comprise financial as well as general legal supervision, based on agreed standards and supported by a system of information exchange between the lead supervisor and local regulators.

Controlling international groups at their headquarters would improve supervisory quality, prevent supervisory arbitrage, increase transparency and reduce the risk of crises. For reinsurers, it would allow maximisation of diversification benefits, facilitate allocation of risk capital and reduce capital costs. Also, ceding companies would enjoy efficiency gains in as much as indirect supervision could be done away with. At the same time, primary insurers could rely on the global security of their reinsurer, irrespective of the institutional form of their local contractual partner.

It is demonstrated that central supervision by a home state regulator would generate significant welfare gains and translate into tangible benefits: More efficient supervision of reinsurers increases protection for primary insurers and their insureds alike. Reduced cost of capital will curb prices for reinsurance cover, thereby increasing direct insurers' competitiveness and again benefiting policyholders.