Dear Chief Executive Officer and Compliance Officer,

Effective use of Reinsurance by Companies

You are receiving this letter as a Chief Executive Officer and Compliance Officer of a (Re)Insurance Undertaking (referred to herein as "undertakings") authorised and supervised by the Malta Financial Services Authority (referred to herein as the "MFSA" or the "Authority").

1. Background

Reinsurance is a fundamental component of prudent risk and capital management. It provides risk diversification, enhances underwriting capacity, contributes to financial resilience and enables undertakings to continue providing protection to policyholders in an increasingly complex risk environment. EIOPA has repeatedly recognised these benefits while also highlighting the need for undertakings and supervisors to ensure that reinsurance arrangements achieve genuine and effective risk transfer and do not create unintended prudential vulnerabilities.

In light of the continuous market developments, increased reliance on global reinsurance capacity, and varying levels of maturity across the market, the Authority considers effective oversight of reinsurance programmes to be of critical importance. This is particularly relevant for third-country reinsurance arrangements, where jurisdictional, legal, counterparty and enforceability risks may differ from those arising from EU-based reinsurers.

The MFSA conducted an outcome-based review assessing whether the insurance market [1]has implemented good governance around the use of reinsurance as a risk mitigation technique as well as their degree of resilience, taking into consideration the applicable framework on the subject matter including the Solvency II Directive 2009/138/CE, the Commission Delegation Regulation (EU) 2015/35 and Chapter 6 of the Insurance Rules issued under the Insurance Business Act (CAP 403). The MFSA also conducted this review against the backdrop of the Supervisory Statement on the supervision of reinsurance concluded with third-country insurance and reinsurance undertakings; the Opinion on the use of risk mitigation techniques by insurance undertakings; and the MFSA Corporate Governance Code.

EIOPA emphasises that while reinsurance is a global market and third-country reinsurers often play a key role in providing capacity, especially in a hard market, undertakings must be able to evidence that such arrangements deliver effective risk

[1] refers to the undertakings authorised and supervised by the MFSA

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mitigation under Solvency II. In particular, EIOPA highlights the need for undertakings to implement and maintain proportionate but strong due diligence, conduct jurisdictional and legal analysis and counterparty-risk assessments, maintain adequate documentation, carry out ongoing monitoring, ensure effective internal challenge, and ensure adequate ORSA integration. The Authority's observations and expectations below mirror these supervisory principles, reflecting areas where strong practices have been noted, whilst at the same time noting identified gaps and/or areas which require enhancement to ensure reinsurance arrangements (especially third-country reinsurance arrangements), continue to operate as a reliable and prudently managed risk-mitigation tool.

The outcome-based review consisted of a thematic review with the scope to primarily assess:

- whether the undertakings have implemented good governance around the use of reinsurance as a risk mitigation technique;
- the oversight responsibilities, identifying areas of strength and potential gaps in decision-making relating to selection and monitoring of reinsurance programmes; and
- reinsurance arrangements, mainly focusing on business rationale, the impact on Solvency Capital Requirement ("SCR"), and overall risk mitigation and control processes.

A number of insurance companies supervised by the MFSA, representing different business models were selected. These Companies were requested to complete a questionnaire consisting of a combination of open-ended, multiple-choice, and closed-ended questions. The questionnaire focused on specific areas, including reinsurance strategy, the integration of reinsurance into the risk management framework, assessment of third-country reinsurer risks, evaluation of the counterparty and credit risk, assessment of the contractual protections, governance and oversight arrangements, as well as operational effectiveness. Each question was mapped to specific regulatory requirements and expectations, which then fed into a scoring matrix developed purposely for this review to assist in the Authority's analysis and assessment.

2. Scoring Matrix Methodology

The Authority applied a structured risk scoring methodology, designed to provide a consistent and proportionate basis for assessing the extent to which undertakings are aligned with the requirements of Solvency II and other applicable regulatory

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requirements and expectations. For the purposes of the assessment, each undertaking was assigned an overall classification based on a four-tier rating scale: **Effective, Requires Minor Improvement, Requires Significant Improvement** or **Ineffective.** In addition to the above qualitative classification, the Authority applied a four-point prudential risk scoring scale: **No significant risk, Low risk, Medium risk** and **High risk**. The score reflected the Authority's assessment of the potential for significant prudential impact, having regard to the level of inherent risk identified and the effectiveness of the Company's management arrangements and controls.

The undertakings chosen for this outcomes-based review, represented 50% of the population within the insurance market retroceding to reinsurance companies registered in third countries whilst 20% of the sample do not use reinsurers registered in third countries.

The Authority contacted the selected undertakings in Q2 2025 and allowed a period of ten weeks within which to submit their respective responses. Upon receipt of the responses, the Authority reviewed the replies and conducted its assessment. As part of the assessment process, meetings were held with 90% of the undertakings to discuss and clarify matters arising from their submissions. Following these meetings, the Authority requested the submission of supporting documentation where required. The clarifications provided and the supporting documentation subsequently received were reviewed and assessed against the criteria set out in the scoring matrix. Based on the outcome of this assessment, an overall score was assigned to each undertaking. The resulting scores were used to determine the extent to which each undertaking was aligned to the assessment criteria.

The Authority positively notes the cooperation showcased by the undertakings throughout the thematic review by taking the time to swiftly reply to the questionnaire as well as to their contributions during the discussions held.

3. General assessment and the relevant key findings

3.1 Reinsurance strategy

The Authority assessed whether the Companies[2] have a formally established reinsurance strategy and, where applicable, whether the reinsurance programme is captured and aligned to the overall business strategy. The assessment further examined whether the Company implemented a process to ensure that the overall

[2] Company or Companies refer to the sample of undertakings that participated in the thematic review

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reinsurance strategy remains aligned with the defined risk appetite, including how any material changes to reinsurance structures and limits are taken into consideration. The assessment also captured the frequency with which the reinsurance strategy is reviewed and updated, the key criteria and considerations applied when selecting reinsurers, including geographical diversification, counterparty creditworthiness and regulatory equivalence. In this regard, the Authority noted that all Companies within the sample have established and integrated the areas noted above within their structures and processes.

3.2 Onboarding process to engage third-country reinsurers

The assessment sought to obtain an overview of the Company's governance and

risk assessment framework applicable, particularly to the use of third-country reinsurers. Particular focus was placed on the business justification, due diligence, and regulatory implications of such arrangements. The review also captured the onboarding stage wherein the Company assesses the rationale for engaging third-country reinsurers, including consideration of the relative cost of reinsurance premiums against the additional risks arising from such counterparties.

Where third-country reinsurers are used, the Companies were assessed as to whether the following criteria are taken into consideration as part of their assessment –

i. the nature and extent of pre-onboarding due diligence performed including financial submission;
ii. reputational risk; and
iii. legal and compliance assessments.

In addition, the assessment considered whether the Company evaluates, at the business justification stage, the impact of third-country reinsurance agreements on its SCR and other applicable regulatory conditions, including the methodologies, processes and assurance mechanisms applied, such as actuarial review, scenario analysis, sensitivity testing and ORSA considerations, and how the resulting impacts are reflected in the Company's regulatory reporting and broader risk management framework.

From the review conducted it shows that while most Companies assess the business justification of using third-party reinsurers, more than 60% of the sample do not differentiate the placement of reinsurance with third-country reinsurers, as shown below within Figure 1. This potentially creates exposure to jurisdictional, legal, and enforceability risks. Third-country reinsurers may operate under different regulatory frameworks and solvency regimes. Accordingly, the Authority expects the insurance

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market to take into account the jurisdictional analysis and regulatory framework when assessing reinsurance programmes. This may include consulting legal experts to identify and understand any potential legal barriers or enforcement challenges that may arise.

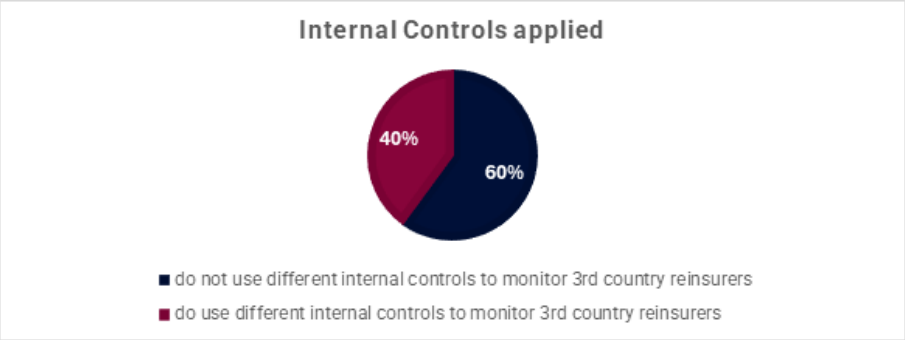


Figure 1 – implementation of internal controls for 3rd country reinsurers

3.3. Assessment of Third-Country Reinsurance Arrangements and Associated Risks

The assessment considered the operational, legal, financial and strategic impact of using third-country reinsurers, including effects on claims and payments, contractual terms, reserving, internal controls and governance. It also considered the implications of the reinsurers' jurisdiction and the Company's contingency planning in the event of reinsurer default, insolvency, downgrade or reduced SCR credit risk recognition. Particular consideration was given to direct claim rights, claims hierarchy, collateral arrangements, accessibility of collateral and measures to replace or mitigate exposures to a deteriorating reinsurer. Additionally, the assessment considered whether the reinsurance agreements provide adequate legal and contractual protections, including rights to terminate or take mitigating action when needed. It also examined whether third-country reinsurers have unilateral termination rights and the circumstances in which these may be exercised. Where reinsurance forms part of a group programme, the assessment considered the decision-making, reporting and oversight arrangements between the Company and the group. The assessment also took into consideration an analysis of portfolio diversification, counterparty concentration, reinsurer governance, expertise, claims performance, regulatory developments and retrocession arrangements. Finally, the Authority assessed how reinsurance is integrated into the ORSA and how the adequacy and resilience of reinsurance coverage are tested under stress scenarios, including any specific considerations applicable to third-country reinsurers.

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3.3.1 Main observations from the above assessment

3.3.1.1 Termination Clauses

With respect to the contractual agreements and terminations clauses, the Authority reviewed the termination provisions included in the reinsurance agreements submitted as part of the thematic review. While most Companies had termination rights in place within the agreements, the scope, triggers and strength of these provisions varied. The review also identified that approximately 60% of the Companies assessed had agreements containing some form of unilateral termination right available to the reinsurer. In certain cases, termination was permitted following non-payment of premium, subject to a minimum notice period of 15 days.

The Authority expects insurance market to assess termination rights available to both parties and to understand their potential impact on the continuity and effectiveness of the reinsurance protection. Agreements should contain clear and legally enforceable provisions addressing relevant events such as insolvency, loss of authorisation, material deterioration in financial standing, rating downgrades, claims-payment breaches and other material contractual breaches. Particular attention should be given to rights allowing the reinsurer, including a third-country reinsurer, to terminate the agreement unilaterally, where this could leave an undertaking exposed to risks that it had intended to transfer.

The insurance market should also review existing and new agreements against Annex 2 to the Opinion on the use of risk-mitigation techniques by insurance undertakings: Reinsurance Agreements' Termination Clauses. Termination clauses may undermine effective risk transfer where they allow the reinsurer to avoid obligations relating to legitimate claims arising during the period of cover, retain premiums or assets without meeting corresponding obligations, or impose penalties that are not objectively linked to the costs arising from termination.

The Authority therefore expects the insurance market to document their assessment of material termination provisions and to remediate any clauses that could undermine effective risk transfer. Where such provisions remain in place and prevent the arrangement from meeting the applicable requirements, the reinsurance agreement should not be recognised as an eligible risk-mitigation technique for SCR purposes.

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3.3.1.2 Pay-as-paid Clauses

The assessment also noted the use of the "pay-as-paid" clause, which is a contractual provision under which the reinsurer's obligation to reimburse the undertaking is triggered only after the undertaking has paid the corresponding claim to the policyholder or beneficiary. While such clauses may be used as part of normal market practice, they can affect the timing and certainty of reinsurance recoveries and should therefore be assessed carefully by undertakings.

The MFSA considers that the principal risk arising from these clauses is a potential timing mismatch between the undertaking's obligation to settle policyholder claims and the receipt of the related reinsurance recoveries. The undertaking remains fully responsible for meeting its obligations to policyholders when they fall due and cannot rely on the timing of recoveries from the reinsurer as a justification for delaying payment. Where claims are significant, or where the undertaking has limited liquid resources, the need to fund claims before receiving the corresponding recoveries may create material liquidity pressure.

The MFSA also considers that "pay-as-paid" clauses may increase counterparty risk. The undertaking may have already paid the underlying claim while remaining exposed to the possibility that the reinsurer delays, disputes or fails to make the corresponding payment. The longer the period between the settlement of the underlying claim and the receipt of the reinsurance recovery, the greater the undertaking's exposure to changes in the reinsurer's financial position, claims-payment behaviour or willingness to honour the agreement. This may be particularly relevant where recoveries are concentrated with a small number of reinsurers or where the reinsurer is established in a jurisdiction that may present additional legal or enforceability risks.

The use of "pay-as-paid" clauses is not, in itself, considered inappropriate. However, the onus remains on the undertaking to demonstrate that the risks arising from such clauses are properly understood, assessed and managed. The MFSA expects the insurance market to consider the materiality of the underlying claims, the expected timing of recoveries, the financial strength and claims-payment history of the reinsurer, the legal enforceability of the arrangement and the Company's capacity to meet claims without depending on the immediate receipt of reinsurance proceeds.

Accordingly, undertakings should maintain effective controls and monitoring arrangements to identify potential delays or disputes in recoveries and should consider appropriate contingency measures where material liquidity or counterparty exposures could arise. These risks should be reflected within the Company's risk-management framework and, where material, within its liquidity assessment and ORSA. The Board should also receive sufficient information to understand the potential impact of these clauses on the undertaking's claims funding, liquidity

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position and the ongoing effectiveness of the reinsurance programme.

3.3.1.3 Group Reinsurance

In relation to Companies forming part of a group, the Authority noted that a more structured approach is generally implemented, particularly in terms of reporting and decision-making process. During the thematic reviews, Companies forming part of an insurance group all had a Company representative within the group committee taking decisions concerning reinsurance. Nonetheless, the Authority wishes to remind the insurance market of its expectation to actively participate in the discussions concerning the subject matter. The meaningful involvement within the decision-making process is essential. Therefore, the insurance market is encouraged to contribute constructively and provide challenges, where appropriate, at group level.

3.4 Risk Management System, Governance Arrangements and Internal Controls

The assessment reviewed the integration and implementation of reinsurance within the risk management system of the Company. The assessment sought to determine how the reinsurance programme affects the Company's solvency position. Additionally, it sought to establish whether effective governance, reporting and communication arrangements are in place with regards to reinsurance matters. This included the involvement and challenge by the Board of Directors and key function holders, the frequency of reporting and the reinsurance expertise and competencies at board level. The MFSA assessed whether the Companies implemented an ongoing monitoring framework, including key performance indicators and key risk indicators, reporting, escalation mechanisms and monitoring of the reinsurance panel. The MFSA also assessed whether a process is in place in relation to the initial and ongoing due diligence performed on third-country reinsurers, including reviews, monitoring frequency, enhanced-monitoring triggers and reassessments. Furthermore, the MFSA also assessed reinsurers' licensing status, regulatory standing, solvency, legal and compliance risks. Through the thematic review, the MFSA assessed controls ensuring compliance with contractual terms and timely claims settlement, including the management of any instances of delayed payments.

3.4.1 Main observations from the above assessment

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3.4.1.1 Risk Management System

The Authority has noted that there is room for improvement in relation to the ongoing monitoring and the integration of reinsurance within the risk management system. The insurance market is hereby reminded that it should implement an ongoing monitoring assessment of its reinsurance programme. This assessment should be broadened to cover risks arising from the domicile of the reinsurer, international events, and claims payments. From discussions held, it emanated that the Companies were not particularly impacted by historical events; having said this, the insurance market is reminded that this shall not relieve it of its obligation to conduct effective assessment of potential impacts and associated risks.

The Authority notes that the Companies participating within the thematic review all carry out monitoring in respect of the reinsurance programme/s. Nonetheless, the Authority observed that most of the Companies rely on the credit ratings agencies for their monitoring. The external credit ratings should not be relied upon as the sole basis for assessing the financial strength and risk profile of reinsurers. In particular, external ratings may not fully reflect emerging or stressed risks. The insurance market is therefore expected to complement external credit ratings with appropriate internal assessments, taking into account the reinsurer's financial position, capital adequacy, earnings resilience and relevant concentration risks. This is intended to ensure that the assessment of counterparty risk remains sufficiently comprehensive and responsive to the Company's specific reinsurance exposures.

That said, the Authority emphasises that reinsurance brokers and credit ratings play an important and specialised role in the placement and servicing of reinsurance programmes, given their market expertise, access to global reinsurer panels and technical underwriting knowledge, and hence adds value. Independent challenge enables Companies to better understand and manage the risks retained after reinsurance.

The insurance market is reminded of the importance of conducting comprehensive due diligence when assessing reinsurance counterparties. Such due diligence should extend beyond the information provided by the reinsurer and / or reliance on the advice provided by the reinsurance brokers. The assessment shall include, where relevant, publicly available information from the supervisory authority in the jurisdiction in which the reinsurer is registered, including any regulatory actions or supervisory measures taken against the reinsurer. Companies should also consider other relevant factors, including the reinsurer's financial statements, governance arrangements, capital position, earnings stability and concentration exposures, in order to support a comprehensive assessment of the counterparty's financial soundness and risk profile.

Companies should maintain strong communication with reinsurers and continue to engage with reputable brokers for placement and servicing of agreements, while

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ensuring brokers are constructively challenged. Additionally, the insurance market should establish internal exposure limits, and any other form of quantitative risk metrics in their risk appetite statements, for all reinsurers, applying stricter limits to third-country reinsurers and avoiding concentration to a single entity unless supported by strong risk mitigations, including but not limited to collateral arrangements or Letters of Credit. Independent internal reviews should be conducted regularly to validate the reinsurance broker recommendations and safeguard against undue risk.

As part of the documentary evidence request, the risk management policy has been requested to demonstrate that the sub-policy addressing reinsurance is within the scope of the risk management system in line with Article 44 (2) of the Solvency II Directive. Nonetheless it has been observed that around 20% of the Companies within the scope of the thematic review are not fully aligned with this expectation, particularly in ensuring that reinsurance-specific policies are clearly documented, consistently applied, and subject to regular review. In this regard, the insurance market is reminded of the obligations emanating from the Solvency II Directive and align its position accordingly.

3.4.1.2 Governance Arrangements

Throughout the discussions held, the Authority noted a common practice within the Companies, whereby key functions circulate a report in relation to the subject matter. Having said this, the Authority notes that the level of challenge and engagements between the Board and the key function holders are limited. Emanating from the thematic review, it has been indicated that the key functions and/or important functions such as claims, depending on the business model, are not always being included in the discussions. The insurance market shall evaluate the value its key functions and/or important functions would provide to the effectiveness assessment of the subject matter. The involvement of the actuarial function is critical in assessing the effectiveness of reinsurance arrangements, including the extent of risk transfer, impact on technical provisions, and implications for the SCR. Actuaries provide an independent assessment of whether reinsurance structures achieve their intended risk-mitigation objectives and support the Board in understanding the associated financial and solvency impacts. As shown within Figure 2 below, based on the thematic review carried out, it has been observed that 60% of the sample have limited interaction between the Board of Directors and Key Functions.

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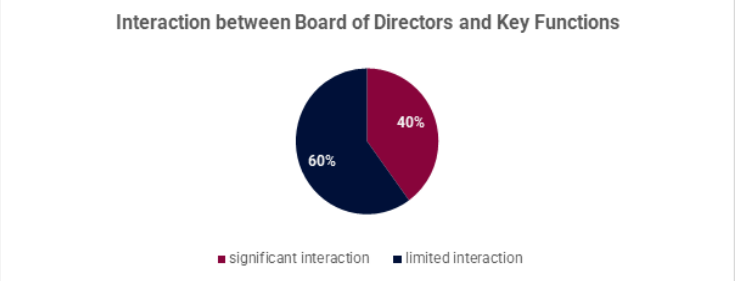


Figure 2: Extent of interaction between KF and Board

Furthermore, with respect to reporting concerning the subject matter, the Authority identified a number of Companies whereby such reporting is conducted primarily through emails. The Authority considers the use of reports, as better suited by providing accessibility, visibility and structure. Undertakings shall establish and maintain a reporting framework ensuring effective communication. As a way of clarification, the Authority deems that discussions in relation to reinsurance shall not be limited solely to the ORSA, while taking into account proportionality in terms of the business model. This is in light of the dependability and assurances provided by the reinsurer/s. From an actuarial perspective, structured and regular reporting on reinsurance programmes is essential to support effective decision-making. This should include clear analysis of the impact on the SCR, counterparty exposures, recoverables, and stress scenarios. Reporting should be sufficiently granular and timely to enable the Board and key functions to assess the ongoing effectiveness of reinsurance arrangements.

80% of the Companies selected for this sample, reference reinsurance in their ORSA. However, the review identified Companies that did not reference their third-country reinsurers despite some material exposures. The Authority emphasizes the importance that reinsurance is fully integrated within the ORSA process. This includes applying stress testing based on materiality and documenting justification where third-country reinsurers are deemed immaterial. Any instances of late claims payments, particularly those involving significant amounts, should also be recorded within the ORSA. Furthermore, stress testing should differentiate between EU-equivalent reinsurers and third-country reinsurers to reflect higher jurisdictional and credit risks. This should support appropriate Board awareness and challenge of reinsurance-related risks.

With respect to risk management and capital implications of third-country reinsurance

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arrangements, the Authority observed that most Companies monitor the overall cost of their reinsurance programme and review the impact on their SCR. The Authority recognises that market conditions, including periods of hard or soft reinsurance cycles, influence the availability of capacity and may naturally lead the Company to consider third-country reinsurers. While the review did not indicate that the Companies are selecting third-country reinsurers purely for cost reasons, the Authority emphasises that reinsurance placement decisions must not be driven predominantly by commercial price considerations, but should reflect the reinsurer's financial strength, contract reliability, and the prudential implications of using a reinsurer operating under a different supervisory regime, in the case of non-equivalence.

3.4.1.3 Internal Controls

When choosing a third-country reinsurer, the insurance market should ensure that factors such as availability of capacity, diversification of panel, underwriting expertise, long-term strategic fit, and quality of security are central to the decision. From a prudential perspective, it is essential that companies clearly analyse and document how the use of a third-country reinsurer impacts their SCR, counterparty default risk, concentration risk and overall solvency position. Where this assessment is not performed or not sufficiently evidenced, there is a risk of underestimating capital requirements and weakening the resilience of the Company's solvency coverage, particularly under stressed conditions.

The Authority therefore expects the insurance market to demonstrate, through actuarial analysis, credit-risk evaluation and Board-level reporting, how the use of third-country reinsurers aligns with prudent risk management. This ensures that reinsurance arrangements continue to function as a reliable and effective risk-mitigation tool under Solvency II across all market cycles.

Furthermore, Solvency II does not allow recognition of reinsurance recoverables from reinsurers below Credit Quality Step 3. Despite this, the survey indicated that only 40% of the Companies had collateral arrangements in place. This implies that a significant proportion may remain materially exposed to counterparty default risk where other mitigants are not present.

Regarding collateral, companies should ensure pledged assets remain fully accessible and legally enforceable in the reinsurer's jurisdiction, with clear triggers for revising or enforcing arrangements. Hence, the Authority recommends that companies establish collateral arrangements to safeguard against potential bankruptcy, default, or financial distress of third-country reinsurers. These arrangements should be clearly defined within reinsurance agreements.

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4. Expectations and Closing Remarks

The MFSA would like to emphasise the following points:

4.1 Board accountability

The ultimate responsibility remains with the Board of Directors of the undertaking to ensure that reinsurance arrangements are aligned with the undertaking's risk appetite, strategic objectives and commitment to policyholder protection. The MFSA reiterates the expectation that the Board of Directors is ultimately responsible for ensuring reliable and robust data on which it has based its decision. Decisions should be clearly documented.

4.2 Understanding of reinsurance arrangements

A strong understanding of the reinsurance programme is expected from the Board of Directors and senior management, to maintain a sound understanding of the economic substance of their reinsurance arrangements, including:

- the nature and extent of the risks being transferred;
- the financial strength and reliability of reinsurance counterparties;
- understanding stress conditions including liquidity and solvency and their potential impact; and
- integration and implementation of the reinsurance programme within the overall risk management strategy.

The Authority reiterates that reinsurance should not be viewed solely as a capital management tool. Rather, it should form part of a broader and coherent risk management framework that promotes sustainable risk transfer and long-term resilience.

4.3 Due diligence on reinsurers and reinsurance agreements

Where undertakings enter into reinsurance arrangements with third-country reinsurers, they are expected to apply robust and proportionate due diligence processes, taking into account the nature, scale, complexity and materiality of the arrangements. This

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assessment should take into consideration a number of factors including:

- the regulatory and supervisory regime applicable to the reinsurer;
- the reinsurer's financial soundness, credit quality and claims-paying ability;
- group structures and any associated contagion risks;
- concentration exposures to individual counterparties, groups or jurisdictions;
- legal, operational and enforceability considerations; and
- the availability of timely, accurate and reliable information regarding the reinsurer's financial condition and risk profile.

4.4 Assessment under stressed conditions

Undertakings should assess reinsurance arrangements beyond their contractual form and ensure that the intended transfer of risk would remain effective under adverse but plausible stress scenarios.

4.5 Effective risk transfer and SCR recognition

Undertakings are expected to ensure that any reduction in the SCR appropriately reflects the extent of risk transferred. Capital relief should be proportionate to the actual economic effect of the arrangement. In particular, undertakings should be able to demonstrate that:

- the arrangement achieves an effective transfer of risk;
- material residual risks are identified, assessed and continuously monitored;
- contractual features do not materially weaken or negate the transfer of risk;
- the prudential treatment of the arrangement is consistent with its economic substance;
- assumptions underpinning solvency calculations remain appropriate throughout the life of the arrangement; and
- undertakings should be able to clearly evidence the analyses and assessments supporting both the effectiveness of the risk transfer and the appropriateness of the resulting capital treatment.

4.6 Legal certainty and enforceability

Undertakings should ensure that reinsurance agreements are:

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- legally robust and clearly documented;
- operationally practicable;
- enforceable in all relevant jurisdictions; and
- capable of delivering the intended protection when required.

Particular attention should be given to contractual provisions that may restrict, delay or otherwise impair recoveries, especially in stressed circumstances. Assessments of legal enforceability should be supported by appropriate legal advice and reviewed periodically.

4.7 Risk mitigation measures and safeguards

Where arrangements with third-country reinsurers give rise to elevated counterparty, legal, operational or concentration risks, undertakings are expected to implement appropriate safeguards to mitigate such risks and enhance the reliability of recoverables. Any safeguards adopted should be proportionate to the nature and significance of the risks identified.

4.8 Integration into governance and ORSA

Reinsurance arrangements should be fully embedded within the undertaking's System of Governance, Risk Management Framework and ORSA. In this regard, undertakings are expected to maintain comprehensive documentation supporting the rationale, structure, operation and ongoing monitoring of their reinsurance programmes. The ORSA should, where relevant, assess a number of areas including:

- dependencies on reinsurance;
- counterparty default scenarios;
- concentration risks;
- liquidity implications; and
- the impact of reduced recoverability under stressed conditions.

Furthermore, undertakings are to ensure effective implementation of an adequate process to assess the effectiveness of risk mitigation actions and their impact on the SCR and MCR, as well as establish strategies to identify and manage risk concentrations and interconnectedness of risk. Particular attention should be given to arrangements involving third-country reinsurers, ensuring that any additional jurisdictional, legal and credit risks are appropriately identified, assessed and reflected within the undertaking’s risk management framework.

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Undertakings are to also ensure that the Actuarial Function is appropriately involved in the assessment of reinsurance arrangements, including the evaluation of risk transfer effectiveness, impact on technical provisions, SCR, counterparty default risk, and stress testing.

Conclusion

The prudent and effective use of reinsurance remains fundamental to the safety and soundness of the insurance sector and to the protection of policyholders. The MFSA therefore expects boards and senior management to keep their reinsurance strategies, governance arrangements and risk management practices under regular review, and to ensure continued alignment with both the requirements and underlying objectives of the Solvency II framework.

On a final note, the MFSA expects undertakings to engage with the Authority at an early stage where proposed reinsurance arrangements are material in nature, complex or innovative, expected to have a significant impact on the undertaking's solvency position, or likely to materially alter the undertaking's risk profile or capital management strategy. Early engagement promotes transparency, facilitates effective supervisory assessment and supports sound prudential outcomes.

Yours Sincerely,
Malta Financial Services Authority

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